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I have no
comments, but
Nancy M.
should read
section " "
" Environment

EW

12/21

I suggest DAB take a
look at pp 52, 53, + 54.

There are several errors
and a slight "tone" problem
which don't serve the report
well.

12/23

N. Maynard

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DIRECTORATE STATUS

FROM: BOSKIN, Michael J.: COUNCIL OF ECONOMIC ADVISERS

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 12/19/91

SUBJECT: HE REQUESTS COMMENTS ON THE PRELIMINARY STAFF DRAFT
OF CHAPTER FIVE OF THE 1992 ECONOMIC REPORT OF THE
PRESIDENT.

DIRECTORATE

ASSIGNED: Dr. Wong

STAFF

ASSIGNED:

ACTION

REQUIRED: COMMENT TO DAB

STAFF

ACTION:

SENDER'S DUE DATE: 12/23/91

OSTP DUE DATE: 12/23/91

STAFF DUE DATE

DATE COMPLETED:

DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #:

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FILE: P-INDUSTRIAL-ECONOMIC COMPETITIVENESS

CENTRAL FILES:

THE WHITE HOUSE
WASHINGTON

December 23, 1991

MEMORANDUM FOR MICHAEL BOSKIN

FROM:

ALLAN BROMLEY *Alan*

SUBJECT:

Chapter Five of the 1992 Economic Report

In general, an excellent piece of work as always. Herein the few minor comments.

1. Page 94, second and third sentence. While I agree entirely, many may feel that this estimate is an extreme one.
2. Page 94, end of first paragraph. I would suggest that you include reference here to the budget numbers for R&D on energy efficient technologies.
3. Page 53, line 3. Suggest that this be changed to read as follows:
"chlorofluorocarbons (CFCs) probably have no net effect on global surface temperature and raised a number of new scientific questions regarding the nature of chemical reactions in the atmosphere including several important gases." CFCs are indeed still greenhouse gases. It is the chemical reactions between them and ozone and nitrous oxide -- among others -- that is at issue.
4. Page 52, penultimate line. Suggest that this should read: "The question of how much several of the gases contribute to the greenhouse effect also remains uncertain; this is -----."

cc: Phil Brady

CLOSE HOLD**WHITE HOUSE STAFFING MEMORANDUM**DATE: 12/19/91 ACTION/CONCURRENCE/COMMENT DUE BY: C.O.B. Monday 12/23/911992 ECONOMIC REPORT OF THE PRESIDENT, Chapter 5 --SUBJECT: COMPETITIVE FORCES AND REGULATION

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	☐	☒	HORNER	☐	☐
SKINNER	☐	☒	MCCLURE	☒	☐
SCOWCROFT	☒	☐	PETERSMEYER	☐	☐
DARMAN	☒	☐	PORTER	☒	☐
BRADY	☐	☒	ROGICH	☐	☐
BROMLEY	☒	☐	SMITH	☐	☐
CARD	☐	☒	BROADMAN, Harry	☐	☒
DEMAREST	☒	☐		☐	☐
FITZWATER	☐	☒		☐	☐
GRAY	☒	☐		☐	☐
HOLIDAY	☒	☐		☐	☐

REMARKS:

Please provide any comments directly to Harry Broadman, Rm. 314,
by close of business on Monday, 12/23, with a copy to this office.
Thanks.

RESPONSE:

CLOSE HOLD

PHILLIP D. BRADY
Assistant to the President
and Staff Secretary
Ext. 2702



THE CHAIRMAN

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

December 19, 1991

MEMORANDUM FOR DISTRIBUTION BELOW

FROM: MICHAEL J. BOSKIN *MB*
SUBJECT: 1992 Economic Report of the President
Chapter 5 -- Competitive Forces and Regulation

Attached is a preliminary staff draft of Chapter 5 of the 1992 Economic Report of the President. Please let us have your comments in memo form by Monday, December 23. CEA welcomes comments and suggestions and finds them extremely helpful in preparation of the Report.

Comments should be delivered to the attention of Harry Broadman, Room 314, Old Executive Office Building.

Please note that the draft is for official use only, should be held close, and should not be copied.

Attachment

White House (Porter, Gardner, Hill)
OMB (Darman, Grady, Hale, Al-Samarrie)
NSC (Scowcroft)
OSTP (Bromley)
USTR (Hills, Moskow, Walters)
CEQ (Deland)
State (Baker, Zoellick, McAllister, Bohlen)
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HHS (Sullivan, Gerry)
HUD (Kemp, Weicher, Humbert, Woodward)
Justice (Barr, Rill)
Labor (Martin, DeArment, Norwood)
Transportation (Murphy)
Federal Reserve (Greenspan, Prell, Truman, Kohn)
CIA (Gates)
CFTC (Gramm)
FDA (Kessler)
EPA (Morgenstern)

CHAPTER 5

COMPETITIVE FORCES AND REGULATION

Government at all levels affects economic activity through such mechanisms as taxes, law enforcement, and the construction of roads and highways. Regulation, however, generally refers to legislation or rules developed by government agencies that alter the way private companies conduct their operations or that mandate government provision of goods and services. "Economic" regulation takes many different forms and includes regulating prices and limiting the extent of competition in an industry, such as by establishing a single local telephone company with regulated rates. The government also attempts to protect safety, health, and the environment through "social" regulation.

While the intentions of many regulations are laudable, they can have unintended adverse impacts on the general public. For example, oil price controls and allocation schemes, begun in 1971 and abandoned in 1981, exacerbated the effects of the two energy crises by creating gasoline lines and spot shortages. During the conflict in the Gulf, the short-lived price spike reflected the potential scarcity of oil created by the war. The higher prices encouraged consumers to reduce their gasoline use, avoiding the

need for government allocations. Soon after the war began, prices receded.

Why are regulations that have an adverse impact on the general public instituted in the first place? One reason is that proponents of increased government regulation fail to consider the costs associated with new regulations, relative to the benefits they are intended to achieve. This is particularly common when regulations are imposed to reduce risk exposure, without consideration of their costs. Similarly, regulation to prevent monopoly pricing by public utilities, while intended to benefit consumers, can be costly if it discourages innovation by the utility. Appropriate regulation is based on a balancing of costs and benefits, taking into account hidden costs such as reductions in the incentives for firms to innovate.

Once in place, a regulation may be very difficult to eliminate or to change. One reason is that regulation is a legal institution, requiring legislation or the actions of a government agency to make the change. Also, regulation may favor a special interest at the expense of the welfare of the consumer. For example, continued restrictions on price cutting and on the number of airlines that can fly on international air routes benefits carriers having rights to those routes because they are protected from competition, but consumers in general suffer because they are forced to pay the higher fares. Those that

benefit from existing regulations, especially subsidized State-owned airlines not normally subject to the disciplines of competition, will resist the change to a more deregulated environment. But deregulation is appropriate when there is reason to believe that, left on its own, a market will be competitive.

The Administration remains committed to the continued process of deregulation in markets that are or can be competitive and to advocating regulation only when there is a strong presumption that the benefits to society exceed the costs. Energy, for example, is an important input into production and is also consumed directly. Increased reliance on the competitive market has improved the ability of the economy to respond to shocks in energy supply and demand. The Administration's National Energy Strategy has proposed regulatory changes that would allow markets to function even more effectively. Further deregulation would encourage the entry of new, low-cost producers by increasing competition in the generation of electric power. Reforming the regulation of financial institutions, while ensuring the integrity of the financial sector, is also a major goal of this Administration. This subject was analyzed in the 1991 Report.

Where regulation remains necessary, the movement toward "incentive regulation" that encourages firms to operate more

efficiently has been a positive regulatory innovation. The Federal Communications Commission (FCC) is now regulating AT&T's residential long-distance telephone rates in a way that encourages the company to minimize costs. The Environmental Protection Agency (EPA) has pioneered the use of a regulatory mechanism that allows the market to determine the most efficient way to achieve air quality levels. The expected savings in pollution abatement costs from this Administration initiative will amount to billions of dollars over the next two decades.

Poorly designed regulations can impose burdens on firms and their workers that in the long run will hurt economic growth. When it is determined that the government should intervene directly, approaches that use market forces, rather than direct bureaucratic control of output and prices, allow markets to retain their flexibility and assure that the economy's resources will be put to their most productive uses.

COMPETITION AND THE ROLE OF GOVERNMENT

The competitive market system has three important features. First, the discipline of competition encourages efficient production. In a competitive market, a firm that did not produce efficiently would have to charge a higher price to make a profit and would lose customers to its competitors. Ultimately the firm will be driven out of business.

Second, a competitive market ensures that the economy's productive resources are put to their best use. For example, automobile manufacturers decide what kind of cars to build based in part on the relative prices of different parts needed for the car, and in part on what they think consumers will pay for different kinds of cars. As economists have known since Adam Smith, in a competitive market, consumers and producers will be led, as if by an invisible hand to a price having the remarkable features that the value of the last unit of output produced just equals the value that society forgoes in producing it.

Third, competition accommodates changes in consumer demand. If consumers demand more washing machines, for example, store owners will quickly begin to run out of inventories. The price will increase to reflect the increased demand for the existing stock of washing machines. In turn, manufacturers will be respond by producing more of them.

One of the roles of government is to establish institutions that facilitate competition, and when markets are not performing well to introduce regulation that accomplishes the goal of restoring competition in the most cost-effective manner.

THE LEGAL SYSTEM

The law determines the environment within which transactions take place. All legal rules, including regulations, impose costs and benefits on different participants in a transaction and therefore alter their incentives. If an inventor knew that another person could copy his idea and sell it to others, there would be very little incentive to invent in the first place. The legal system protects the inventor's rights by giving him specified rights to exclude others from the use of the invention, and therefore the right to require compensation for its use. Besides defining and protecting a person's property rights, the legal system provides a method for enforcing contracts and for compensating people when they are harmed from an accident or an injury.

Among its many benefits, the legal system provides a forum for resolving disputes and establishes the ground rules upon which market transactions take place. But there are also costs to resolving conflicts within the legal system. A legal system can constrain economic activity if disputes are resolved slowly and the costs of litigation are high. Reform of the legal system, like regulatory reform, involves setting rules that achieve their aims in the most cost-effective way possible. In the case of the law, the goal is to create rules and a system of adjudication that provides a fair and efficient system for settling disputes.

Property Rights, Contracts and the Tort System

Ownership of a piece of land conveys on that person the right either to exclude others from or give them access to the property, generally to the benefits or use of a resource on that property. The deed to a piece of land defines a property right, and the law protects those rights by giving the owner redress to the courts if someone tries to use the property without the owner's permission. Property rights are not absolute, however. Society balances the goals of private ownership against other social goals. In the case of land, local communities have zoning laws that restrict the types of buildings that can be constructed in a particular neighborhood.

Examples of property rights include not only a deed to a piece of land, but less tangible equivalents to a deed such as a patent that allows an inventor to receive the profits from his work, or a license from the Federal Communications Commission that gives the owner sole rights to a part of the radio spectrum. The licensee of a particular portion of the spectrum would have little incentive to promote the use of the frequency if any other person could begin broadcasting on the same frequency. By defining what the license is, and providing a forum to enforce that right, the legal system allows the frequency owner to capture the returns from the investment.

The rules of contract law enforce agreements among individuals and establish what actions will take place when contracts are breached. Even if a person could specify all outcomes when writing a contract, legal enforcement is still necessary to ensure that people will honor the agreement. If a tire manufacturer has contracted to deliver tires to an auto assembler, and he does not deliver, the assembler can go to the courts to have the contract enforced. Without enforcement, people would have to depend exclusively on the good will of others to ensure that the agreement in a contract is carried out. For the auto manufacturer, it is much easier to plan production of new cars when it is clear that the contract for tire delivery is enforceable.

The legal system also includes a system of tort law, whose major goal is to provide victims of accidents and injury the opportunity to be compensated for their losses. By awarding damages to victims, the tort law creates an incentive for individuals to behave responsibly. Because there is potential for being sued to compensate a victim, people will respect property rights and put more effort into accident prevention and into reducing the potential loss from accidents.

Proposed Reforms for the Legal System

The process of enforcing civil law has been criticized for being costly, arbitrary, and unpredictable and for using unscientific standards. Because of the way the rules for resolving legal disputes are currently written, parties to a legal case do not consider all of the costs of resolving a lawsuit. For example, both sides of a legal dispute have almost unlimited ability to take sworn depositions of witnesses, request documents, and submit written questions to each other within the pre-trial process called "discovery." Discovery is provided without cost to the requestor, so there is virtually no incentive to limit the amount of the request. The result is often unnecessary requests for information, adding substantially to the cost of litigation with little offsetting benefit.

The President's Council on Competitiveness has proposed a comprehensive set of reforms to the civil justice system in its "Agenda for Civil Justice Reform in America." Many of the reforms are meant to accelerate the resolution of disputes and to discourage waste in litigation. The Council on Competitiveness, under the leadership of the Vice President, has proposed establishing rules to set quantitative limits on the amount of discovery provided cost-free to the requestor. The proposed civil justice reforms also include encouraging alternative methods of dispute resolution, placing caps on punitive damages, and promoting judicious use of expert testimony (Box 5-1). In Executive Order 12778 the President has directed all Federal

agencies to implement several of these reforms, including changes in discovery procedures and in the use of expert witnesses, whenever it is feasible.

Box 5-1: Civil Justice Reform Proposals

In August 1991, the President's Council on Competitiveness recommended 50 specific changes to the civil litigation system. The major reforms include:

Loser Pays. The Council has proposed the use of the English rule or "loser pays." Under this proposal the person who loses a case would pay the winner's attorney fees. The amount of the payment would be capped at a level equal to the amount spent by the loser. Knowing that the law establishes a penalty for losing, a person might be discouraged from bringing a frivolous suit. The use of the English Rule would be limited to cases involving State law brought under the Federal courts' diversity jurisdiction.

Punitive Damages. Punitive damages are often awarded over and above actual damages. While some States have attempted to limit punitive damages, the current approach has been criticized for distributing awards in a random and capricious manner. The Council proposes that limitations be placed on punitive damages. Under one proposal, the amount of the punitive damages would not exceed an amount equal to the plaintiff's actual damages.

