REGULATION BY COST-BENEFIT ANALYSIS

G. R. BALDWIN AND C. G. VELJANOVSKI

Executive Order 12291 requires that all US federal executive agency regulations should pass a cost-benefit test before promulgation. The Reagan Administration's procedures for implementing the Order are described and the strengths and problems of using cost-benefit analysis to restrain and reform regulation are examined. The article then goes on to examine the feasibility of introducing a similar cost-benefit approach in Britain. It is concluded that, apart from the inherent practical and administrative difficulties of using cost-benefit, its introduction would pose special problems. Radical changes would have to be made in British central administration, in judicial training and attitudes and in regulatory law if cost-benefit testing was to be used in anything other than an ad hoc form.

Successive US presidents have followed Gerald Ford in attempting to restrain the growth of federal government regulation. Foremost among the management techniques used has been cost-benefit analysis. In 1981 President Reagan took this trend to its logical extreme by issuing Executive Order 12291 which requires all major regulations to undergo cost-benefit analysis (CBA) and that executive agencies should only propose regulations when economic benefits exceed costs. CBA was thus made the linchpin of Reagan's programme of 'regulatory relief'.

While the role played by regulation in Britain is less pronounced, there is nonetheless a similar concern with the present (re-elected) Conservative Government that state intervention is responsible for the economy's poor performance and is generally inefficient. Although the form of 'regulation' differs in these two countries, both Governments are intent on rolling-back the state, reforming the existing regulatory framework and increasing central control of government agencies and departments.

In this paper we look at President Reagan's attempt to use CBA to control federal regulation and we caution that a similar technique in Britain would present a number of special difficulties. The first part of the article examines the general theoretical and practical problems of subjecting regulatory activity to CBA. In part two the feasibility of a similar approach in Britain is discussed.

G. R. Baldwin is a Lecturer in the Department of Law, Brunel University and C. G. Veljanovski a Research Officer at the Centre for Socio-Legal Studies, Oxford.

Public Administration Vol. 62 Spring 1984 (51-69)
 ISSN 0033-3298 $3.00

EXECUTIVE ORDER 12291 AND CBA IN AMERICAN REGULATION

Mandatory CBA is a vital part of the Reagan Administration's programme of 'regulatory relief'. The President's regulatory policy is based on the beliefs that regulation was imposing an unacceptable economic burden on the US economy (Eads and Fix 1982), that the costs to industry were being ignored by regulators, and that the plethora of social regulations had been largely ineffective in protecting workers and consumers (Lave 1981). A more cynical analysis held that much regulation benefited the regulated industries more than consumers by restricting competition and entry (Stigler 1971; Jordan 1972; Posner 1976; Quirk 1978). Apart from this concern over industry's 'capture' of the regulatory agencies, a strong consensus was developing that many of their activities lacked political legitimacy and that they were becoming unaccountable government bureaucracies (MacAvoy 1970; Freedman 1978).

The use of CBA to restrain the growth of federal regulation is not novel. In late 1974 President Ford, concerned not so much with the extent of regulation as its inflationary consequences, set up the Council on Wage and Price Stability (CWPS) and the Inflation Impact Statement (IIS) programme. The CWPS acted mainly as a 'watch dog' over governmental activity which might aggravate the then double digit inflation. The Ford programme was, however, also intended to encourage agencies to look to the costs and benefits of their proposals. CWPS economists would review proposed regulations and file comments: they would express views in public testimony to the agency and would submit detailed analyses as part of an 'internal review' procedure (Miller and Yandle 1979; White 1981).

President Carter continued this initiative with his 'Improving Government Regulation' programme. Executive agencies were required to publish semi-annual agenda of forthcoming regulations and to prepare impact analyses of, and economic justifications for, those regulations likely to have major economic consequences. Regulations were to be cost-effective, to impose the minimum burden on industry and were to be reviewed and eliminated when no longer efficient.

In many respects the Reagan scheme resembles those of Ford and Carter. Order 12291, however, goes further. Under Carter, impact analyses were not meant to subject agency rules to a cost-benefit test: agencies had to quantify costs and benefits and justify the rule but the onus of showing whether or not a proposal was cost-effective rested on the White House. Reagan's approach is more stringent: CBA is obligatory, and all proposed regulations must satisfy the simple criteria of an excess of economic benefits over costs.

Content and review procedure

The stated objectives of Order 12291 are to reduce the burden of regulations, to increase agency accountability, to provide presidential oversight of the regulatory process, to minimize conflicts between regulations and to ensure that these are well-reasoned. All executive agencies are forbidden to take regulatory action unless the benefits to society outweigh the costs. They must choose objectives that

maximize the net social benefits and act to achieve these by the method that imposes the least net cost on society. In setting their priorities all agencies must take into account three additional factors: the condition of the national economy; the condition of the regulated industries; and the impact on those industries of the regulatory actions of other agencies. The Order applies to all 'major rules' which are defined as those regulations likely to result in: (1) an annual effect on the economy of $100m. or more; (2) a major increase in costs or prices or; (3) a significantly adverse effect on competition, employment, investment, productivity, innovation or on the ability of US-based enterprises to compete with foreign-based enterprises.

The system of presidential oversight is much more centralized than previous attempts to impose CBA. Executive Order 12291 is overseen by the White House Office of Management and Budget (OMB), within which the Office of Information and Regulatory Affairs (OIRA) reviews all major executive agency rules for compliance with the Order. The Director of OMB has the authority to issue guidance on the content of each agency's CBA and to designate major rules for review. He has no power, however, to enforce OMB directives other than by presidential intervention.

Review tends to follow a set procedure. All proposed and final regulations must be submitted to OMB for review before they are published in the *Federal register*. The proposing agency must prepare a Regulatory Impact Analysis (RIA) and submit it together with the proposed 'major rule' to OMB, where three principle staff members are given copies. The desk officer is responsible for overseeing the activities of the particular agency proposing the regulation and he or she puts into effect the Paperwork Reduction Act which is designed to reduce the burden of government forms. The second copy goes to an economist who scrutinizes the RIA to determine whether an appropriate cost-benefit calculation has been made. The third copy is sent to the budget examiner to determine the budgetary effects of the proposed rule. It is up to the desk officer and economist to examine the RIA and consult with the agency, academics and industry to determine whether it satisfies Order 12291.