Expert Evidence. Often, "expert" testimony is unsupported by accepted professional practice or scientific knowledge. A principal recommendation would require experts to base their testimony on theories "widely accepted" by others in the field.

Voluntary Dispute Resolution. Most disputes are resolved through litigation, either at trial or in an out-of-court settlement. The Council on Competitiveness recommends greater access to alternative mechanisms such as private mediation or arbitration to resolve matters without resort to the legal system.

WHY AND HOW GOVERNMENTS REGULATE

Regulation, it is commonly argued, is intended to correct market imperfections. First, an industry may not be competitive because it contains only one or a few producers. In this case, the government uses antitrust enforcement or price regulation to protect consumers. Second, the presence of "externalities," or third-party effects, means that people do not account for the effects of their actions on others. As an example, pollution imposes costs on third parties. This is the argument made for environmental regulation: a manufacturer dumping pollutants into a river does not consider the effects on a fisherman who also uses the river.

An externality can also benefit rather than harm third-parties. Information is one important example. When a company discloses information on a product's characteristics, it may be difficult to exclude competitors from capturing the benefits of that information as well. The effect of an external benefit is that the incentives to disclose the information are diminished. In principle, when the benefits of having the information outweigh the costs of providing it, the government's role may be to provide the information directly, or to require firms to provide it, and then to let consumers make choices about which goods or services to buy. Examples of government required information include food and drug labeling, and energy efficiency

labels for household appliances. In other cases, it may be costly for consumers to assess the information they receive relative to the benefits of having the information. Rather than requiring disclosure, the government sets standards, as in airplane or consumer product safety.

Either the absence of competition or the presence of externalities represent imperfections in the private market system. If government regulators were acting primarily to correct these imperfections, one would expect that the primary characteristic of regulation would be to simulate the features of the market, such as by encouraging regulated businesses to produce efficiently. In practice, however, the United States and other nations have often relied on command-and-control mechanisms that dictate a particular level of profits or technology, rather than on mechanisms that encourage firms to reduce their costs or to improve services.

For example, EPA's 1979 rules for new electric power plants required costly limestone "scrubbers" to reduce sulfur emissions at virtually all new coal-fired plants. A better alternative would have been to set emissions targets and then allow firms to meet the targets by the most cost-effective means. Other examples of command-and-control regulation include restricting price competition among ocean shippers, limiting the number of firms that can provide cable television service, and using

administrative hearings to determine who gets the rights to new positions on the radio spectrum.

One reason that command and control regulations remain in place is that the decision to introduce regulatory reform or to deregulate an industry affects the distribution of wealth among consumers and regulated companies. The outcome of the regulatory process may be determined by the strength of interest groups rather than by what regulation maximizes net benefits to society. A regulated company that is producing inefficiently, for example, knows that if competition is introduced the company will either be forced to go out of business or to invest in a more efficient production process. Such a company will resist regulatory reform.

In the following sections the traditional forms of regulation are briefly analyzed, accompanied by a discussion of the interest group theory of regulation.

Antitrust

Sometimes an industry may not be competitive--either because a producer has a monopoly over production or because it has only a few large firms that can make decisions collusively. In these situations, producers tend to reduce the amount of production below what a competitive market would produce, causing prices and

profits to rise at the expense of consumers. The desirable characteristics of markets are attenuated when competition is absent. In particular, the outcome is inefficient because some consumers would be willing to pay more for the good than the additional cost of its production. If competition were greater, producers' profits would decline, but by less than the value of increased output, and all consumers would enjoy lower prices.

Although not normally discussed as a form of regulation, antitrust policy is one way to inhibit anticompetitive behavior. The Federal Government enforces the antitrust laws through the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC). The primary focus of these agencies is to challenge mergers that significantly reduce competition and to prosecute businesses that collude to raise prices.

The Regulation of Prices and Competition

Economic regulation generally refers to control of the prices a business can charge and sometimes the number of businesses that can provide a good or service. One goal of price regulation is to place a check on companies that have a monopoly in the market that they serve. Yet, competitive industries have also seen their prices regulated. Price regulation of natural gas sales was instituted in 1954, even

though approximately 2,300 independent producers of natural gas were operating as of 1947. Because prices were set too low in an industry that was already competitive, shortages of gas developed in the 1970s.

Another motivation for economic regulation is to protect existing companies from new competition. Regulation of interstate trucking by the Interstate Commerce Commission (ICC) in 1935 was stimulated by railroads' concern that unregulated trucking companies would be able to undercut the prices of railroads in areas where railroads were not the efficient carrier. The ICC restricted the ability of trucking companies to offer discounts, and regulators were hostile to companies that wanted to extend service into new geographic regions and to the development of completely new firms. In fact, existing firms were allowed to protest proposed service by a new carrier. The Motor Carrier Act of 1980 changed all of that by limiting the ICC's regulatory authority. By 1990 the total number of licensed interstate carriers exceeded 40,000, compared with 17,000 in 1980. During fiscal 1987, truckers filed 1.2 million new rate schedules, as opposed to 394,000 in 1979. Because trucking services represent 75 percent of all expenditures on transporting goods, reduced regulation contributes to economic growth by reducing a major cost of production.

Price regulation and limitations on competition have a much stronger justification in industries that are "natural monopolies." These are industries where it is less costly to produce all of a product in a single firm than in several different firms. Within a particular geographic area, firms such as electric utilities, local telephone companies, and local distributors of natural gas have been considered natural monopolies.

If several electric utilities attempted to compete with each other for the same customers, each company, realizing that cost reductions come from having more customers, would begin to lower prices to capture those customers. Eventually only one firm would survive this battle. Exactly this type of competition occurred in the late 19th century when several companies provided electric service in New York City, with one company eventually emerging to serve the whole city. The expenditure on the overlapping electric lines was wasteful since competing firms could not survive.

The usual policy response is to carve out a monopoly for an electric utility over a fixed geographic area, and to then regulate its prices. While constraining the pricing of a monopolist and eliminating wasteful duplication, regulation of this type can also have drawbacks. As discussed below, the way prices are regulated can diminish the incentive for the regulated

company to minimize its costs. Also, the protection of a monopoly by the government may prevent new competitors from implementing new technologies that are not natural monopolies.

The Environment, Health, and Safety

Since World War II, the government has assumed an ever-increasing role in regulating the environment, health, and safety. Spurred by increasing public concern over risks, government agencies now regulate discharges of air pollutants, set safety standards for cars, and oversee the food Americans eat.

The goal of regulating the environment, health, and safety is to correct the problem of externalities or third-party effects. Externalities may take the form of something people want less of--like air pollution--or something they want more of--like information on safety. If one man's clothes are soiled by his rural neighbor's furnace, he may be able to arrange compensation from the neighbor. But if his clothes are soiled by air pollution from a thousand furnaces and cars, then it will not be practical to obtain compensation from, or even identify, all those who caused the harm. In this case, one person can pollute another's air without paying compensation, and the result will be too much air pollution. Ronald Coase, the winner of the 1991 Nobel Prize in Economics, pointed out that the difficulties in

correcting the externality through bargaining may necessitate regulation to reduce pollution (Box 5-2).

Box 5-2: Ronald Coase, Property Rights, and Pollution

Prof. Ronald Coase recognized the inextricable link between establishing property rights and correcting externalities. In the case of pollution, Coase asserted that if property rights to the air could be assigned, and there are no costs of bargaining between individuals, no government intervention would be necessary to deal with pollution. No matter who is originally assigned the property right, a market will develop for that right. Polluting firms and injured parties would then be able to negotiate on their own, producing an efficient level of pollution.

The negotiations necessary to achieve this solution will not necessarily occur, however. As Coase emphasized, there are "transaction costs" of engaging in bargaining. In the case of air pollution, millions of people may be affected, making negotiation impossible. When transaction costs are high, how the legislature originally assigns property rights becomes very important. If they are assigned to a polluter, for example, it can be difficult for injured parties to seek redress through negotiation. In that case regulation may become necessary.

Besides protecting the environment, the government protects consumers by providing information or requiring that businesses provide information. In 1990 the President signed the Nutrition Labeling and Education Act, requiring the FDA to establish rules that would make it easier for consumers to understand the nutritional content of foods. Because the benefits of providing information on nutrition are conferred on all individuals and the food company is not compensated for those benefits, their incentive to provide the information is diminished. To help correct this problem, the FDA has proposed standardized measures

of a "serving" for more than 100 different foods to make it easier for consumers to compare products. The FDA has also placed limits on the health claims that food manufacturers can make. Although the information benefits consumers, it is important to recognize that businesses will incur costs to develop the new information and to alter the food labels. Also, strict regulation of health claims could have the adverse impact of suppressing dissemination of useful information. Furthermore, the presence of an externality does not mean that no information on nutrition will be provided. Even when firms cannot capture all of the benefits, information may still be supplied by others (e.g., through consumer magazines).

For certain risks, the government may go beyond requiring that information be provided. Because it is costly for people to assess the information associated with consumer products, workplace safety, and similar risks relative to the benefits of having the information, it is argued that the government should regulate the risks directly.

Many actions have some external or third party effects that could be used to justify government intervention. But government action itself has third-party effects, and government intervention to correct the "market failure" of an externality carries with it the risk of unintended outcomes because of government intervention or "government failure."

Government failure may occur for at least three reasons. First, it can be difficult to determine who is affected by an externality and to what extent. This is particularly true where the scientific consensus is still evolving. For example, the scientific consensus on air pollutants and toxic substances has changed often enough to impede sound regulatory decisions; the scientific debates surrounding asbestos, dioxin, and global climate change all attest to this.

Government failure may also occur when regulatory solutions impose large unintended costs on innocent third parties. Thus, long delays in the testing of new drugs harms those forced to use the older, often less effective, substances. The Administration has proposed using private organizations to complement the FDA's function of testing the safety and effectiveness of new drugs. The goal of privatizing some of the testing function is to reduce the average time it takes to get a new drug to market from 9.75 years to 6 years.

Third, as explained in the next section, government failure may occur when regulation becomes the mechanism that allows one group of citizens to take advantage of another.

Interest Groups and Regulation

Regulation creates winners and losers. Firms know this, and spend considerable time and money trying to capture the benefits of regulation. New regulations rarely affect all firms equally. New firms may face higher costs than existing firms; large firms may be able to finance costly changes demanded by new regulations; some firms may be able to gain exemptions from the existing rules.

An example is in the development of the pipeline that brings Alaskan natural gas to the rest of the country. A waiver of certain Federal regulations granted by Congress in 1981 facilitated construction of the pipeline. Companies involved in the project lobbied heavily for this waiver, which reduced their liability in the event the project failed. Their success in obtaining passage of the waiver increased the value of these firms considerably.

Through regulation or other policy, the government can transfer income from one group to another. One way is by creating or protecting a firm's position as a monopolist, or by restricting a market to a small number of firms. Protected firms enjoy higher profits than competitive firms; these higher profits become the prize sought by others. Thus, as explained above, truckers used the ICC to block entry of new competitors.

But gaining a protected position from the government can involve large expenditures. Firms hire lobbyists and lawyers, and even alter their business plans in order to acquire a protected position. Since all interest groups must make similar expenditures, the regulatory process tends to favor those groups or businesses who can capture the greatest benefits from a protected position. Once achieved, a protected position must be defended against competitors trying to dislodge the incumbent firm.

Before deregulation in 1978, for example, the Civil Aeronautics Board (CAB) granted effective monopolies to airlines on many routes. The CAB held hearings in which the airlines attempted to persuade the board members to award them the exclusive franchises and to keep out competitors. Although the post-deregulation domestic airline industry continues to use lobbyists to gain a favorable hearing for its views, the industry no longer has protected domestic monopolies to spend time and money defending.

The U.S. Department of Agriculture's (USDA) agricultural marketing orders are another illustration. These orders restrict supply in markets for milk, lemons, oranges, and other crops (Box 5-3). For decades farmers have made investments with the belief that the orders would protect their profitable position. They

resist proposals that would eliminate these orders because doing so would reduce the value of their investment.

Box 5-3: Agricultural Marketing Orders

Marketing orders regulate handlers (first buyers) of certain fruits and vegetables and fluid milk. A Federal marketing order for California-Arizona navel oranges has been in effect since 1933. Under the present order, the maximum quantity each handler may ship to the domestic fresh market is set weekly. Harvested oranges not sold in the domestic market are sold abroad or to the domestic processing industry. By diverting oranges that would typically be sold in fresh markets to these other markets, total revenue to growers is increased.

Although land owners gain because of higher farm income, the marketing order penalizes lower cost producers by restricting the amount of fresh oranges that can be sold to the higher priced domestic market. Consumers of fresh oranges lose as well because of higher prices.

What are the costs and benefits of such regulation? A recent USDA study suggests that eliminating the marketing order would cost producers about \$13 million annually, while saving consumers about \$30 million. On a per-capita basis, however, each consumer would gain about \$.12, while each grower would lose about \$3,150 from eliminating the order.

The problem of entrenched protected interests can be avoided by arrangements that discourage expenditures solely to defend the special position. Auctioning public property, for example, makes the auction winners owners of the property and gives them an incentive to make the best use of it. Currently, the FCC uses a lengthy process of hearings or a purely random lottery system to assign new licenses to the radio spectrum. Competitive bidding for newly available portions of the radio spectrum ensures that licenses will be allocated to those parties who value it most. Bidding would also simplify the application process.

Another solution would be to require supermajorities for passing certain kinds of legislation, such as imposing tariffs, quotas, or price supports. Supermajorities would reduce the ability of narrow interests to impose costs on the larger public.

THE REGULATORY PROCESS

Regulation has become pervasive at the local, State, and Federal levels. Local regulation typically focuses on issues of interest to cities and towns. These include such measures as setting zoning restrictions and building codes, regulating sewer and water prices, and granting cable television franchises. In some cases local municipalities own the local electric utility, buying the needed power from generators of electricity. States regulate similarly, usually through regulatory commissions, which set retail rates for local telephone calls, electric power, and natural gas. States also regulate in a broad range of other areas, such as intrastate trucking, the insurance industry, and the environment.