Appraisal of an RIA is usually completed within 30 days of submission. At this stage a period of discussion, often by telephone, begins between staff of OMB and the agency to resolve difficulties or negotiate changes in either the rule or the RIA. Around day 40 the director of OMB will discuss the proposed rule with the head of the sponsoring agency and on completion of these talks the OMB decision will be given. If the rule is held to be inconsistent with Order 12291 it will either be withdrawn or reconsidered; otherwise it will be published in the *Federal Register* and will proceed through the normal rulemaking procedures in accordance with the Federal Administrative Procedure Act 1946.

Evaluation of cost-benefit testing in regulation

Conceptual issues

The central tenet of CBA is simple and attractive: that *social* costs should be compared to *social* benefits and the policy chosen that maximizes net social benefits (Pearce 1971; Mishan 1974). It is a quantitative technique which uses the

measuring rod of money. All policy effects are evaluated in $'s and the strategy which has the greatest excess of monetary benefits over costs is chosen. While Order 12291 does not define the terms 'potential costs' and 'potential benefits', OMB's document, *Interim regulatory impact analysis guidance* (June 1981) makes it clear that agencies are to calculate the 'monetary net benefit estimate' (cf. Sunstein 1981).

If every cost and every benefit of a regulation could be calculated in monetary terms then CBA would be a precise quantitative approach to regulatory decision-making. Unfortunately there is substantial disagreement amongst economists as to which costs and benefits should be taken into account and how these should be evaluated. These differences will obviously affect calculations as to the relative desirability of alternative regulations. Uncertainties concerning the effects of regulation and the unavailability of appropriate data further aggravate the problems.

It is, therefore, highly unlikely that CBA will offer definite conclusions. There will always be difficulties concerning assumptions, valuation procedures and predictions. These difficulties will tend to be greater for social regulations, where the effects are often unknown and the valuations of benefits pose considerable theoretical difficulties not to mention controversies, e.g. value of life. The theoretical problems besetting CBA can, however, be resolved arbitrarily by directive. All that is required is an 'Official Handbook of Cost-Benefit Procedure' which ensures that all CBA's are consistent. Order 12291 gives OMB the task of imposing such uniformity.

Data constraints

The real drawback of CBA is the measurement problem. The proponents of CBA have tended to underestimate the difficulties of quantifying the potential costs and benefits of proposed regulations. But even before this task is faced the agency must first identify the impact of a proposed regulation. In many areas this will be extremely difficult, if not impossible. A rule that all machinery must be fitted with guards, for example, may reduce accidents for a period but workers may take less care thereafter causing accidents to increase in number again. Protection on one front may lead to recklessness on another and adaptive responses may be hard to isolate in advance (Peltzman 1975; Viscusi 1979).

CBA studies generally fail to consider all such adaptive responses to proposed regulations. Data on the performance of past legislation is rarely obtainable, often problematic and difficult to extrapolate (McKean 1980). Moreover, assumptions have to be made concerning enforcement activity or levels of compliance (Most CBA's assume full compliance) and recent studies show enforcement to be a complex process (Kelman 1981; Hawkins 1984; Richardson et al. 1982) that economists have made few attempts to model (Diver 1980). Clearly, if it is not known whether a regulation will reduce accidents by 5% or 30% it will not be possible to apply a CB test with anything like the scientific precision that is assumed by its proponents.

The costs of regulation may be broken down into those of rulemaking, enforcement and compliance (McKean 1980). These are not simple financial costs but real net social (or resource) costs and are particularly difficult to calculate 'owing

to the far-reaching assumptions that have to be made about what would happen in the absence of regulation' (OECD 1979). Undoubtedly difficult to measure are the costs imposed on industry and the economy in general. Compliance costing involves a mass of variables relating to enforcement practices, compliance rates, shifted compliance costs and double counting. In addition there are 'hidden' costs such as reduced productivity and incentives, expenditure on evading regulation (e.g. transfer pricing) and the distortions in investment and production caused by some financial controls, e.g. rate of return regulation (Averch and Johnson 1962). Moreover the data required to calculate compliance costs is usually in the hands of the regulated industry, which has a strong incentive to select, withhold and/or distort the figures (Allen 1978). The stronger the lobbying power of an interest group (and this usually means the regulated industry) the more it will tend to be favoured in the costing process.

To minimize the costs of those most directly affected or most vocal and to ignore those borne by large numbers of unorganized individuals may actually be to end up imposing higher total costs on society. The head of Reagan's programme has made this argument himself (De Muth 1980) and it is not without significance that the Reagan Administration's policy is called regulatory *relief*, implying priority to the reduction of compliance costs. CBA only brings 'regulatory relief' if compliance costs outweigh the estimated benefits to society as a whole in having regulation. A possible solution to this bias is to provide public funding for interest groups, as has been proposed in Canada (ECC 1979, 82) but Order 12291 makes no such provision, indeed OMB policy is to reduce such forms of financial assistance.

The measurement of the benefits is more problematic, most of all in the area of social regulation because of the absence of a market in, and hence data on the value of, for example, less pollution or safer roads. The benefits of social regulation tend not to be reflected in conventional measures of economic activity (such as national income or GNP statistics) and they are, therefore, more easily the subject of speculation and/or manipulation. Thus in valuing say, 'life', economists' calculations differ from each other by several orders of magnitude and figures could be selected either to pass or fail a CB test (Smith 1979).

It is frequently argued that there are a number of benefits of regulation that cannot be priced: life is one; other examples are the right to children, peace and quiet, good health and other so-called 'intangibles'. This really raises two questions: Can a monetary value be given? And should one be given? The answer to the first is a qualified yes — we can ask what people would be willing to pay to enjoy, for instance, a lower risk of death. Such implicit valuation goes on all the time when such decisions as whether to build road barriers or put up new lighting systems are made. Stated boldly, each moral question has an economic dimension when it involves a choice. Whether the economist's valuation of these benefits should determine policy is a political question which, in the case of Order 12291, has been answered in the affirmative.

In practice many 'intangibles' will defy pricing by the economist because data is unavailable. Order 12291 recognizes this by requiring non-quantifiable benefits

to be 'described'. This, however, still leaves the problem of how to balance qualitative policy effects against those that are quantitative. The great danger inherent in CBA is that, because it purports to offer quantitative answers on policy issues, it tempts policy-makers to seize on the 'hard' figures and ignore 'soft' variables. This suggests that *CBA will be weakest where the need for more rational and effective regulation is greatest.*

Distributional considerations

Order 12291 is concerned with maximizing wealth, not its distribution among individuals nor the incidence of losses from regulatory change. While each RIA must identify those who bear the costs and benefits of proposed regulation, no guidance is given on distributional factors. The implication is that each $ gain or loss will be given equal weighting to whomsoever it accrues. This procedure involves several assumptions and value judgements: that the present distribution of wealth is acceptable; that proposals to regulate or de-regulate will not make the distribution of wealth less acceptable; that (de)regulation will not lead to a significant redistribution of wealth and that all affected individuals place the same (constant) value on each $ decrease/increase in their wealth.

These assumptions ignore several factors. First, the way people value the effects of a policy in monetary terms depends in part on their wealth. It is a standard theorem of welfare economics that for every different pattern of wealth (inequality) there will be a different valuation of the costs and benefits of a given policy. Secondly, failure to take into account the 'wealth effects' of a policy and acceptance of the *ex ante* distribution of wealth biases the CBA in favour of those who already possess economic power. Both these assumptions are at odds with President Reagan's diagnosis of the reasons for regulatory failure. If the present structure of regulation is grossly inefficient and redistributes income to special interest groups and away from consumers, then it cannot possibly be true that society's wealth is distributed in a desirable pattern. Finally, this methodology precludes the use of regulation as a wealth transfer mechanism. Although direct subsidies and taxes are generally a more efficient way of directing assistance there may be instances where regulation is more cost-effective in providing groups with in-kind benefits (Posner 1972). Order 12291 prohibits this, thus raising the possibility that inefficient redistributive policies will be pursued.

Administrative issues

White House oversight of regulation gives rise to political and administrative difficulties, most obviously the increased workload imposed on the President's offices. If CBA's are to be reviewed properly, a new layer of government is required between the President and his agency heads. Proper review demands a familiarity with the relevant spheres of regulation that requires research and analyses going far beyond the capabilities of the OIRA staff of 90 (Eads 1981).

Were an effective OIRA to be set up, of course, the paperwork and costs of compliance would escalate rather than diminish. If, on the other hand, a more pragmatic approach was to be taken, as when Vice-President Bush went to industry

and compiled a 'hit-list' of regulations in 1981, this could well strain presidential credibility within the agencies and adversely affect morale, status and motivation of the agency staff (Verkuil 1980).

The success of Order 12291 depends on the extent to which incentives within agencies are changed so that economic efficiency becomes a high priority. Agency staff have their own interests and policy aims and some statutes set down objectives defined in terms other than efficiency. The danger is that Order 12291 imposes a CBA requirement that bureaucrats will treat as just one more hurdle to be overcome, in this case by dressing up proposed regulation in pseudo-economic analyses. Thus a mandated CBA approach may be thwarted by forces within the regulatory process. Presidential appointments to the agencies will deter this tendency but it should be cautioned that, insofar as these persons favour deregulation, CBA is liable to be used as an excuse for not proposing a new regulation even though it may be justified in CBA terms.

Political issues

The Reagan plan aims to involve White House staff at the earliest stages of agency rulemaking. This might be said to expose unelected bureaucrats to the influence of the President but, on the other hand, the aides themselves are unelected. More seriously, in the eyes of many they are not officials imbued with the public interest but the representatives of strong commercial forces. They are liable to have two principal concerns: to further private interests and to ensure the electoral popularity of the President. Their incentives, it could be said, are to make short term political gains rather than to allow the exercise of regulatory expertise. As a result, agency analytic standards could be prejudiced under the influence of persons immune from public or congressional scrutiny who are in no position 'to make a meaningful balancing choice between competing national goals' (Verkuil 1980, 951).

Sole reliance on CBA also runs the risk of obscuring central issues in a web of economic technicalities and language. Peter Self (1979, 212) has made this point in relation to the Roskill Commission's £1m. CBA of London airport sites:

> The main effect of the exercise was to translate policy issues into complicated technical analysis without thereby elucidating or resolving those issues. The main use of cost-benefit analysis appears to be as a supporting argument for particular organisational or policy view-points.

Finally, CBA as employed by Order 12291 has a narrow view of the public interest: the maximizing of consumer welfare as measured by willingness to pay for goods and services. This need not be the case. In general CBA can be consistent with a host of public interest criteria as long as these clearly specify which costs and benefits are to count. Yet economic efficiency is a normative concept based on a number of premises that many would find objectionable — for example that the individual is the best judge of his/her own welfare — and which may conflict with the public interest criteria set down by the legislature (see action below). The type of CBA promulgated by Order 12291 does not permit the

balancing of justice, distributional and/or other non-efficiency goals (e.g. defence, international relations) to be incorporated in the rulemaking process.

Legal issues

The breadth of Order 12291 raises numerous legal questions. Some have argued that it is an unconstitutional act of executive legislation in violation of the separation of powers principle (Rosenburg 1981). But this view may considerably underestimate the legitimacy of the presidential goals expressed in the Order. A recent decision indicates that the courts may be willing to allow the President considerable input into the regulatory process.

Space does not permit an extended review of such constitutional issues but there is a more general legal problem facing those putting Order 12291 into effect. It is one that may be closely paralleled in Britain: can an agency be instructed to regulate 'efficiently' even if this is at variance with its statutory duties and objectives?