Federal regulation is concerned primarily with goods and services that are sold in interstate commerce. Congress has responded to economic and social problems by creating regulatory agencies or by expanding the role of an existing Cabinet

Department. In health and safety, for example, 9 separate Federal agencies write regulations under the authority of 26 major statutes. In a process called a "rulemaking," agencies propose rules to conform with the requirements of the legislation. They are then published in the Federal Register, and finalized only after a period for public comment.

Box 5-4: Writing the Rules: The Clean Air Act

Congress legislates regulation broadly but leaves to the agencies the task of filling in the details. Each major regulatory agency is charged with implementing certain laws. As an illustration, the Clean Air Act Amendments of 1990 (CAAA) contains 9 major titles running to 300 pages and requires EPA to issue over 55 separate regulations in the first 2 years alone.

Consultation and public comment. On November 15, 1990, President Bush signed the CAAA. In late 1990, EPA began work on the first set of rules to be drafted, meeting formally and informally with affected industries, environmental groups, and other outside groups. In early 1991, EPA published in the Federal Register the first of a series of notices of proposed rulemaking, soliciting public comment. At several stages of the rule writing process, EPA must solicit public comments to be considered as the regulations are finalized.

Reg-neg. Recently, some rules have been formulated through negotiated regulations or "reg-negs," which aim to get around some of the lengthy and cumbersome steps of the conventional process. The 1991 draft rule on reformulated gasoline was drawn up with a reg-neg.

Agency review. The Office of Management and Budget (OMB) and other agencies have the opportunity, and in some cases the statutory obligation, to review proposed rules, generally for 30 to 60 days.

Final rule. After a last round of public comments, and concurrence from OMB, the EPA Administrator signs the final rule, which is promulgated in the Federal Register.

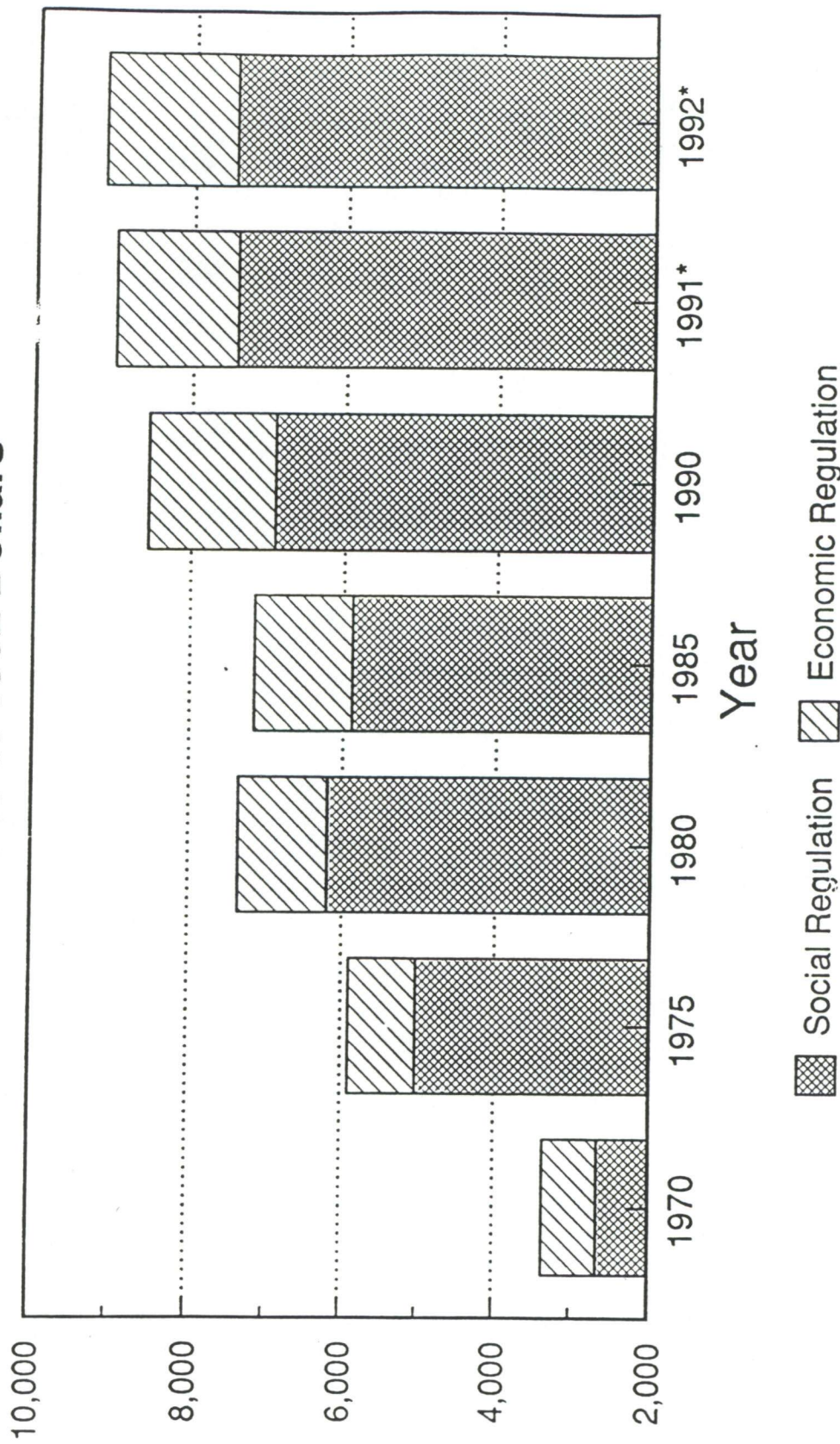
As shown in figure 5-1, researchers estimate that the administrative costs of enforcing and writing regulations have increased almost threefold since 1970. These costs, however, do not include the additional costs imposed on the firms that are regulated--costs that are ultimately borne by consumers. One recent estimate puts the total cost of Federal regulation at about \$400 billion a year, or 7 percent of GNP.

To make regulations more cost effective and to create some consistency in the way regulations are formulated in each agency, a system of regulatory oversight has been established within the Executive Office of the President. In 1981, President Reagan issued Executive Order 12291, which authorizes the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB) to work with the various regulatory agencies to develop more effective and less costly regulations. The Executive Order directs all agencies proposing new regulations, reviewing old ones, or developing legislation to estimate costs and benefits and to demonstrate that the potential benefits outweigh the potential costs to society. In 1990, OIRA reviewed over 2,100 rules to ensure that the principles of Executive Order 12291 were applied.

Federal vs. State Regulation

Administrative Costs of Federal Regulation

in Millions of 1982 Dollars



* Estimated

Source: Center for the Study of American Business, Washington University.

Figure 5-1

One barrier to increasing the overall effectiveness of regulation is the dual system of Federal and local regulation. Often, local governments can respond more effectively to problems that arise in their communities. Federal involvement in local zoning laws, for example, would require knowledge of local conditions that would be very costly to accumulate. Sometimes overlapping jurisdictions can create problems. For example, State regulations that impose food labeling laws distinct from the Federal rules of the Food and Drug Administration (FDA) force businesses to develop differently labeled products for these States. The inevitable increase in production costs would lead to higher food prices for all consumers. In cases where local regulation interferes with economies of production, a uniform system of Federal regulations would reduce the burdens on firms and their workers and lower prices for consumers.

SUMMARY

- o A system of competitive markets creates the discipline that encourages firms to produce efficiently and directs resources to their best use.

- o A well-functioning legal system should increase the level of economic activity by protecting property rights, ensuring that contracts are fulfilled, and protecting the victims of injury.

- o Although the presence of an externality may be clear, measuring its size can be difficult. When it can be measured, policies that incorporate market incentives are superior to command and control solutions.

THE BENEFITS OF ECONOMIC DEREGULATION

The primary purpose of deregulation is to allow competition to determine the prices that consumers are charged and the amount of goods and services that are produced as well as to encourage innovation and the development of new products. For example, before deregulation, the CAB determined the number of airlines that could serve each air route and the air fares they could offer. Ostensibly, fares were regulated so that consumers would benefit from prices that would prevail in a competitive market. Since deregulation in 1978, fares have decreased on long-distance routes and increased on short-distance routes, but taken together average air fares have declined 20 percent. Forty percent of high-density routes are now served by three or more carriers, double the percentage before deregulation. Also, once freed from regulation airlines developed "hub and spoke" systems, an innovation that has given passengers a much greater range of flight choices.

New technologies mean that some industries are no longer natural monopolies, but regulation can mask that fact by keeping the new technologies out of the market place. Instead of perpetuating the monopoly, deregulation would allow new firms to enter. The market would then determine how the service should be provided and at what price.

This is especially true in telecommunications where technology is changing rapidly. For example, before the breakup of AT&T most supporters of regulation considered long-distance telephone service to be a natural monopoly. Now firms have set up fiber optic and microwave networks that compete directly with AT&T in long-distance service. The Administration proposed in November 1991 to allow competition with INTELSAT, the international consortium that provides international long-distance telephone service by satellite. Under the new policy new satellite companies would be allowed to compete with INTELSAT by 1997.

Even when competition is not feasible, innovative regulatory measures can still be taken. Reforming the way prices are regulated would give regulated firms greater incentive to reduce costs and to innovate. Currently, monopolies are usually regulated using traditional cost-of-service regulation. The regulator determines the cost of providing the service and then prices are set to cover those costs, including a return on the

capital that is invested in the regulated company. This method is used to ensure that the company will not lose money, and that it will not be able to charge prices above its costs.

The problem with cost-of-service regulation is that it does not give the regulated firm the incentive to reduce its costs or provide better service. An attempt to reduce costs will eventually be followed by a reduction in allowed revenues, leaving the firm no better off. If new services lead to increases in profit, prices will eventually be reduced to bring revenues in line with costs.

New regulatory approaches, commonly labeled "incentive regulation," are being tried as alternatives to cost-of-service regulation. In the transition from regulation to unregulated competition in long-distance telephone service, some of AT&T's rates are tied to an index that is adjusted for inflation minus a correction for expected productivity improvements. If AT&T reduces its costs or improves its products, it is allowed to keep the profits. Many States have also instituted this incentive rate regulation for local telephone companies. And in its National Energy Strategy, the Administration has proposed instituting incentive rate regulation for natural gas pipelines. In this way regulators monitor monopoly profits while giving the regulated company incentives to produce efficiently.

Proposals for further deregulation are now being considered to improve performance in the natural gas, electric power, and cable television industries. Regulatory reform will bring more competition to natural gas delivery and the generation of electric power. The benefits of deregulating cable television will be fully realized only when entry barriers to new competitors, possibly using alternative technologies, are removed. The goal of deregulation is to secure a more efficient allocation of resources. That goal can be achieved by eliminating price regulation and barriers to entry where markets are competitive.

NATURAL GAS

Regulation in the natural gas industry is a primary example of the problems that can arise when regulators set prices incorrectly. Before 1978, the price paid for the natural gas that is extracted from the ground, often called the "wellhead" price, was regulated by the Federal Energy Regulatory Commission (FERC). Unfortunately, the regulated prices were set too low, reducing the incentive to extract more natural gas. Because there was a greater demand for natural gas at the regulated price than was being produced, Federal regulators were forced to ration the use of gas. To alleviate this problem, the Natural Gas Policy Act of 1978 began the process of decontrolling prices. The Natural Gas Wellhead Decontrol Act of 1989 set a timetable

for completing the deregulatory process. By January 1, 1993, all regulatory control over wellhead prices will be eliminated.

The Current Status of Natural Gas Regulation

The process of transporting natural gas to a residence or a commercial user remains regulated by FERC and the States, however. Once natural gas is extracted from the ground, it is transported by pipeline, often over long distances and ^{across} ~~over~~ State lines, and then sold to local distribution companies, electric utilities, and industrial users. FERC regulates the prices charged for interstate transportation of natural gas and the prices that pipelines charge for the gas they sell to local distributors and others. Pipeline companies must provide FERC with information on costs of production. FERC then sets prices to cover those costs.

The local distribution segment of the industry, which distributes the gas to residences and commercial users, remains a regulated monopoly. Having multiple natural gas lines to every home and business would be inefficient. One company delivering the gas to all homes within a market is a less costly method of distribution. Because distribution has natural monopoly characteristics, the local distributors have monopolies over their service areas, and the rates are regulated by States.