Order 12291 acknowledges this point by requiring compliance 'to the extent permitted by law'. On this point Professor Cass Sunstein (Sunstein 1981, 1274-5) has argued that regulatory statutes fall into three groups. In the first are those that aim to promote efficiency, such as antitrust statutes and those protecting against an 'unreasonable risk to health or safety'. Order 12291, she says, can clearly be applied to these. The second category consists of statutes that do not aim at economic efficiency, for example, civil rights statutes and laws to protect the environment notwithstanding the cost. These do not subsume easily to the economic approach to regulation. In the third group are statutes that have mixed aims — such as many items of anti-pollution legislation. The legality of applying Order 12291 here depends on how any CBA test is applied — whether it undermines statutory objectives or successfully translates these into CB terms. A legal challenge would be most likely to succeed where it can be shown that Congress has passed a statute that does not promote 'efficiency' and that the President has nullified this on the grounds that a policy based on efficiency would be preferable (Schwartz 1981).

OMB's view is that there is nothing in any statute to say that statutory objectives may not be viewed in the light of knowledge concerning the costs and benefits of various courses of action. In the case of non-efficiency-oriented statutes, OMB and OIRA staff simply attempt to push agency officials as far as they can in the direction of efficiency by requiring cost-effective regulation. As one OIRA man put it to us: 'Congress must have intended us to take a *responsible* attitude to statutory discretions (interview, OMB Washington, 6 October 1982).

Preliminary assessment

As one might expect, the Order has had considerable impact. The number of final regulations published in the *Federal Register* from February to December 1981 fell by 21% on the same period in 1980 and proposed regulations declined by a third. Preliminary figures also suggest that judicial challenge of final regulations has decreased substantially, which the OMB have claimed is evidence that new

regulations are now 'better reasoned' and 'more empirically solid' (OMB 1982, 7).

Even the opponents of CBA must concede that the device can lead administrators to look to regulatory costs and to avoid regulations that are unnecessarily restrictive. CBA can act as a check on the enactment of grossly expensive or inefficient regulations. The mere process of carrying out CBA forces agencies to consider costs and benefits, to list the adverse and beneficial effects of regulations and to set down the assumptions underlying their calculations, all of which increases the likelihood that regulations will be 'better reasoned'. OMB also requires the agencies to test the sensitivity of their results to changes in assumptions and to array these so that the policy-maker can make an informed judgement. The CBA requirement, furthermore, will often favour modes of regulatory intervention that minimize the need for elaborate calculations — that are more market-oriented, less restrictive methods of control. Thus fees, charges, marketable permits, information provision and performance standards are more likely to be regarded as cost effective than, say, statutory design and specification standards (Mitnick 1980; Breyer 1982; Ogus and Veljanovski 1984).

However, the proponents of CBA will find it difficult to show how the technique can routinely be applied in regulatory policy-making in such a way as to pass final judgement on specific regulations. By holding out economic efficiency as the basis of all regulatory policy, Order 12291 has set up a demanding and, we would argue, unattainable ideal. In large part, the deficiencies of Reagan's CBA policy result from a misperception about the nature of CBA. Its supporters herald it as a scientific way to come to definite answers but, as a recent US congressional committee (cited in Allen 1978) stated: '. . . the most significant factor in evaluating a cost benefit study is the name of the sponsor'.

If a management technique, such as CBA, is to contribute to more rational regulation and be administratively workable then we suggest that it must satisfy certain conditions. A far from exhaustive list would include the following:

(i) that consistency should be developed in the principles and methodology governing CBA;

(ii) that the techniques are capable of application to the rules requiring CBA clearance;

(iii) that the resources consumed in undertaking a CBA are not excessive;

(iv) that the incentives and constraints on agency officials are made consistent with the pursuit of economic efficiency;

(v) that the techniques are reconcilable with statutory formulations of the public interest;

A realistic appraisal suggests that while Order 12291 may score well on the first and second conditions, it probably does not on the other three. The general applicability and usefulness of CBA is not assured because of data problems, because faithful adherence is probably extremely costly, and because the Order itself makes

little attempt to reform the administration of executive agencies to ensure that efficiency is accorded a high priority.

CBA AND BRITISH REGULATION

It might be argued that whether or not CBA testing is applied in British regulation is a mere question of political will. This, however, is too simplistic an approach. To assess the potential of regulation by CBA in this country we have to look at the nature of British regulation and the feasibility of grafting a scheme such as that contained in Order 12291 onto our existing institutional and legal framework.

Regulation in British government

It is less easy to make the case for a crisis in British than in American regulation. Regulation, in the first place, is not such a major political issue in this country. Instead of controlling the private sector in the public interest the tendency here has been to nationalize, especially in the area of public utilities (Robson 1960; Schwartz and Wade 1972, 38). As a result regulation has been less contentious than in the US. Trust in the political neutrality of civil servants (Brown and Steel 1979, 88) and ministerial accountability on their behalf has allowed the task of regulation to fall to central departments more readily than would be the case in the United States. Thus departmental regulation has not suffered the diminishing of political authority that the US commissions have.

If there is no regulatory crisis here then one of the political reasons for introducing deregulation by CBA is missing. There are signs, however, that if privatization continues there will be a shift from the nationalized to the regulated industries model of government control. Recent proposals for independent bodies to regulate the telecommunications and cable industries are cases in point (Department of Industry 1982; Home Office and Department of Industry 1983). British policy-makers may soon have to face the problems now confronted in the US, but, as we shall see, it is doubtful whether the British governmental system is amenable to an oversight structure of the type envisaged by Order 12291.

Developments in CBA

CBA had a later start in Britain than in the US but is now used extensively by government departments, especially in the areas of transport, urban development, education, defence and health (Peters 1973). Thus the Department of Transport routinely carries out CB assessments of proposed road safety regulation (Saunders and Benson 1978). There are, however, few published CB studies of British government regulation (EIU 1976; Hartley and Maynard 1982), partly because of the small role played by economists in British government and partly because governments have been more concerned with the efficiency of the civil service and the nationalized industries than with the costs of regulation to industry and the economy at large (Treasury and Civil Service Committee 1981/2; Garner 1982).

A notable exception to this position is health and safety regulation. In 1972 the Robens Committee (Robens 1972) published the first serious attempt to cost

accidents. Although that Committee acknowledged the problems of insufficient data and underdeveloped CBA techniques, it recommended that the proposed Health and Safety Executive (HSE) should develop 'a more cost-effective approach' to the use of public resources. Eight years later the Pliatsky report (1980) made a similar recommendation. Economic assessment of all proposed health and safety requirements is now standard practice in the HSE (HSE 1980, paras 113-117). Unlike Order 12291, however, the HSE 'does not make a fetish' of the CBA. It is used to assist, rather than substitute, for the judgement process (HSE 1982).

CBA and the nature of British rulemaking

The British equivalent of Order 12291 would affect the major rules issued by government departments and departmental agencies: that is, delegated legislation and informal departmental rules of major economic and regulatory significance. British rulemaking procedures, however, differ from those in the US, as does the use made of delegated legislation in regulation. British governments have traditionally placed less emphasis on regulation by formally delegated rulemaking powers than their counterparts in the US. There are not only fewer regulations put into force in Britain but the subject matter is less important. This is due to a number of factors besides the use of nationalization as an alternative to regulation. Where the private sector is regulated, alternative control techniques obviate the need to use delegated legislation. (Thus the use of statutory standards and specialist courts or tribunals minimizes rulemaking — as in the field of trade descriptions [Cranston 1978, ch. 8]). Departmental regulation may involve a number of techniques, from licensing or registration to the issue of contracts and grants. Although such controls affect private rights, British departments have been given extensive discretions and few demands have been made that these be structured by rules. This is partly because ministers, who know how their departments will operate a statute, are able to incorporate broad discretions in legislation and substitute these for rulemaking prescriptions. When rules are made they tend to be of dubious status and to come under the title of 'codes', 'guidelines', 'conditions' or 'considerations to be taken into account'. By such devices, British faith in bureaucrats has been little challenged and this has produced an unstructured system of rulemaking on which few demands are made by parliament or courts.

As for British rulemaking procedures at law, these differ markedly from the provisions of the Federal Administrative Procedure Act, 1946, (Beatson 1979). Following repeal of the Rules Publication Act, 1893, in 1946 there remained no equivalent of the US statutory notice and comment rulemaking procedure, nor is there provision for any system of publication as in the *Federal Register*. British statutes usually state only that formal rules, in the shape of statutory instruments, be 'laid' before Parliament for approval by a variety of procedures. Although this process renders statutory instruments visible, the Statutory Instruments Act, 1946, does not apply to the mass of less formal rules encountered in the administrative process, some of which would be covered by Order 12291. Apart from byelaws, with their special rules, there are no general provisions governing the making or

publication of the various kinds of subordinate legislation other than statutory instruments (Garner 1979, 85). Procedural and substantive controls over these, insofar as any exist, depend not on statutory law but on demands imposed by the courts.

Thus the loose system of British rulemaking means that it would be difficult to bring CBA's into the light of public scrutiny if relying on present law and judicial attitudes. Whereas US courts have made significant demands on rulemakers (such as the 'reasonable evidence' rule, the requirement to disclose methodologies and scientific reports and the need publicly to give reasons that deal with outside comments) British judges would, on present evidence, not impose duties to open out rulemaking to public involvement. In the recent *Bushell* decision, concerning an inquiry into a motorway construction scheme, the House of Lords (1 [1980] 2 A11 ER 608) upheld an inquiry inspector's refusal to call departmental witnesses to be examined on their methods for measuring the burden on roads and for projecting future traffic growth. Although it is not yet clear how far the principles of *Bushell* will be applied beyond public inquiries, similar reasoning would lead judges to state that where a minister is conducting a CBA, then the process of deliberation is a matter of 'policy' with which the courts will not readily interfere.

Even, it seems, were the courts inclined to control the executive, — for example, by expanding the principle that exercises of powers must *reasonably* relate to the provisions of the parent statute — it is questionable whether they would be prepared to delve into the economic arguments in any depth. The state of the judicial art is perhaps best indicated by the recent ruling in *Bromley v. GLC* ([1982] 1A11 ER 129). The 'cheap fares' case turned on the meaning of 'integrated, efficient and economic' in the Transport (London) Act 1969. But the courts, including the House of Lords, failed to bring any kind of economic analysis to bear on the issues. The judges were not interested in going beyond highly legalistic definitions. The *Bromley* case holds out little hope that any CB testing introduced into regulation would be opened out for public comment by the courts. Legal training in Britain does not equip judges for economic analysis in the way that US law schools do (Veljanovski 1982) and judges are likely to persevere with a commonsense approach to any rulemaking that affects economic interests.

The rules on consultation present a similarly bleak picture. If administrative action is deemed to be quasi-judicial in the sense of affecting a person's rights then the rules of natural justice normally apply, but these rules will be of little avail if legislative activity is at issue. Mr Justice Megarry has said:

> Many of those affected by delegated legislation . . . are never consulted in the process of enacting that legislation; and yet they have no remedy. . . . I do not know of any implied right to be consulted or make objections (*Bates v Lord Hailsham* [1972 1 WLR] 1373, 1378).

A number of statutes, of course, specifically require consultation and administrators do in general consult widely on a voluntary basis, (Beatson 1979, 204; Garner 1964; Jergesen 1978). Nevertheless British rights of participation in rulemaking are severely lacking and judicial demands on bureaucrats are limited. CBA could be

introduced into British departmental rulemaking but, unless changes in both substantive law and judicial attitudes are encouraged, there would be little to ensure that this would operate on an open and accountable basis.

The legality of cost-benefit testing

If the equivalent of Order 12291 was applied to British government departments, ministers would be free from many of the constitutional difficulties faced in the US. Ministers here undoubtedly do have the power to instruct their officials on how to undertake rulemaking. As in the US, however, there is a need to comply with the terms of statutory powers. This means, for instance, that discretions should not be fettered (e.g. by the adoption of inflexible rules), nor ignored or wrongfully delegated, and that statutory procedural demands (e.g. to consult) be complied with.

A more difficult question, as in the US, is whether particular statutory powers allow the pursuit of economic efficiency. Here a number of forms of statutory provision should be considered: (1) the unrestricted discretion; (2) where tests such as 'reasonably practicable' are involved; (3) explicit references to efficiency; and (4) powers making no mention of costs or efficiency.