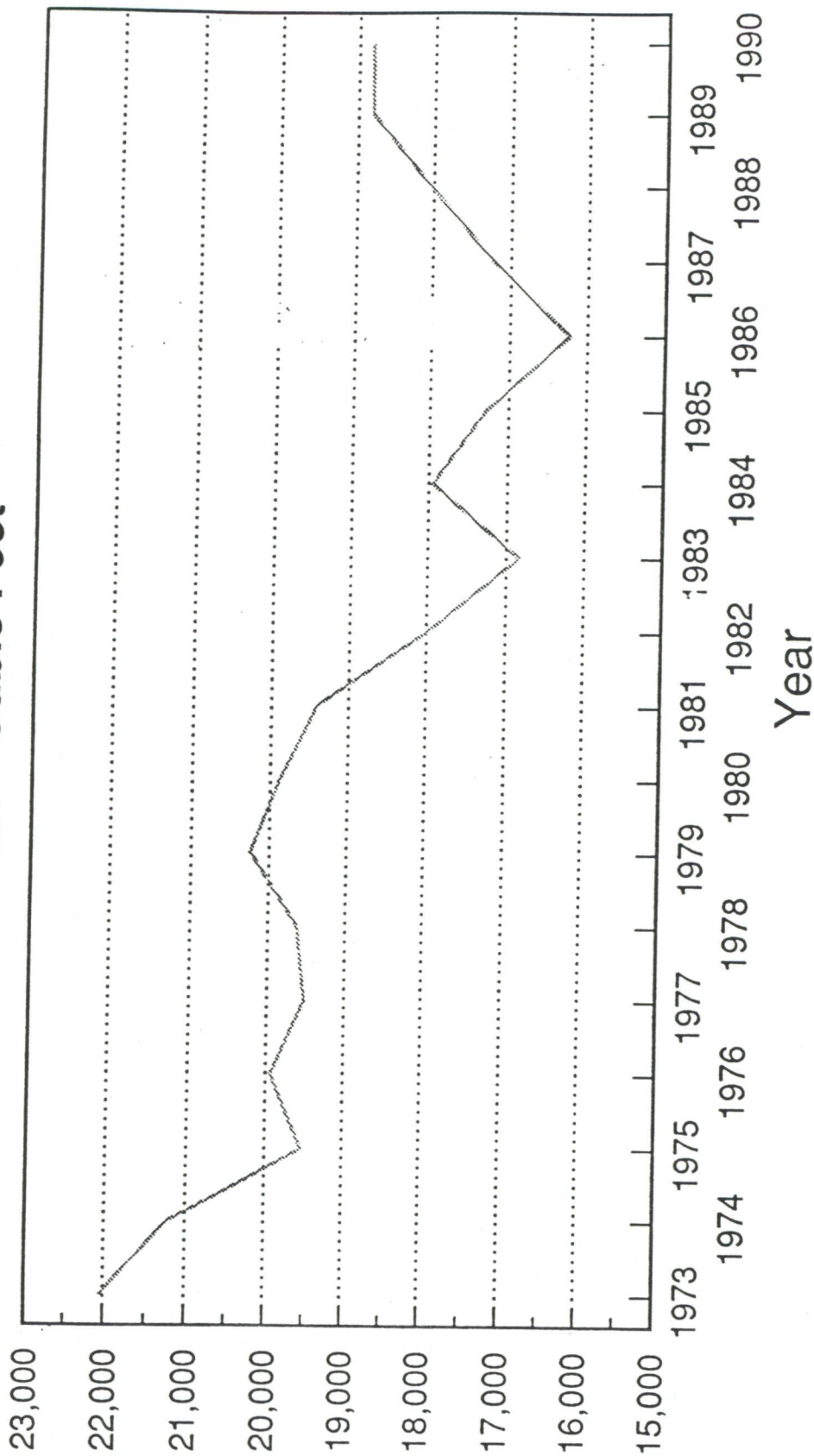
Despite the fact that wellhead prices have been deregulated, the utilization of natural gas has actually declined in the electric generation and industrial sector over the last two decades. Although natural gas is a relatively clean fuel with abundant domestic supplies, total domestic consumption has declined more than 10 percent since 1973 (see figure 5-2). One primary obstruction to increased use of natural gas is the process of granting permits for construction of new natural gas pipelines. An interstate pipeline must apply to FERC for permission to construct a pipeline. Often, an administrative hearing is held in which outside parties, including competitors, can object to the application. Several years may elapse before a construction permit is granted, sometimes prompting consumers to turn to alternative, more expensive fuels. Legislation based on the Administration's National Energy Strategy would streamline the process of reviewing applications for pipeline construction.

*This would
not explain
a decline
in consumption*

Additionally, local distribution companies, electric utilities, and industrial users may be limited in their ability to negotiate directly with natural gas producers. For example, an industrial user's only source for gas may be from the pipeline that serves its plant. With a monopoly over gas sales, the pipeline can set a higher than competitive price for the gas, prompting the user to consider alternative fuels. In fact, before 1985, almost all of the gas transported by pipelines was actually purchased by the pipeline and then resold to

United States Consumption of Natural Gas

in Billion Cubic Feet



Source: Energy Information Administration, Monthly Energy Review, October 1991.

Figure 5-2

distribution companies or industrial users. In 1982, only 3 percent of the natural gas transported by the pipelines was owned by others. To protect buyers, some type of regulation was necessary.

Open Access to Natural Gas Pipelines

Recent FERC initiatives have significantly changed the position of pipelines in the sale of gas by creating incentives for pipelines to transport gas that is owned by other companies. This policy is commonly called "open access." Since pipelines also sell gas, they have developed "gas affiliates" to market the product. Open access pipelines are required to provide gas transportation services to nonaffiliated natural gas sellers that are comparable to those it provides for its own gas affiliates. Because of this policy, nonaffiliates now account for 80 percent of the interstate sales of natural gas. Pipelines now play a dual role, marketing their own gas and transporting gas owned by others.

The effect of the open access policy is that utilities and industrial users can contract directly with a large number of producers, and not just the pipeline, when purchasing gas. Indeed, a competitive market has developed. Recognizing this fact, FERC has proposed to relax regulation of pipeline gas sales. Limited regulation of natural gas pipeline sales means

that the competitive market will determine which transactions take place and at what price.

Because local distributors and other gas consumers may still be captive to a single pipeline, the rate the pipeline charges for transporting the natural gas remains regulated. Critics of natural gas deregulation note that when a pipeline sells its own gas, it is actually selling a bundled commodity consisting of the gas and the transportation service. Other gas sellers pay for the transportation services separately, but the price they pay may not be comparable to the rate the pipeline's own gas affiliate is implicitly paying for the service. If there is no other competing pipeline through which the natural gas can be delivered to a particular customer, the non-pipeline seller will be at a disadvantage relative to the pipeline's own gas affiliate. Discrimination of this type could reduce the benefits of competition.

One of the goals of the Administration's National Energy Strategy is to eliminate the possibility of discrimination. As a remedy, FERC has proposed that pipelines be required to separate their business of selling gas from their business of transporting gas for others. Gas would be sold unbundled from the various transportation services, as on an "a la carte" menu, making it the comparability of transportation rates much easier to monitor.

Mandatory unbundling does have its costs, however. It is important to recognize the tradeoff between solving the problem of discrimination and forgoing the economies in the dual role of pipelines as both merchants and transporters of gas. Mandating unbundling would deny the benefit of these "economies of scope" to purchasers desiring a bundled package of services. The loss of productive efficiency needs to be considered before comprehensive unbundling is mandated.

ELECTRIC POWER

Similar to the natural gas industry, the electric power industry consists of three different segments: the generation of power, the transmission of power from generators to local utilities, and the distribution of electricity to homes and businesses by the local utility company. Some electric power companies participate in all three segments of the industry: they produce their own power and then transmit it to their own local utility. Other firms specialize in one particular segment, such as generating electric power that is sold wholesale to utilities or industrial users.

Currently, all three segments of the industry are subject to State and Federal regulation to some extent. Competition in the distribution of electricity, as with natural gas, is generally not considered feasible because of its natural monopoly

characteristics. Instead, local utilities are granted monopolies over the markets they service, and States or local municipalities regulate the rates they can charge customers. FERC regulates the price of interstate purchases of wholesale power and the prices charged for use of interstate transmission facilities. But competition has emerged among firms that sell wholesale power. Regulators now face the problem of determining when to step aside and allow the market to determine the price at which that power is sold.

Deregulating Electricity Generation

The ability to buy and sell electric power allows utilities to make more efficient use of existing capacity. For example, by buying power from other companies, a local utility can satisfy an extraordinary demand for electricity, such as that which occurs on an unusually hot day, without having to build the capacity itself. When utilities purchase power, however, the Federal Power Act of 1935 requires FERC to determine whether the prices charged for the interstate sales are "just and reasonable." That determination requires the regulated company to provide cost information to FERC, and significant delays in determining the rates can occur. Since the Federal Power Act was passed, however, the need to regulate all sales has been questioned because many alternative sources of electric power have developed.

One major step in developing competition in the sale of electric power was the Public Utilities Regulatory Policies Act of 1978 (PURPA). PURPA defined a set of "qualifying facilities," such as cogenerators of steam and electricity that were exempted from FERC rate control and were relieved of other financial requirements. PURPA has been successful in encouraging the development of nontraditional sources of power. In the 1980s qualifying facilities added 13,000 to 15,000 megawatts (MW) of capacity to the national market, while utilities that produce their own power ordered only 9,500 MW of new capacity. Other power producers that are too large to qualify under PURPA have also emerged. The availability of alternative power sources has encouraged 13 States to make use of competitive bidding, rather than regulation, when a utility needs generating capacity.

One barrier to the further development of a decentralized market for electricity generation is the Public Utility Holding Company Act of 1935 (PUHCA). The original intent of the Act was to curb financial abuses by holding companies of electric utilities. Its effect today, however, is to restrict the development of independent generating sources. For example, certain holding companies are barred from owning more than 10 percent of a power producer whose sole purpose is to sell power in the wholesale market. Legislation based on the Administration's National Energy Strategy would change the role

of PUHCA by encouraging entry by new independent power producers as well as the establishment of new sources of wholesale power controlled by utilities.

Transmission Access

Unfortunately, the control of transmission services by firms that also sell wholesale power has inhibited the ability of FERC to rely fully on market prices for power sales. The primary reason for this is that a utility may be captive to a single provider of transmission who also sells power. The owner of the transmission capacity could deny other power producers access to the lines, allowing it to charge prices above competitive levels for the power. The presence of a monopoly provider of transmission forces FERC to keep a close watch over the prices charged for wholesale power.

A seller of power who also controls transmission of power does not always set rates above the competitive level, however. A purchaser may have several alternative sources of supply. It could generate power itself, it could purchase power produced by others in its own service area, or it could purchase power produced outside of its service area by firms that have access to the necessary transmission. When the purchaser of power has a number of alternative sources, a competitive market can develop.

Prices that arise from those markets are a sufficient substitute for regulated rates.

When there are no alternative sources of power, denial of access to transmission would leave the utility captive to only one supplier. In that case a requirement that the transmission owner give a buyer access to alternative sellers, while being compensated for the costs of using the transmission, would increase competition in wholesale markets and ensure that power can be purchased at competitive rates. Unfortunately, FERC has very limited legal authority to require owners of transmission to provide access. Legislation by Congress would give FERC the authority to accept an application by a power supplier for access when it would promote competition in the sale of power at wholesale.

CABLE TELEVISION

Cable Television is now available to more than 90 percent of all homes with television, and more than 60 percent of these households subscribe to the service. Cable television normally includes television stations that are broadcast over the air and services, such as CNN and ESPN, that are delivered by satellite to the cable operator. In most communities, consumers can only obtain these services by subscribing to the local cable television service. The operator charges subscribers a fee for

delivering these services to their television. The problem now facing policy makers is how to encourage competition that will restrain the local cable system from setting high fees.

The Effects of Cable Deregulation

By virtue of their control over permits to string cable along local roads, local communities established the right to regulate cable television, and most of them decided that having more than one cable system was inefficient. Multiple systems would have meant duplicating all of the cable connected to each household or business. Most cable television companies were thus granted a monopoly franchise over the market they serve, with a local authority regulating the rates that the cable franchises could charge. In 1969 the Federal Communications Commission (FCC) affirmed that local communities could regulate the rates of "basic service," a package that usually includes both broadcast channels and satellite-delivered programs.

In the early 1980s the need for continued regulation was questioned because of the availability of alternatives to cable. Possible alternatives included purchasing satellite dishes, using VCRs, or simply opting to limit viewing to channels available via broadcast antenna. The Cable Communications Policy Act of 1984 (Cable Act) stated that regulation was not necessary where there was "effective" competition, which the FCC defined to mean that

local residents could receive three or more broadcast channels. The effect of this rule was to leave only 3.5 percent of all cable franchises regulated by the end of 1989, down from 67 percent before deregulation.

Cable TV rates increased substantially between the end of 1986, when the Cable Act took effect, and the end of 1990. Over that period, the average rate for the lowest-priced basic service increased 32 percent in constant dollars. Cable operators explain the increase by noting that most basic service now includes more channels and a greater variety of programs. But others blame deregulation, noting that the alternatives of watching broadcast television or renting video tapes do not provide enough competition to restrict the prices charged by cable operators.

Introducing Competition for Cable

Responding to that criticism, the FCC changed its effective competition standard in 1991. Now local communities have the right to regulate rates, except in those areas that receive competition from six or more broadcast channels. Although there have been calls to increase the scope of rate regulation even further, an alternative policy that introduces new competition for cable operators would both encourage price competition and provide alternative sources of television programming.

The emergence of competition will depend on whether a second cable provider finds it profitable to put up the necessary wires and other equipment or to use a different technology in order to compete with the incumbent cable operator. One possible competitor that has already invested in much of the fixed equipment is the local telephone company. Current FCC regulations and the Cable Act, however, prevent competition from the local telephone company.

Under one proposal, local telephone companies would become an alternative way of transmitting television or other video signals, with both the telephone company and companies not affiliated with the telephone company being allowed to control the programming or other video content that was being provided. Critics of this plan worry that because telephone rates in some States are still determined using cost-of-service regulation, the telephone companies might transfer the costs of programming to the regulated telephone sector, thereby making telephone customers pay for the costs of some of the programming services and putting unaffiliated companies at a disadvantage. This is commonly called "cross-subsidizing." Telephone companies might also use their control over the telephone lines to discriminate against competing programmers simply by designing the network to favor their own product.

The problems of discrimination and cross-subsidization are a legitimate concern. If local telephone companies are to be permitted to control video content, adequate regulation is needed to prevent costs from being shifted to telephone ratepayers and to ensure access to the telephone lines. The FCC already has adopted cost allocation rules that can be used to prevent cross-subsidization. Rules that prevent discrimination need to be in place before telephone companies can fully take part in providing video content. While these safeguards are being developed, competition for existing cable operators could be enhanced by permitting local telephone companies to carry television and other video services that are controlled by independent companies. The FCC began to ask for comment on such a policy in November 1991. The alternative policy would be to continue banning the most likely competitor for incumbent cable operators. Such a policy is untenable in the face of unregulated rates and monopoly franchises.

SUMMARY

- o Implementation of the National Energy Strategy will enhance competition in the generation of electric power and in the delivery of natural gas.
- o Instead of reregulating to control cable rates, a policy that removes the barriers to competition for existing cable

operators would lower rates and provide alternative services.

- o The economies of producing in both a regulated and unregulated market should not automatically be sacrificed in order to eliminate problems of discrimination and cross-subsidization.

REFORMING REGULATION OF THE ENVIRONMENT, HEALTH, AND SAFETY

Environmental, health, and safety regulation attempts to remedy externalities or third-party effects. During the past two decades, the Federal Government has significantly widened the scope of regulation in these areas, generally using command-and-control regulation. And because legislation in these areas has rarely required regulators to balance the costs and benefits of their actions, costs to the economy have increased substantially. Recent initiatives have attempted to improve on traditional regulation by allowing more flexibility, and by balancing benefits and costs. This section describes several areas where regulatory reform offers significant benefits to the Nation.