The class of unfettered powers presents few problems for proponents of CBA but more complex issues arise with the second group of statutes where, as in section 2(1) of the Health and Safety at Work Act 1974, there is a duty to ensure the health, safety and welfare of employees, 'so far as is reasonably practicable'. Does this mean that the HSE can regulate so as to maximize efficiency? In *Edwards v. National Coal Board* ([1949] 1 KB, 704), Lord Justice Asquith said that 'reasonably practicable' was narrower than 'physically possible' and implied:

> that a computation must be made by the owner in which the question of risk is placed on one scale and the sacrifice involved in the measures necessary for averting the risk (whether in money, time or trouble) is placed on the other, and that, if it is shown that there is a gross disproportion between them . . . the defendants discharge the onus on them (p. 747).

This was not an exact balancing of costs and benefits — precautions had to be taken unless the cost was *disproportionate*. In the more recent case of *Associated Dairies v. Hartley* ([1979] IRLR, 171) a preciser evaluation of costs was made and the expense of providing protective footwear was found to be disproportionate. The implication of such cases for mandatory CBA testing is that while the courts will be prepared to take costs and benefits into account in considering 'reasonableness', they have shown no willingness to allow the issue to turn on a CB test or to translate all considerations into economic terms. On the other hand it could be argued that a balancing of time, trouble and costs against risks is consistent with CBA and that the word 'disproportionate' only means that, in a CBA, costs have to be shown grossly to exceed benefits before employers will be released from their obligations. It may, therefore, be best to explain the present system of merely taking economic issues into account as due to two factors: the reluctance of lawyers fully to set out costs and benefits before judges; and a judicial fondness for deciding issues according to legalistic criteria rather than by reference to

economic factors. It can be concluded that the law would not rule out regulation by CBA, provided that all relevant statutory considerations were dealt with.

Where a statute implicitly refers to efficiency, an important factor again is judicial reluctance to venture into economics. In the *Bromley* case the Transport (London) Act, 1969, involved such a provision, but, as already noted, the judges were disinclined to examine the economic factors relevant to terms such as 'economic' and 'cost effective'. In another area, development planning under the Town and Country Planning Act, 1971, there is a requirement (section 7[4][b]) that a planning authority should in formulating its plans have regard to 'the resources likely to be available'. One commentator (Purdue 1979) has argued that this requires planning authorities to 'cost out their proposals' and a number of cases suggest that costs are a valid consideration in development planning, but it has yet to be shown that a decision based on costs and benefits alone would satisfy the Act.

Finally we come to statutes giving powers that are to be exercised so as to achieve certain objectives, irrespective of efficiency. The danger of using these solely on the basis of a CBA is that this would constitute an abuse of discretion. Halsbury's Laws (4th edn, Vol. 1, para. 60) states the rule succinctly:

> If the purposes for which the power can legitimately be exercised are specified by statute and those powers are construed as being exhaustive, an exercise of that power in order to achieve a different and collateral object will be pronounced invalid.

If a statute openly rules out economic considerations (e.g. 'the safety of passengers shall be ensured, regardless of cost') then action on the basis of a CBA would break the above rule by unreasonably referring to irrelevant considerations. Where statutes are silent on economic matters, however, contested cases are liable to depend on the regulator's success in arguing either that the relevant statutory objectives did not rule out reference to economic matters, or else that such objectives had all been taken into account in the CBA itself.

If the CBA approach to regulation was to be introduced to Britain, new regulatory statutes would have to cater for this expressly. In relation to existing legislation there are real difficulties, especially where non-efficiency objectives are involved. Proponents of regulation by CBA might have to consider a review of regulatory legislation and one of formidable proportions.

Parliamentary controls and CBA

If Parliament were to scrutinize the departmental rules that result from CBAs they might do so by means of the Joint Committee on Statutory Instruments (the Joint Scrutiny Committee) which may draw Parliament's attention to a rule on a number of grounds, none of which should impinge on the merits or policy behind a rule. Merits may, however, be considered by a committee of that name but this body has no power to make recommendations.

The form of control exercised by ordinary MPs largely depends on the procedure for laying an item of delegated legislation before Parliament that is contained in

a particular statute. There is no general requirement to lay: many rules are in force by the time they are laid and only around 10% are laid in draft. Of those items of delegated legislation that are laid before Parliament, only a small percentage require positive approval by affirmative resolution and of the larger percentage that are subject to negative resolution few are given attention. The system of parliamentary scrutiny is thus weak because it is overloaded and works *ex post facto*. The absence of any general requirement to publish rules in advance of laying means that MPs are in a poor position to review the rulemaking process. Moreover, delegated legislation must be approved or rejected in toto — there is no provision for amendment.

In short, as with legal controls, parliamentary review does not at present exist in a form which would allow the scrutiny of rules that are based on CBA. If mandatory CBA was introduced into executive rulemaking, extensive reforms would be desirable to provide MPs with advance information on the content and background of rules and with an opportunity to debate them.

CBA and government departments

Besides the difficulties of controlling mandatory CBA in British rulemaking, there are further problems in placing it in the machinery of government. It seems there is a choice: to apply the technique intra-departmentally or else, as in the Reagan system, to impose it from above by a review body.

Supra-departmental control by CBA would be difficult. In British government the predominant lines of control are horizontal rather than vertical as in the US. Instead of a strong body exercising authority over weaker agencies, the British system relies in the main on the co-ordination of parallel departments. Peter Self (1979, 141) has said of the British Prime Minister:

> Even a large personal staff will not enable him to examine an issue as fully or as adequately as it has already been considered in the originating department . . . he will duplicate work that has already been done and probably done better. He will run the risk of having too much faith in his own snap judgements and in the extra evidence or opinions collected by his own assistants.