IMPROVING THE ENVIRONMENT

By requiring firms to account for the costs they impose on others through pollution, the Clean Air Act, the Clean Water Act, and the Resource Conservation and Recovery Act have to some extent dampened the incentives for the excessive use of environmental resources. These measures have contributed to cleaner air and water in most regions of the country.

At the same time, their costs have been significant. Just one new initiative, the Clean Air Amendments of 1990, when fully implemented in 2006, will likely cost \$25 billion per year or more. EPA estimates that efforts to reduce pollution costs the U.S. economy \$115 billion in 1990, more than in any other major industrialized country, both in absolute terms and as a percentage of GNP. Between 1972 and 1990, pollution control costs tripled (in constant dollars), rising from 0.9 percent to 2.1 percent of GNP; by 2000, EPA expects this total to rise to 2.6 percent. By some estimates, indirect costs (which arise, for example, when a firm must use a higher-priced substitute product) add significantly to this total.

Acid Rain

Significant uncertainties surround many environmental issues. This can be seen in the scientific controversy that emerged in the National Acid Precipitation Assessment Program (NAPAP), a 10-year study authorized by Congress because of

concern that acid rain might be harming the environment. When the NAPAP study began in 1980, the consensus view held that acid rain caused acid lakes; the study demonstrated, however, that soil conditions had a far greater influence than acid rain on acid lakes, and suggested that simple mitigation strategies were far more cost effective than the technology-based command-and-control regulation usually favored by Congress.

In the recent past, scientific consensus has shifted abruptly on several other important issues as well. These examples should remind us not to rush into expensive new regulatory regimes on the basis of incomplete evidence. But once a policy decision has been made to correct an externality associated with the environment, then market-based incentive programs usually can accomplish their objectives at a lower cost than traditional command and control approaches.

The Clean Air Act Amendments of 1990 institute the first large-scale emissions trading regime for a pollutant. This program sets a national level of sulfur dioxide emitted annually from coal-fired power plants. Firms must possess an emission allowance for each unit of SO₂ they emit or face heavy fines. To comply, firms are allowed to buy and sell allowances; the desired level of emissions will be attained efficiently because firms self-select, purchasing or selling allowances (which are effectively inputs) to minimize costs. The same level of

emissions could be achieved under command-and-control regulation, but the cost of compliance, which falls ultimately on the consumer through high energy prices, would be far greater.

Economic incentives decrease firms' compliance costs by offering them the flexibility to make the best use of information regarding their production process. In contrast, efficient command-and-control regulation requires the regulating agency to collect detailed, firm-specific information on pollution control costs, substitution possibilities, and the value of capital stock in place--an almost impossible task. With economic incentives, regulators merely lay down ground rules and allow firms to determine how to meet strict emissions targets; the government--and the nation--gets the benefit of the firm's internal information without having to discover it.

Box 5-5: Are Emission Allowances Licenses to Pollute?

Some have opposed the implementation of emission allowance trading systems on the grounds that the allowances give their holders a license to pollute. By these standards, however, any environmental regulation that does not hold pollution to zero also constitutes a license to pollute. The costs of pollution abatement become prohibitive compared with benefits as emissions are steadily reduced, making some tradeoffs inevitable. Consequently, regimes should be implemented that protect the environment to some desired level while minimizing the losses to economic growth.

Under traditional emission control regulation, firms pay nothing for emissions until they reach the statutory limit, then pay often exorbitant fines for exceeding it. This deters firms from polluting excessively, but because pollution is free up to this limit, firms do not compensate for the environmental resources that they consume. An allowance trading system

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D. Poy or
CEA seems to
accept the notion
of a tax (carbon
tax?) to compensate
for externalities
in the fuel economy
case
- surprise

requires firms to consider the cost of each unit of pollutant in their production decision.

Fuel Economy Standards

The transportation sector accounts for two-thirds of U.S. petroleum consumption, with more than half going to gasoline for cars, trucks, and buses. Gasoline consumption imposes at least three kinds of externalities on society: pollution, vulnerability to oil shocks, and road congestion. Reducing oil consumption to correct the first two of these problems was the original justification for Corporate Average Fuel Economy (CAFE) standards in 1975. Proponents claimed the standards would improve air quality, particularly in cities, by reducing ground-level ozone and would reduce U.S. vulnerability to shocks in the oil market by reducing the demand for imported oil.

CAFE standards require each manufacturer to meet the target of 27.5 miles per gallon for both its domestic and imported fleet. Recent proposals would increase CAFE standards by varying amounts. Proponents argue that higher standards would reduce both oil imports and consumption.

Government can correct the externalities associated with gasoline consumption by several means, including fuel and vehicle

taxes. The most direct solution would be for regulators to determine the damage caused by gasoline consumption and then set a tax on its use equal to the value of the harm. (State and Federal gasoline taxes, which now average 26 cents per gallon, already correct 26 cents worth of the externality in this way.)

Higher CAFE standards would be a poor substitute for this approach, because they fail to address the externalities directly. First, higher CAFE standards may reduce pollution, because drivers would burn less gasoline per mile. However, because higher mileage cars generally cost less to drive per mile, motorists would drive more, offsetting some or all of the gain from the higher standards. Second, although higher CAFE standards would indeed reduce oil imports, they may not reduce U.S. vulnerability to oil shocks, which depends not on the level of imports, but rather on the flexibility of the economy and economic responses to the shock.

Much of the CAFE debate has centered on engineering feasibility, on what mileage targets could be achieved by the automakers. But consumers, who are the ultimate decisionmakers, do not base vehicle purchase decisions on engineering feasibility. Size, options, and performance are also important. Indeed, engineering feasibility does not itself establish value to society; it does so only in conjunction with economic feasibility. Manufacturers can produce cars with high CAFE

ratings, but if consumers will not buy them, then they should not be produced.

Proponents of higher CAFE standards generally overlook the indirect effects of their proposals, which would tend to offset many of the purported benefits. First, to comply with higher CAFE standards, firms would probably produce fewer large cars and more small cars. This would raise the price of large cars and likely cause consumers to respond by holding onto their present (older, less fuel-efficient) vehicles. Second, because small cars are, all else being equal, less safe in an accident than large cars, higher CAFE standards could significantly increase deaths on the Nation's highways.

Higher CAFE standards pose other problems as well. The CAFE requirement that manufacturers divide production into a "domestic" and an "import" fleet ignores the realities of a globalized auto industry and forces them to make less than efficient input choices to meet the standard in each category. Moreover, current proposals would penalize firms whose technology gives them a comparative advantage in the production of larger cars. They could be forced to abandon these competitive technologies in order to comply. Finally, as with other forms of regulation, CAFE standards could be coopted by political forces and used by some firms to gain an advantage over others.

Global Climate Change

Global climate change is another example of an environmental externality. The presence of "greenhouse gases" such as carbon dioxide, methane, and water vapor in the atmosphere helps to maintain surface temperatures at historic levels; without them, the temperature of the earth would be about 33°C lower. These gases retain and reflect some of the heat given off by the earth back to its surface, providing a sort of blanket to the planet. Some production processes such as the burning of fossil fuels result in the emission of greenhouse gases. These additions to the earth's natural supply of such gases have raised concerns over possible effects on global climate. Those who emit greenhouse gases do not account in their production decision for the climatic effects they cause. For this reason, there is an externality present to the extent that there are ecological and economic effects from global climate change and to the extent that such effects are adverse.

As with many global environmental issues, much of the research regarding the effects of greenhouse gases is in its preliminary stage. Indeed, the Intergovernmental Panel on Climate Change, under the aegis of the United Nations, estimated that it may take a decade or more to be certain that man-induced climate change has occurred. The question of ~~which gases~~ ^{how much several of the gases} contribute to the greenhouse effect also remains ~~open~~ ^{uncertain}; this is

illustrated by the conclusion of the Scientific Assessment of Stratospheric Ozone, a recent study, which stated that chlorofluorocarbons (CFCs) probably have no net effect on global surface temperature and thus are probably not greenhouse gases, reversing the previously accepted conclusion. *wrong!*

and raised a number of new scientific questions regarding the nature of chemical reactions in the atmosphere involving several important gases
Most scientists agree that some warming will occur as a result of fuel burning, deforestation, and other human activities. At issue is timing and magnitude. The increase in global average temperature resulting from a doubling of atmospheric CO₂ has been estimated at between 1.5°C and 4.5°C, with the most recent estimates falling in the lower end of this range. ~~More recent scientific research generally discounts the severe effects predicted in some preliminary work a few years ago.~~ *not necessary*

In choosing among alternative courses of action, the scientific uncertainty surrounding climate change should be considered along with estimated costs and benefits of action. A prudent course includes taking these actions that would be desirable on their own merits, while deferring costly steps that should properly await resolution of key scientific uncertainties. Rational policy requires balancing the costs of delay with the benefits of information that will be available later.

The potential effects of climate change are generally long term, and the initial costs of proposed remedies may be high. One proposal aims to stabilize global greenhouse gas emissions at 80 percent of 1985 totals by 2010. Studies put the eventual cost of achieving this goal at 1 to 5 percent of world gross domestic product per year with most of the cost attributed to the reduction in output needed to achieve the emission reduction. In today's world economy, this would be \$200 billion to \$1 trillion per year. *also this the best scenario to use? perhaps, extreme*

Hasty attempts to remedy the externality imposed by greenhouse gas emissions could have small benefits relative to these very large costs. A better understanding of the science of global climate change is needed before agreeing to policies with potentially large costs. To help resolve the scientific questions, the President's 1993 budget marks a total of \$xxx billion for research on global climate change, including \$xxx million for research in the economics of global change, making this the largest national research effort in climate change. *include ref. to budget for R+D on energy efficient technologies*

HEALTH AND SAFETY REGULATION

Decisions to wear a seat belt, to take a job as a telephone lineman, or to fly a small plane all involve balancing exposure to risk against other objectives. In the United States, government addresses risk indirectly, by providing the legal framework for the market and the tort system; and directly, by an extensive and growing program of safety regulation. For example,

a 1967 National Highway Traffic Safety Administration (NHTSA) rule sets safety standards for automobile steering columns, a 1979 EPA rule regulates chemicals used to treat drinking water, a 1985 Federal Aviation Administration (FAA) rule sets fire protection standards for aircraft cabins, and a 1990 EPA decision listed certain wood-preserving chemicals as hazardous wastes.

Proponents of a larger government role in health and safety assert that in these areas, people are not able to make proper decisions about risk bearing. Some also argue for intervention on equity grounds. If a certain risk is exceptionally high or prohibitively expensive for an individual to bear, society will sometimes assume the burden through regulatory intervention or public funding, as it does for neonatal intensive care, and burn and trauma centers.

Congress has expanded budgets, staffs, and the regulatory scope of the agencies regulating these areas, almost tripling administrative costs of health, safety, and environment regulation between 1970 and the present. The Federal Register, which chronicles official actions of the regulatory agencies, including those that regulate health and safety, and whose size gives an idea of the regulatory burden on the economy, occupied 26 inches of shelf space for the year 1956, 36 inches for 1966, and over 10 feet at its apogee in 1978; in more recent years it has been somewhat thinner.

Public perceptions have fueled this growth. The public believes, according to surveys, that life is becoming more risky. In fact, life is becoming safer, as demonstrated by the steady increase in life expectancy, from 70.8 years in 1970 to 74.9 years in 1988; by the steady decrease in age-adjusted death rates from most diseases; and by the steady decrease in accident rates on highways and in the workplace.

Public concern over risk has sometimes given rise to regulations requiring that all risk be eliminated. The Delaney Clause of the Food and Drug Act prohibits the use in food of any "substance shown to cause cancer in animals or humans." Regulators have interpreted this to mean at any dose, however unrealistic for humans, and with no regard with potential benefits. In the Clean Air Act, Congress set a slightly looser standard when it instructed EPA to fix primary air quality standards that "protected the most sensitive group in the population with an adequate margin of safety." Similarly, Congress charged the Occupational Safety and Health Administration (OSHA) with ensuring that "insofar as possible, no employee will suffer diminished health, functional capacity, or life expectancy as a result of his work."

Just as individuals must balance risks and benefits in making their individual decisions, so must government regulators.

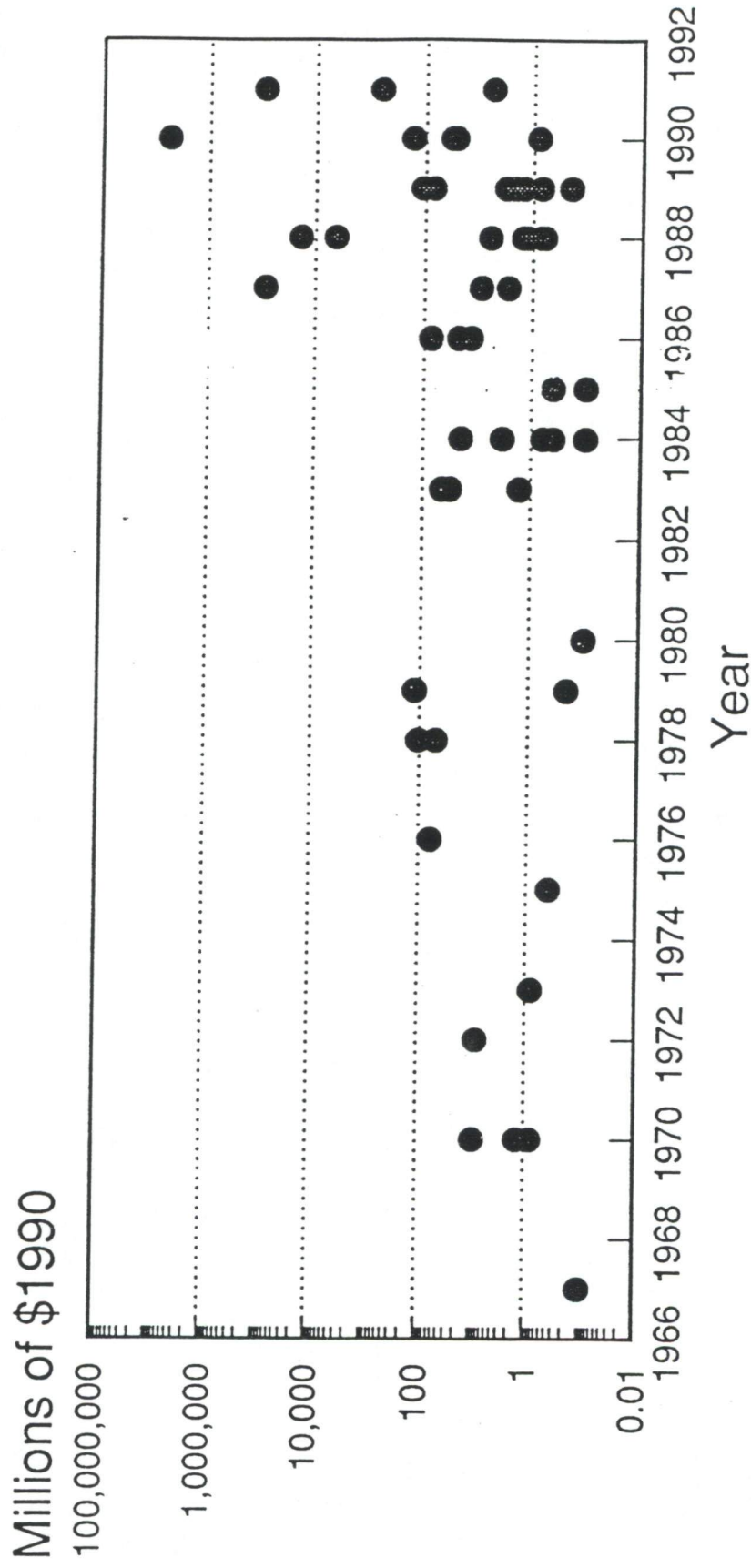
Commercial air travel, for example, is relatively safe; at some cost, though, it could be made still safer. Yet each extra safety-related increase in ticket prices makes some travelers decide to drive instead, which is about 20 times more dangerous per mile traveled.