In fact the British cabinet secretariat does not attempt such review and, far from exercising minute control, operates at the level of the most general policy. The departments are the sources of policies which are not scrutinized in detail. The British system of delegating policy-making downwards thus lends itself to the imposition of CB testing from above far less readily than does a system that is already attuned to control through a vertical hierarchy as in France or the US. This may explain the relative lack of success of previous British attempts to increase supervision from the top (Edward Heath's Central Policy Review Staff of 1970 and Harold Wilson's Department of Economic Affairs of 1964). Overview systems in Britain tend to duplicate functions without matching departmental expertise. Indeed, the feasibility of supervision by overhead staff agencies has diminished further as governments have sought to improve co-ordination not by strengthening

at the top but by creating giant departments such as Trade and Industry, Environment and Social Services.

An additional problem is the British civil service and its emphasis on the generalist as policy-maker. Whereas in France economic and social administration have been separated, here, in spite of the Fulton Committee's recommendations (Fulton 1968, ch. 2), the administrative class has successfully resisted specialization and the teasing apart of economic and policy questions. Such administrators might be expected similarly to resist demands that policy issues be handed over to professional economists to be translated into the language of CBA.

If the Cabinet was determined to use CBA then it seems that central control (by Cabinet Office, Treasury or a new body resembling OMB) would have only one real advantage over CBA as applied by individual ministers to their departments — it would be better able to look at the cumulative effects of regulation. Against this there would be increased departmental frictions arising from debates not merely on alternative policies but on the manner in which the various CBAs were carried out.

Intra-departmental CBA would be more simple: senior civil servants would be instructed to accompany draft rules and regulations with CBAs when submitting them to ministers. Being a voluntary system, this might as easily be applied to informal rules, circulars and regulations as to delegated legislation. This would allow CBAs to be fed into rulemaking at the earliest possible stage. The key problem would be inter-departmental co-ordination, especially where ministers were in competition over shares in budgets or cuts. And a political factor would be the reluctance of ministers committed ideologically (or by manifesto) to certain policies to justify these in CBA terms. If fixed upon these policies on non-economic grounds then substantial resistance to CB testing could be expected within certain departments.

General problems for CBA in British government

The process of downward delegation of expertise brings more difficulties. First, the mechanisms of economic control as presently found in British government are ill-suited to CBA. The Treasury exercises general financial control over departments but, beyond routine accounting appraisal, its budgetary control involves not so much expert technical scrutiny as inter-departmental compromise and the negotiation of rival claims. There is some provision, however, for external auditing by the Comptroller and Auditor General (C & AG) and the Exchequer and Audit Department (E & AD) (Treasury 1980). Audits are conducted of all government departments and a range of statutory bodies and since the nineteenth century these have gone beyond mere scrutiny of financial regularity to include 'value for money audit' (VFM). More recently the VFM audit has been extended administratively to cover an 'effectiveness audit', which is said to assess whether programmes have met designated policy goals. It is present government policy, however, not to extend the C & AG's role further into the realm of merits than a review of cost effectiveness. In 1981 the Public Accounts Committee (PAC 1981) advocated some broadening of scope and a power for the C & AG to draw Parliament's attention

to policies of doubtful effectiveness. But it was soon clear how unpopular even such small steps in the direction of CB testing of policy were within the civil service. The Treasury (1981) rejected the widening of audit powers in autumn 1981. This prompted a former chairman of the PAC, Mr Edward du Cann, to point out in Parliament on 29 November 1981 that there were only 47 accountants internally auditing 11 departments. He called current financial controls 'a joke'.

What does this indicate for the workability of a mandatory CBA approach to regulations? Firstly, that neither government nor Treasury, civil service nor departmental agencies are presently organized in a manner that caters for the application of economic tests to policy issues, nor are they inclined to favour that movement. Secondly, that bureaucratic resistance to economic review on the merits might be expected if CB testing was introduced by government. Thirdly, that agencies will oppose CBA overview as a duplication of functions in the way that the nationalized industries opposed the National Economic Development Office's proposals for policy councils (NEDO 1976). The more specialized a sphere of regulation, the harder it is for proponents of CBA to counter this argument.

Conclusions

With CB testing as provided for in Order 12291 there are a number of theoretical, administrative, legal and political difficulties. Nonetheless, the technique has a number of features (such as the spotlighting of excessively costly regulations) that may be attractive to governments who wish to reduce regulatory burdens. Although one should exercise caution in drawing conclusions from the experience of a governmental device in one country to its potential in another, there do seem to be special problems facing a government which wishes to regulate by CBA in Britain. We have pointed to a number of institutional factors that suggest that the problems of a CBA approach to regulation may well be magnified in a British setting. A British government could introduce a CBA requirement into regulatory rulemaking but to do so in a workable, open and accountable fashion would necessitate some radical changes in the nature of rulemaking, in judicial and civil service attitudes, in the parliamentary review system, in the structure of the government bureaucracy and in the statutory (and actual) aims of social regulation. To point to these and more general difficulties of regulation by CBA is not of course to argue that the intelligent appraisal of costs should not be an important factor in regulatory decision-making. What we doubt is the appropriateness and feasibility of treating CBA as a routine method of deciding complex policy issues.

REFERENCES

Allen, J. W. 1978. *Costs and benefits of federal regulation: an overview*. Congressional Research Service Report, no. 78-152E.

Averch, H. and Johnson, L. L. 1962. 'Behavior of the firm under regulatory constraint', *American Economic Review* 52, 1053-69.

Beatson, J. 1979. 'Legislative control of administrative rulemaking: lessons from the British experience', *Cornell International Law Journal* 12, 199-226.

Breyer, S. 1982. *Regulation and its reform*. Cambridge Mass.: Harvard University Press.