As figure 5-3 indicates, regulations issued during the 1980s were, on average, far more costly per unit of safety achieved than earlier ones had been. (The vertical axis is logarithmic; each grid line represents 100 times more cost per unit of safety than the one below it). EPA's rule regulating wood-preserving chemicals, while not large in total costs, is estimated to avert only one case of cancer every 2.9 million years, and cost \$5 trillion dollars per death averted; this is 10 million times more costly per unit of safety than a number of earlier rules. Complying with the Superfund and other laws governing hazardous wastes will cost between \$400 billion and \$1 trillion (in 1991 dollars) over the life of the program. In these examples and elsewhere, regulation often targets expensive risks and passes over those where greater reductions are possible at the same cost.

Market failure justifies government intervention if the government can improve on the market. Cost-benefit analysis can be a useful tool for setting appropriate goals when regulating risk. In regulating risk, as in regulating other areas,

Cost-Effectiveness of Federal Health and Safety Regulations

Cost per Premature Death Averted



Dots represent Federal regulations.

Source: U.S. National Report for UNCED.

Figure 5-3

government policies should strive to maximize net benefits, enacting only those regulations in which benefits to society outweigh costs. To do otherwise diverts resources from more important risks, and impedes economic growth.

SUMMARY

- o Market-based solutions are the most efficient means of allocating a given level of pollution.
- o Increased CAFE standards are potentially costly, would encourage consumers to maintain their older, less fuel efficient automobiles, and could decrease automobile safety.
- o Careful evaluation of the economic effects of policies addressing global climate change is necessary before their institution.
- o In regulating health and safety risks, government policies should maximize net benefits, promulgating only those regulations whose benefits to society outweigh their costs.

CONCLUSION

The government plays a crucial role in facilitating competition through the establishment of a legal system that

governs contracts, protects property rights, and protects people from harm. Proposed reforms to the legal system would reduce the burdens on industry from litigation, while maintaining a fair system for settling disputes. Regulation can also play a direct role in improving the performance of the market system. Any proposal to regulate the market, however, should be tempered by an understanding that regulation can be as imperfect as the market it is trying to improve.

The government must constantly reevaluate the need to intervene in markets. For instance, the necessity of continuing to regulate industries where prices and the structure of the industry can be determined by competition should be reconsidered. The National Energy Strategy would accelerate deregulation in the markets for pipeline sales of natural gas and in the generation and sales of electric power, benefiting consumers with lower energy prices. Environmental protection is also an important goal of this Administration, but measures should reflect the opportunity costs of shifting resources away from other uses to meet this challenge. Tradable allowances are an appropriate tool for meeting strict pollution standards at minimum cost. Similarly, resources expended to reduce one type of risk must be balanced against the effectiveness of those resources in reducing other risks.

"Document Control"

TYPE: MEETING REQUEST DOCUMENT NUMBER: 9125132
ORIGINATOR: 02 STATUS I DIRECTORATE STATUS

FROM: BEGGS, James M.: NASA ALUMNI LEAGUE

TO: DR. D.A. BROMLEY

*703-525-5656
Sue Kersey*

DATE OF
CORRESPONDENCE: 12/11/91

SUBJECT: THEY REQUEST A MEETING WITH DR. BROMLEY REGARDING
THE IMPLEMENTATION OF THEIR RECOMMENDATIONS
REGARDING U.S. COMPETITIVENESS IN HIGH TECHNOLOGY
PRODUCTS AND SERVICES.

DIRECTORATE STAFF
ASSIGNED: INDUSTRIAL ASSIGNED:

ACTION STAFF
REQUIRED: AS APPROPRIATE ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: 12/31/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #: CONTACT PERSON:
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3/5 Mary I entered these comments into tracking system
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FILE: P-INDUSTRIAL-ECONOMIC COMPETITIVENESS
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December 11, 1991

Dr. D. Allan Bromley
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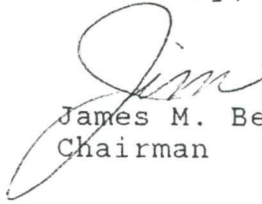
Dear Dr. Bromley:

You may recall that the NASA Alumni League held a Workshop on Technology Applications and Competitiveness some time ago. Reports on the results were published earlier this year. The final report included four recommendations aimed at improving U.S. competitiveness in the international marketing of high technology products and services.

The enclosed paper carries these recommendations one step further in providing suggestions for implementation. The League desires your considered comments on these suggestions in terms of whether they hit the mark or whether there are better alternatives.

We will be contacting your office in the next week or two to set a date for a meeting with you to explore your ideas and interest. If your time permits, written comments also would be most welcome.

Sincerely,


James M. Beggs,
Chairman

PROGRAMS TO IMPROVE U.S. TECHNOLOGICAL COMPETITIVENESS

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National actions are described in the brief papers attached.* and specific approaches are presented as examples for accomplishing four objectives considered critical and urgent to the improvement of U.S. technological competitiveness:

1. To use the potential for commercial applications inherent in federal R&D efforts

An example mechanism is described aimed at identifying and encouraging possible commercial applications of on-going federally funded R&D programs so as to contribute to the international competitiveness of U.S. industry.

2. To provide mechanisms better government/industry interaction in identifying and achieving priority technology goals

A detailed mechanism, based on successful precedent, plus an illustrative program, is proposed to provide for joint government/industry action to address national requirements for strategies and programs in critical commercial technology sectors.

3. To support technology development to the point of readiness for application in critical commercial sectors.

Recommendations are included for supporting the development and validation of technology in areas critical for U.S. competitiveness in order to assure that it is brought to the point of readiness for application by the commercial sector.

4. To establish a focal point for federal technology activities in support of U.S. international competitiveness

Options are described for providing a focus within the federal government for coordination and direction of such agency/industry programs as those above to enhance commercial competitiveness.

*This report is based on an independent study/workshop conducted by the NASA Alumni League with preponderantly non-NASA participants and without special reference to NASA.

(1) RECOMMENDATION TO UTILIZE THE POTENTIAL FOR COMMERCIAL APPLICATION INHERENT IN FEDERAL R&D EFFORTS

Problem

The annual investment in federally sponsored R&D is very large--currently approaching \$80 billion per year. While government funded programs are major contributors to our technological and industrial base, there is no general recognition within the federal government of a need to factor commercial potential into the judgements as to which programs are to be supported or how they are structured. In addition, there is inadequate expression by U.S. industry regarding their projected technology needs and the role government R&D could play in improving U.S. competitive posture in the international arena.

Two dominant reasons exist for the lack of consideration for the economic potential of government programs. First, the assumption that private enterprise should be totally responsible for pursuing and funding commercial endeavors and, second, an environment wherein federal R&D agencies tend to be totally focused on their own mission needs.

These inhibitions to commercial developments continue despite the fact that the U.S. is falling behind its international competitors in the application of high technology to commercial products. Yet, it is well established that our future economic strength depends upon our ability to exploit technological innovations in the commercial arena.

A Solution



In programs sponsored by the federal government, greater emphasis should be placed on R&D that have commercial potential. These programs can be major contributors to the commercial technology base of the nation without significant impact on agency mission needs. This additional emphasis can be accomplished by requiring that identification of potential commercial applications and their implementation strategies be an integral part of the process for government R&D programs. Such an activity could be initiated either through the issuance of a presidential directive or enactment of legislation.

An Implementation Example

Any federal agency, on issuance of a Request for Proposal (RFP) involving significant R&D effort, would encourage the proposer to identify and assess the potential commercial applications that might be derived from the technologies or systems, incorporated in the proposal. In addition, the proposer would be encouraged to outline strategies for pursuit of the commercial opportunities including any government assistance felt to be necessary.

The sponsoring agency would make a preliminary evaluation of the commercial possibilities and assessment of government support needs. Its recommendations would be forwarded both to the agency office responsible for activities in the commercial arena and also to an appropriate office in the Executive Branch for coordination, possible integration with other proposals, communication with commercial interests, and recommendations as to government support requirements.

(2) RECOMMENDATION TO PROVIDE BETTER MECHANISMS FOR
GOVERNMENT/INDUSTRY INTERACTION IN IDENTIFYING AND ACHIEVING
PRIMARY TECHNOLOGY GOALS

Problem

A clear need exists in certain critical sectors for government/industry interaction to identify priority technology requirements and to define broad plans and programs to achieve their commercial potential. Opportunities for competitive advances are lost because short-range industry considerations may not add up to long-term national interests, because development and market risks exceed individual firms resources, or because of limited communications, coordination and cooperation within industry or between industry and government. Although some R&D areas have mechanisms in place to carry out these functions, most are inadequate or non-existent.

A Solution

The government should have its R&D agencies examine their current program review and planning mechanisms, make the necessary adjustments to strengthen commercial awareness, and highlight government programs which could contribute to U.S. international competitiveness. Improved interaction and more open communications among industrial firms and between industry and government must take place to assure that government and industry R&D plans, programs, and future thrusts are focused on critical technologies and the marketplace. Mechanisms similar to those employed by NASA's predecessor, the National Advisory Committee for Aeronautics (NACA), should be implemented to effect better government-industry interaction for selected industrial sectors. The NACA had a set of working committees that provided a very effective means for industry, academia and other government agencies to address priorities and strategies for aeronautical R&D.

An Implementation Example (Computer Software)

Software Problem

Software is a central element in vital civil and military systems and constitutes an infrastructure that undergirds all other high industrial and defense technologies as well as an increasing range of consumer goods technologies. Government agencies, notably in the defense and space sectors, are major contractors for and users of software products.

Substantial foreign government/industry cooperative efforts are applied to this sector and foreign competence and competition is growing. Thus, U.S. overseas software markets are increasingly challenged and, of most concern, foreign firms are moving into the lead in the areas critical to future commercial success such as automation of software development (with its attendant

cost/time reductions and reliability improvement). U.S. industry stands to lose ground steadily if it continues to face such cooperative activities without the support of similar mechanisms adapted to American conditions.

A Software Solution

As stated above, an American model exists for government and industry cooperation to assure competitiveness in a critical technology: this model was created by the National Advisory Committee for Aeronautics to remedy a critical gap in U.S. aviation technology. The National Advisory Committee for Aeronautics brought government, industry and academia together in the formulation and implementation of critical technological programs with conspicuous success.

To provide a similar capability, the following steps would be taken in the Software area:

1. Enact legislation authorizing the federal agencies which are the principal users of software, especially the Department of Defense and the National Aeronautics and Space Administration, to work with private firms to establish and operate a Joint National Program Committee for Software. Its purpose would be to identify, develop and promulgate technology programs to enhance the U.S. competitive posture in the area of software, in conformance with the criteria described below.

2. The Office of Science and Technology (or other government agency) would be authorized to designate the agencies which should participate with industry in the establishment and operation of said Joint Software Committee and to coordinate the government participation, including the allocation of the government share of funding requirements.

3. The Joint Software Committee would operate under the following guidelines:

- o industry membership should be voluntary,
- o industry and government participants should be broadly representative,
- o academic participation as may be agreed should be invited,
- o it should be structured to undertake such advisory and operational programs as the Joint Software Committee agrees are required and appropriate to its objectives,
- o it should be chaired by an industry representative, with industry representatives in the majority.
- o it would conduct its business by consensus (but should not require unanimity for action),
- o it should utilize or enlist the support and cooperation of relevant existing government and industry mechanisms/facilities wherever possible and constructive.

4. The federal agencies concerned, subject to the coordination prescribed above, would be authorized to provide for contributions to the funding required for the operation of the Joint Committee for Software, provided that the industry sector matches or exceeds the government contribution and that the contributions required from the participating government agencies appear in agency budget submissions and accounting.

5. The Joint Committee would determine the content, management arrangement and continuity of its program.

(3) RECOMMENDATION TO SUPPORT TECHNOLOGY DEVELOPMENT TO THE POINT OF READINESS FOR APPLICATION IN CRITICAL COMMERCIAL SECTORS

Problem

Continued advancement of the technology base available to U.S. industries is critical to maintaining a competitive position in the international marketing of products and services. Even more important is the ability of our industrial firms to apply new technology rapidly and confidently to create superior products at competitive prices. This ability has been degrading relative to other nations over several decades.

In areas of high technology, it is not sufficient for industry just to be knowledgeable of technological innovations. This results in a slow, methodical application of new technology, often stimulated solely as a result of earlier use by foreign competitors. This conservative approach is often taken by U.S. industry because the financial risk is viewed as too great. If the practicability of the application has not been demonstrated in advance, the technology is not ready for application. Other countries have found ways to speed this process, sometimes through direct subsidies but also through use of indirect incentives such as low cost financing.

A Solution

A number of remedial actions can be taken by the congress and the executive branch. The following premises apply:

- o Leadership of this activity to a large degree should rest with industry,
- o The federal government should play a catalytic role which, in some cases, would include some funding support,
- o The free market system, which has served the country well, should not be affected in any material way.

On this basis, the following is recommended:

1. The federal government should recognize the need in selected important areas, to help carry development of technology to the point of readiness for application and consider ways in which to foster the validation of the technology, e.g.:

- o The use of revolving funds to provide resources for validation effort. Benefiting companies would make repayments to the fund as and if they recover investment through sales,
- o Joint funding of industry-proposed technology readiness programs,

o The licensing of the products of government R&D to industries that are willing to fund continued development,

o The granting of a limited period of exclusive use to provide incentive for industrial investment.

2. Where completely new products or services have been demonstrated to be technically feasible and show economic promise, agencies of the federal government should consider committing to the purchase of such products or services as can be useful in the execution of their respective missions.

An Implementation Example (Aeronautics)

An appropriation would establish an Aeronautical Technology Validation Fund, under the guidance of an Aeronautical Technology Validation Steering Committee, administered by NASA. Additional appropriations, in following years, would be limited with the intent that the fund becomes a self-supporting revolving fund.

The Steering Committee, consisting of appropriate executives such as the NASA and FAA Administrators, the Secretary of Commerce, the U.S. Trade Representative, the Secretary of Defense, and number of industry representatives, would be chaired by the Assistant to the President for Science & Technology.

The revolving fund would be exclusively to validate practical commercial applicability of aeronautical technology critical to U.S. competitiveness. The fund would be independent of and not affect individual agency research and technology budgets.

The selected technologies would represent advances which have been found feasible and clearly important to competitiveness, but which still require validation under realistic conditions to establish readiness for economical commercial applications. In most but not all instances, industry would recommend and NASA would provide support to the conduct of the program, upon Steering Committee approval. Industry and academic assistance in identifying critical technology needs could be obtained through NASA's existing aeronautics advisory committee structure. For competitive technology specifically related to areas such as air traffic control and flight safety, the responsibility would be shared between FAA and NASA.

Performing contractors or contractor teams would be selected through the conducting agency's normal procurement processes, with heavy emphasis on the degree of proposed cost sharing and recoupment provisions would help maintain the fund. Other U.S. companies would be given advanced access to results and details under similar recoupment agreements.

The conducting agency would present for Steering Committee approval the terms to be applied to a proposed validation

project. Given the goal of maintaining a self-supporting fund, a general guideline would be to seek approximately 50% industry cost sharing, complemented by appropriate recoupment based on product sales over a time period. (Business and competitive conditions may warrant different terms in specific instances.) Allowances should be made for firms with limited cost sharing capability but technology which otherwise meets the fund's objectives.

(4) RECOMMENDATION TO ESTABLISH A FOCAL POINT FOR FEDERAL TECHNOLOGY ACTIVITIES IN SUPPORT OF U.S. INTERNATIONAL COMPETITIVENESS

Problem

No means exists in the U.S. government to produce the concerted effort needed for the planning and implementation of activities aimed at establishing and/or maintaining leadership in critical areas of commercially applicable technology. Most of the industries which are competitive in the international arena and provide the nation with economic trade advantages, e.g., air transport, computers and agriculture, have been beneficiaries of government sponsored technology, acquisition programs and other support, and have close interactions with government departments and agencies such as DoD, DoA, DoC and NASA. Yet, there is no means for establishing national priorities in these and any other economically critical areas. This problem is compounded by the lack of a mechanism for setting relative priorities between substantially unrelated activities.

Almost all the nations which are our strongest economic competitors have effective means to accomplish coordination between industrial firms and government agencies, as well as means for establishing and allocating government support.

A Solution

This country does not need an industrial policy or a "Department of Industry" but the federal government does need to recognize the common sense and practicality of government cooperation with industry in the national interest and the importance of government's playing a catalytic and supportive rather than a negative role in encouraging commercial applications and economic competitiveness. Required actions are:

1. Government-industry cooperation in determining those measures necessary to enhance technology application and competitiveness in critical sectors.
2. Government designation of a focal point to coordinate and stimulate the federal R&D establishment in the catalytic and supportive activities recommended

The efforts recommended can be accomplished largely using the institutional resources currently existing with the federal government; however, a focal point for budget and programmatic planning and coordination needs to be designated. This organization would not replace functions already in existence, e.g., program management capabilities and procurement. In this context, an existing office within the Executive Branch could be assigned these responsibilities, at least in an interim sense. Then, based on that experience, other steps could be taken such

as the establishment of a new office or agency.

An Implementation Example

As an initial step in providing a focus on the commercial facets of technology innovation and application within the federal government, the Office of Science and Technology Policy (OSTP) could be designated to define and develop the appropriate functions and responsibilities. Some are indicated in the previous recommendations such as:

1. An evaluation function in establishing priorities in economically critical areas of technology,
2. An oversight, coordination and integration function pertaining to federal agency and industry program efforts in the commercial technology area,
3. A central point of contact with industry in support of U.S. international competitiveness,
4. A fund source for agencies and industry in areas of cost sharing, revolving funds and other catalytic allocation of resources.

OSTP, or any other office designated to accomplish these tasks, would not manage the conduct of programs which would be left in the hands of federal agencies, industry or both as the case may be. OSTP, however, would organize and conduct "pilot" activities in connection with such functions as listed above in order to determine how they should be carried out. Based on the OSTP experience, other steps could be taken such as the augmentation of an existing office or agency or the establishment of a new one.

"Document Control"

TYPE: MEETING REQUEST DOCUMENT NUMBER: 9125132
ORIGINATOR: 02 STATUS I DIRECTORATE STATUS

FROM: BEGGS, James M.: NASA ALUMNI LEAGUE

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 12/11/91

SUBJECT: THEY REQUEST A MEETING WITH DR. BROMLEY REGARDING
THE IMPLEMENTATION OF THEIR RECOMMENDATIONS
REGARDING U.S. COMPETITIVENESS IN HIGH TECHNOLOGY
PRODUCTS AND SERVICES.

DIRECTORATE STAFF
ASSIGNED: INDUSTRIAL ASSIGNED:

ACTION STAFF
REQUIRED: AS APPROPRIATE ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: 12/31/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #: CONTACT PERSON:
REMARKS: PHONE: EXT:

2/20/92 Dr. Wong & Env. meet w/ Beggs per.
mn. DAB.

OSTP RECEIVED: 12/17/91 DEPT RECEIVED:
FILE: P-INDUSTRIAL-ECONOMIC COMPETITIVENESS
CENTRAL FILES:

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MAIL ROOM

December 11, 1991

Dr. D. Allan Bromley
Assistant to President for
Science and Technology
Old Executive Office Bldg., #358
Washington, DC 20503

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cost/time reductions and reliability improvement). U.S. industry stands to lose ground steadily if it continues to face such cooperative activities without the support of similar mechanisms adapted to American conditions.

A Software Solution

As stated above, an American model exists for government and industry cooperation to assure competitiveness in a critical technology: this model was created by the National Advisory Committee for Aeronautics to remedy a critical gap in U.S. aviation technology. The National Advisory Committee for Aeronautics brought government, industry and academia together in the formulation and implementation of critical technological programs with conspicuous success.

To provide a similar capability, the following steps would be taken in the Software area:

1. Enact legislation authorizing the federal agencies which are the principal users of software, especially the Department of Defense and the National Aeronautics and Space Administration, to work with private firms to establish and operate a Joint National Program Committee for Software. Its purpose would be to identify, develop and promulgate technology programs to enhance the U.S. competitive posture in the area of software, in conformance with the criteria described below.

2. The Office of Science and Technology (or other government agency) would be authorized to designate the agencies which should participate with industry in the establishment and operation of said Joint Software Committee and to coordinate the government participation, including the allocation of the government share of funding requirements.

3. The Joint Software Committee would operate under the following guidelines:

- o industry membership should be voluntary,
- o industry and government participants should be broadly representative,
- o academic participation as may be agreed should be invited,
- o it should be structured to undertake such advisory and operational programs as the Joint Software Committee agrees are required and appropriate to its objectives,
- o it should be chaired by an industry representative, with industry representatives in the majority.
- o it would conduct its business by consensus (but should not require unanimity for action),
- o it should utilize or enlist the support and cooperation of relevant existing government and industry mechanisms/facilities wherever possible and constructive.

4. The federal agencies concerned, subject to the coordination prescribed above, would be authorized to provide for contributions to the funding required for the operation of the Joint Committee for Software, provided that the industry sector matches or exceeds the government contribution and that the contributions required from the participating government agencies appear in agency budget submissions and accounting.

5. The Joint Committee would determine the content, management arrangement and continuity of its program.

(3) RECOMMENDATION TO SUPPORT TECHNOLOGY DEVELOPMENT TO THE POINT OF READINESS FOR APPLICATION IN CRITICAL COMMERCIAL SECTORS

Problem

Continued advancement of the technology base available to U.S. industries is critical to maintaining a competitive position in the international marketing of products and services. Even more important is the ability of our industrial firms to apply new technology rapidly and confidently to create superior products at competitive prices. This ability has been degrading relative to other nations over several decades.

In areas of high technology, it is not sufficient for industry just to be knowledgeable of technological innovations. This results in a slow, methodical application of new technology, often stimulated solely as a result of earlier use by foreign competitors. This conservative approach is often taken by U.S. industry because the financial risk is viewed as too great. If the practicability of the application has not been demonstrated in advance, the technology is not ready for application. Other countries have found ways to speed this process, sometimes through direct subsidies but also through use of indirect incentives such as low cost financing.

A Solution

A number of remedial actions can be taken by the congress and the executive branch. The following premises apply:

- o Leadership of this activity to a large degree should rest with industry,
- o The federal government should play a catalytic role which, in some cases, would include some funding support,
- o The free market system, which has served the country well, should not be affected in any material way.

On this basis, the following is recommended:

1. The federal government should recognize the need in selected important areas, to help carry development of technology to the point of readiness for application and consider ways in which to foster the validation of the technology, e.g.:

- o The use of revolving funds to provide resources for validation effort. Benefiting companies would make repayments to the fund as and if they recover investment through sales,
- o Joint funding of industry-proposed technology readiness programs,

- o The licensing of the products of government R&D to industries that are willing to fund continued development,

- o The granting of a limited period of exclusive use to provide incentive for industrial investment.

2. Where completely new products or services have been demonstrated to be technically feasible and show economic promise, agencies of the federal government should consider committing to the purchase of such products or services as can be useful in the execution of their respective missions.

An Implementation Example (Aeronautics)

An appropriation would establish an Aeronautical Technology Validation Fund, under the guidance of an Aeronautical Technology Validation Steering Committee, administered by NASA. Additional appropriations, in following years, would be limited with the intent that the fund becomes a self-supporting revolving fund.

The Steering Committee, consisting of appropriate executives such as the NASA and FAA Administrators, the Secretary of Commerce, the U.S. Trade Representative, the Secretary of Defense, and number of industry representatives, would be chaired by the Assistant to the President for Science & Technology.

The revolving fund would be exclusively to validate practical commercial applicability of aeronautical technology critical to U.S. competitiveness. The fund would be independent of and not affect individual agency research and technology budgets.

The selected technologies would represent advances which have been found feasible and clearly important to competitiveness, but which still require validation under realistic conditions to establish readiness for economical commercial applications. In most but not all instances, industry would recommend and NASA would provide support to the conduct of the program, upon Steering Committee approval. Industry and academic assistance in identifying critical technology needs could be obtained through NASA's existing aeronautics advisory committee structure. For competitive technology specifically related to areas such as air traffic control and flight safety, the responsibility would be shared between FAA and NASA.

Performing contractors or contractor teams would be selected through the conducting agency's normal procurement processes, with heavy emphasis on the degree of proposed cost sharing and recoupment provisions would help maintain the fund. Other U.S. companies would be given advanced access to results and details under similar recoupment agreements.

The conducting agency would present for Steering Committee approval the terms to be applied to a proposed validation

project. Given the goal of maintaining a self-supporting fund, a general guideline would be to seek approximately 50% industry cost sharing, complemented by appropriate recoupment based on product sales over a time period. (Business and competitive conditions may warrant different terms in specific instances.) Allowances should be made for firms with limited cost sharing capability but technology which otherwise meets the fund's objectives.

(4) RECOMMENDATION TO ESTABLISH A FOCAL POINT FOR FEDERAL TECHNOLOGY ACTIVITIES IN SUPPORT OF U.S. INTERNATIONAL COMPETITIVENESS

Problem

No means exists in the U.S. government to produce the concerted effort needed for the planning and implementation of activities aimed at establishing and/or maintaining leadership in critical areas of commercially applicable technology. Most of the industries which are competitive in the international arena and provide the nation with economic trade advantages, e.g., air transport, computers and agriculture, have been beneficiaries of government sponsored technology, acquisition programs and other support, and have close interactions with government departments and agencies such as DoD, DoA, DoC and NASA. Yet, there is no means for establishing national priorities in these and any other economically critical areas. This problem is compounded by the lack of a mechanism for setting relative priorities between substantially unrelated activities.

Almost all the nations which are our strongest economic competitors have effective means to accomplish coordination between industrial firms and government agencies, as well as means for establishing and allocating government support.

A Solution

This country does not need an industrial policy or a "Department of Industry" but the federal government does need to recognize the common sense and practicality of government cooperation with industry in the national interest and the importance of government's playing a catalytic and supportive rather than a negative role in encouraging commercial applications and economic competitiveness. Required actions are:

1. Government-industry cooperation in determining those measures necessary to enhance technology application and competitiveness in critical sectors.
2. Government designation of a focal point to coordinate and stimulate the federal R&D establishment in the catalytic and supportive activities recommended

The efforts recommended can be accomplished largely using the institutional resources currently existing with the federal government; however, a focal point for budget and programmatic planning and coordination needs to be designated. This organization would not replace functions already in existence, e.g., program management capabilities and procurement. In this context, an existing office within the Executive Branch could be assigned these responsibilities, at least in an interim sense. Then, based on that experience, other steps could be taken such

as the establishment of a new office or agency.