Brown, R. G. S. and Steel, B. R. S. 1979. *The administrative process in Britain*. London: Methuen (2nd ed).
Cranston, R. 1978. *Consumers and the law*. London: Macmillan.
De Muth, C. 1980. 'Constraining regulatory costs: the White House review programme', *Regulation* 13-26.
Department of Industry. 1982. *The future of telecommunications in Britain*. Cmnd. 8610. London: HMSO.
Diver, C. S. 1980. 'A theory of regulatory enforcement', *Public Policy* 28, 259-99.
Eads, G. C. 1981. 'Harnessing regulation', *Regulation* 19-26.
—— and M. Fix. 1982. 'Regulatory policy' in J. Palmer and I. V. Jawhill, eds. *The Reagan experiment*. Washington DC: The Urban Institute Press.
ECC. 1979. *Interim report: responsible regulation*. Ottawa: Economic Council of Canada.
EIU. 1978. *The additional costs to the British consumer of compliance by industry with consumer legislation*. London: Economist Intelligence Unit.
Freedman, J. O. 1978. *Crisis and legitimacy*. Cambridge Mass.: Cambridge University Press.
Fulton Committee. 1968. *Report of the committee on the civil service*. Cmnd. 3638. London: HMSO.
Garner, J. F. 1979. *Administrative law*, (5th ed.) London: Butterworths.
——. 1964. 'Consultation in subordinate legislation', *Public Law* 105-24.
Garner, M. R. 1982. 'Auditing the efficiency of nationalized industries: enter the Monopolies and Mergers Commission', *Public Administration* 60, 409-428.
Hartley, K. and A. Maynard. 1982. *The costs and benefits of regulating new development in the UK pharmaceutical industry*. London: Office of Health Economics.
Hawkins, K. O. 1984. *Environment and enforcement: regulation and the social definition of pollution*. Oxford: Oxford University Press.
Home Office and Department of Industry. 1983. *The development of cable systems and services*. Cmnd. 8866. London: HMSO.
HSC. 1982. *Cost/benefit assessment of health, safety and pollution control*. London: Health and Safety Commission.
HSE. 1980. *Plan of work 1981-82 and onwards*. London: Health and Safety Executive.
Jergeson, A. D. 1978. 'The legal requirement of consultation', *Public Law* 290-315.
Jordan, W. A. 1972. 'Producer protection, prior market structure and the effects of government regulation', *Journal of Law and Economics* 15, 151-76.
Kelman, S. 1981. *Regulating America, regulating Sweden*. Cambridge Mass.: MIT Press.
Lave, L. 1981. *The social strategy of social regulation*. Washington DC: Brookings Institution.
MacAvoy, P. W. 1970. *The crisis of the regulatory commissions*. New York: Norton and Co.
McKean, R. 1980. 'Enforcement costs in environmental and safety regulation', *Policy Analysis* 6, 269-90.
Miller, J. C. and B. Yandle. 1979. *Benefit-cost analysis of social regulation*. Washington DC: American Enterprise Institute.
Mishan, E. J. 1977. *Cost-benefit analysis*. London: George Allen and Unwin.
Mitnick, B. M. 1980. *The political economy of regulation*. New York: Columbia University Press.
NEDO. 1976. *A study of UK nationalized industries*. London: National Economic Development Office.
OECD. 1979. *Competition policy in regulated sectors*. Paris: Organization for Economic Co-operation and Development.
Ogus, A. I. and C. G. Veljanovski. 1984. *Readings in the economics of law and regulation*. Oxford: Oxford University Press.
OMB. 1982. *Executive order 12291 on federal regulation — progress during 1981*. Washington: Office of Management and Budget.
Pearce, D. W. 1971. *Cost-benefit analysis*. London: Macmillan.
Peltzman, S. 1975. 'The effects of automobile regulation', *Journal of Political Economy* 83, 677-725.
Peters, G. H. 1973. *Cost-benefit analysis and public expenditure*. London: Institute of Economic Affairs.
Pliatsky, Sir Leo. 1980. *Report on non-departmental public bodies*. Cmnd. 7797. London: HMSO.
Posner, R. A. 1971. 'Taxation by regulation' *Bell Journal of Economics* 2, 22-50.
——. 1976. 'Theories of economic regulation', *Bell Journal of Economics* 5, 335-58.
Public Accounts Committee. 1981. *The role of the Comptroller and Auditor General*. HC. 115-21. London: HMSO.
Purdue, M. 1979. 'The economics of development — its status as a planning consideration', *Journal of Planning and Environmental Law*, 146-51.
Quirk, P. J. 1981. *Industry influence in federal regulatory agencies*. Princeton: Princeton University Press.

Robens, 1972. *Report on safety and health at work*. Cmnd. 5034. London: HMSO.
Robson, W. A. 1960. *Nationalised industry and public ownership*. London: George Allen and Unwin.
Rosenburg, M. 1981. 'Beyond the limits of executive power: presidential control of agency rulemaking under executive order 12291', *Michigan Law Review* 80, 193-247.
Richardson, G. M. et al. 1980. *Policing pollution: a study of regulation and enforcement*. Oxford: Oxford University Press.
Saunders, A. B. and D. A. Benson. 1975. *The practical application of social costing in road safety policy making*. London: HMSO.
Schwartz, B. 1981. 'The court and cost-benefit analysis: an administrative law idea whose time has come — or gone', *Supreme Court Review* 291-307.
—— and H. W. R. Wade. 1972. *Legal control of government*. Oxford: Oxford University Press.
Self, P. 1979. *Administrative theories and politics*. London: George Allen and Unwin.
Smith, R. S. 1979. 'Compensating wage differentials and public policy: a review', *Industrial and Labor Relations Review* 32, 339-51.
Stigler, G. J. 1971. 'An economic theory of regulation', *Bell Journal of Economics* 2, 3-21.
Sunstein, C. R. 1981. 'Cost-benefit and the separation of power', *Arizona Law Rev.* 23, 1267-82.
Treasury. 1980. *The role of the Comptroller and Auditor General*. Cmnd. 7845. London: HMSO.
——. 1981. *The role of the Comptroller and Auditor General*. Cmnd. 8323. London: HMSO.
Treasury and Civil Service Committee. (Session 1981-82). 3rd report. *Efficiency and effectiveness in the civil service*. Vol. 1. Report. HC. 236-I. London: HMSO.
Veljanovski, C. G. 1982. *The new law-and-economics: a research review*. Oxford: Centre for Socio-Legal Studies.
Verkuil, P. R. 1980. 'Jawboning administrative agencies: ex parte contacts by the White House', *Columbia Law Review* 80, 43-89.
Viscusi, W. K. 1979. 'The impact of occupational safety and health regulation', *Bell Journal of Economics* 10, 117-40.
White, L. J. 1981. *Reforming regulation — process and problems*. New York: Prentice Hall.