An Implementation Example

As an initial step in providing a focus on the commercial facets of technology innovation and application within the federal government, the Office of Science and Technology Policy (OSTP) could be designated to define and develop the appropriate functions and responsibilities. Some are indicated in the previous recommendations such as:

1. An evaluation function in establishing priorities in economically critical areas of technology,
2. An oversight, coordination and integration function pertaining to federal agency and industry program efforts in the commercial technology area,
3. A central point of contact with industry in support of U.S. international competitiveness,
4. A fund source for agencies and industry in areas of cost sharing, revolving funds and other catalytic allocation of resources.

OSTP, or any other office designated to accomplish these tasks, would not manage the conduct of programs which would be left in the hands of federal agencies, industry or both as the case may be. OSTP, however, would organize and conduct "pilot" activities in connection with such functions as listed above in order to determine how they should be carried out. Based on the OSTP experience, other steps could be taken such as the augmentation of an existing office or agency or the establishment of a new one.

"Document Control"

TYPE: INFORMATION DOCUMENT NUMBER: 9124821
ORIGINATOR: 02 STATUS C DIRECTORATE STATUS

FROM: FISHER, George: COUNCIL ON COMPETITIVENESS

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 11/15/91

SUBJECT: RE: A RECENT POLL THE COUNCIL COMMISSIONED TO GAUGE
THE EXTENT OF PUBLIC UNDERSTANDING AND AWARENESS OF
U.S. COMPETITIVENESS.

DIRECTORATE STAFF
ASSIGNED: ASSIGNED:

ACTION STAFF
REQUIRED: ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley
INDUSTRIAL

WHITE HOUSE TRACKING #: CONTACT PERSON:
REMARKS: PHONE: EXT:

OSTP RECEIVED: 11/18/91 DEPT RECEIVED:
FILE: P-INDUSTRIAL-ECONOMIC COMPETITIVENESS
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American Society for Training and Development

Association of American Universities

Business - Higher Education Forum

Center for Strategic and International Studies

Collective Bargaining Forum

Committee for Economic Development

Council on Research and Technology

Health Industry Manufacturers Association

IC² Institute

Industrial Research Institute, Inc.

Labor-Industry Coalition for International Trade

National Alliance of Business

National Association of Manufacturers

National Association of State Universities
& Land-Grant Colleges

National Association of Wholesaler-Distributors

National Center for Manufacturing Sciences

The Aspen Institute

The Association for Manufacturing Technology

The Brookings Institution

The Conference Board

The Institute of Electrical and Electronics
Engineers - U.S. Activities

4821
Council on Competitiveness

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November 15, 1991

91 NOV 18 A 9:29
D. Allan Bromley
Assistant to the President
for Science and Technology
Office of Science and Technology Policy
Old Executive Office Building
Room 358
Washington, DC 20506

Dear Allan:

The private-sector Council on Competitiveness has undertaken a major effort aimed at reshaping the national debate on competitiveness and competitiveness-related issues. We recently commissioned a national, bipartisan poll of over 1,000 American voters to gauge the extent of public understanding and awareness of U.S. competitiveness.

The poll, conducted by two of America's leading political pollsters (one Republican, one Democratic), was followed by a series of focus groups held across the country. The poll results, along with a Council report entitled Looking for Leadership: The Public, Competitiveness and Campaign '92, will be released officially at a press conference on Monday, November 18.

The results of the poll indicate a deep-seated concern about the present condition of the U.S. economy and prospects for the future. Most Americans feel a squeeze on their pockets and their standard of living, and believe their children will have a harder time starting out in life.

To put the country back on track in terms of economic, industrial and technological competitiveness, most voters feel that the federal government must take a more direct, activist role in working with business.

Our challenge, and, I believe, a challenge for the Administration and '92 candidates as well, is to educate voters on the links that exist between technology, training, infrastructure, and savings and investment on the

November 15, 1991
Page Two

one hand, and long-term prosperity and a rising standard of living on the other. The Council has repeatedly stressed the importance of and need for pragmatic partnerships between government and industry, most notably in key critical technologies, as outlined in our March 1991 report, Gaining New Ground: Technology Priorities for America's Future.

Clearly, the economic competitiveness of the United States will be one of if not the major issue of the '92 elections. Enclosed is a copy of the poll results, the Council's report, and a Republican strategy memo for the '92 campaign cycle drafted by Linda DiVall, one of the Council's pollsters and President of American Viewpoint. I think you will find this both interesting and useful as you help shape the Administration's agenda for 1992.

Please do not hesitate to call me or any of the Council staff if you have any questions about the poll or if we can be of assistance.

Sincerely,


George Fisher

Enclosures

COUNCIL ON COMPETITIVENESS



"Document Control"

TYPE: INFORMATION DOCUMENT NUMBER: 9124633
ORIGINATOR: 02 STATUS C DIRECTORATE STATUS

FROM: HUBBARD, ALLAN B.: COUNCIL ON COMPETITIVENESS

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 10/30/91

SUBJECT: HE IS FORWARDING A COPY OF A LETTER HE HAD WRITTEN
TO THE SENATE GOVERNMENT OPERATIONS COMMITTEE.

DIRECTORATE STAFF
ASSIGNED: ASSIGNED:

ACTION STAFF
REQUIRED: ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley
INDUSTRIAL
Carl Bretscher

WHITE HOUSE TRACKING #: CONTACT PERSON:
REMARKS: PHONE: EXT:

OSTP RECEIVED: 11/04/91 DEPT RECEIVED:
FILE: INDUSTRIAL-ECONOMIC COMPETITIVENESS
CENTRAL FILES:



46
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OFFICE OF THE VICE PRESIDENT

WASHINGTON

October 30, 1991

OFFICE OF THE
DIRECTOR

MEMORANDUM FOR DIRECTOR BROMLEY
OFFICE OF SCIENCE AND TECHNOLOGY POLICY

FROM: ALLAN B. HUBBARD
EXECUTIVE DIRECTOR *ABH*
COUNCIL ON COMPETITIVENESS

SUBJECT: LETTER TO THE SENATE GOVERNMENT OPERATIONS
COMMITTEE

The Vice President asked that I forward a copy of the enclosed response to a letter from Senators Glenn, Levin and Kohl of the Senate Committee on Government Operations. He thought you might be interested in light of the recent letters from the Senators to several Cabinet members inquiring as to their agency's relationship with the Council on Competitiveness.



OFFICE OF THE VICE PRESIDENT
WASHINGTON

October 22, 1991

Senator John Glenn
Chairman, Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Chairman Glenn:

The Vice President has asked me to respond to your letters requesting additional information about the Council on Competitiveness. As you know, the Vice President has met with you and Senator Levin to discuss the Council and its mission. Additionally, our staff has met with committee staff to discuss the Council's operations.

Let me make two basic points about the Council and its mission:

First, in implementing one of the Council's primary assignments from President Bush--to reduce the regulatory burden on our economy--the Vice President seeks to promote the general interest of all Americans. We are committed to reducing and--wherever possible--eliminating excessive, burdensome and unnecessary regulations that:

- o Threaten the loss of American jobs,
- o Raise the cost of products to American consumers,
- o Impose needless government paperwork on America's small business women and men, and
- o Impose unnecessary federal mandates on our cities, counties and towns.

Second, I understand that there is some concern that the Council is a "secret, backdoor channel" for deciding regulatory issues. Let me assure you that this is definitely not the case. Citizens from around the country are invited to bring regulatory problems to the Council's attention. Whenever there is a policy issue, our staff welcomes representatives of all sides of the debate to come in and present their arguments. In so doing, we always encourage them to present their arguments to the regulatory agency responsible for issuing the regulation.

The agency is responsible for compiling a record available to the public of the pertinent factual information on which the agency relies to support its rulemaking decisions. The Council on Competitiveness uses this record, together with the analyses of the regulation prepared by professionals at the regulatory agency, OMB, and other government agencies, in its deliberations regarding policy issues. As the attached Fact Sheets and Press Releases demonstrate, the Council publicly announces its regulatory initiatives.

We look forward to working with you to reduce the regulatory burden on all Americans. Attached is a copy of my April 25th response to your first letter that includes the basic information about the Council. In addition, the following information addresses the specific questions you raised in your first letter.

1. **What specific role does the Council play in reviewing agency regulatory activities? Through what specific legal authority and through which executive orders or directives does the Council perform those functions?**

Executive Order Nos. 12291 and 12498 set forth the specific procedures for the regulatory review process. On June 15, 1990, President Bush directed the Council on Competitiveness to exercise the same authority over regulatory issues as did the Presidential Task Force on Regulatory Relief under Executive Order 12291. The President also designated the Council on Competitiveness, chaired by Vice President Quayle, as the appropriate council to review issues raised in conjunction with the regulatory program under Executive Order 12498.

2. **What is the relationship of the Council to OMB's Office of Information and Regulatory Affairs (OIRA) and to the Office of the OMB Deputy Director for Management (established by the Chief Financial Officers Act of 1990)?**

Executive Orders 12291 and 12498 vest responsibility for their implementation in the Director of the Office of Management and Budget, subject now to the review of the Council on Competitiveness. The Office of Information and Regulatory Affairs (OIRA) reviews regulations under these Executive Orders. OIRA staff keeps the Council staff informed about the regulatory review process and the status of particular issues under review. The Chief Financial Officers Act of 1990 provides that OMB's Deputy Director for Management is to, inter alia, "perform all functions of the Director, including all functions delegated by the President to the Director. . . [relating to] regulatory affairs." (Sec. 503(b)(2))

3. Please describe the council's regulatory review activities. How are regulatory activities referred to or selected by the Council for review? What procedures are followed and what standards are used to review those regulatory activities? How are Council decisions or comments communicated to agencies?

The Council's regulatory review activities involve working closely with the OMB in carrying out OMB's regulatory review under E.O. 12291 and its development of the Regulatory Program under E.O. 12498. The Council determines which items it will review based on the views of its members and staff; normally the items it takes up are those that present difficult issues under E.O. 12291 that require Cabinet-level attention, particularly issues where there is a policy disagreement among agencies.

The process for reviewing regulations is spelled out in Executive Order Nos. 12291 and 12498 which provide inter alia:

"the Director [of OMB], subject to the direction of the Task Force, shall have authority, . . .to prescribe criteria for making [determinations whether a rule an agency intends to propose or to issue is a major rule]." (E.O. 12291 Section 3 (b))

"The Director [of OMB], subject to the direction of the Task Force, which shall resolve any issues raised under this Order or ensure that they are presented to the President, is authorized to review any preliminary or final Regulatory Impact Analysis, notice of proposed rulemaking, or final rule based on the requirements of this Order." (E.O. 12291 Section 3 (e)(1))

"'Regulation' or 'rule' means an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice of an agency... [with certain exceptions for formal rulemaking, national security, agency organization, management or personnel]" (E.O. 12291 Section 1(a))

"The Director [of OMB], subject to the direction of the Task Force, may designate currently effective rules for review in accordance with this Order, and establish schedules for reviews and Analyses under this Order." (E.O. 12291 Section (3)(i))

"The Director, subject to the direction of the Task Force, may, to the extent permitted by law: (1) Require agencies to provide additional information in an agenda [published every 6 months of proposed regulations that the agency has

issued or expects to issue, and currently effective rules that are under agency review]; and (2) Require publication of the agenda in any form." (E.O. 12291 Section 5(b))

"To the extent permitted by law. . .the Director shall have authority, subject to the direction of the Task Force, to:

- (1) Designate any proposed or existing rule as a major rule in accordance with Section 1(b) of this Order;
- (2) Prepare and promulgate uniform standards for the identification of major rules and the development of Regulatory Impact Analyses;
- (3) Require an agency to obtain and evaluate, in connection with a regulation, any additional relevant data from any appropriate source;
- (4) Waive the requirements of Sections 3,4, or 7 of this Order with respect to any proposed or existing major rule;
- (5) Identify duplicative, overlapping and conflicting rules, existing or proposed, and existing or proposed rules that are inconsistent with the policies underlying statutes governing agencies other than the issuing agency or with the purposes of this Order, and, in each such case, require appropriate interagency consultation to minimize or eliminate such duplication overlap, or conflict;
- (6) Develop procedures for estimating the annual benefits and costs of agency regulations, on both an aggregate and economic or industrial sector basis, for purposes of compiling a regulatory budget;
- (7) In consultation with interested agencies, prepare for consideration by the President recommendations for changes in the agencies' statutes; and
- (8) Monitor agency compliance with the requirements of this Order and advise the President with respect to such compliance." (E.O. 12291, Section 6 (a))

"The Director, subject to the direction of the Task Force, is authorized to establish procedures for the performance of all functions vested in the Director by this Order." (E.O. 12291 Section 6 (b))

"In the event of disagreement over the content of the agency's draft regulatory program, the agency head or the

Director may raise issues for further review by the President or by such appropriate Cabinet Council or other forum as the President may designate." E.O. 12498
Section 3 (a)

The standards used to review a regulation are also spelled out in E.O. 12291:

"In promulgating new regulations, reviewing existing regulations, and developing legislative proposals concerning regulation, all agencies, to the extent permitted by law, shall adhere to the following requirements:

(a) Administrative decisions shall be based on adequate information concerning the need for and consequences of proposed government action;

(b) Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society;

(c) Regulatory objectives shall be chosen to maximize the net benefits to society;

(d) Among alternative approaches to any given regulatory objective, the alternative involving the least net cost to society shall be chosen; and

(e) Agencies shall set regulatory priorities with the aim of maximizing the aggregate net benefits to society, taking into account the condition of the particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future." (Section 2)

It is important to keep in mind the key distinction between the role of the Council in coordinating with OMB to implement the review of regulations pursuant to the Executive Order and the role of an agency in issuing regulations. The Council serves as a deliberative forum where senior agency officials can gather to discuss and resolve policy issues that affect major regulatory proposals often involving several agencies.

The Council does not have the authority to issue regulations. This authority is vested in the regulatory agencies of jurisdiction, which often have a great deal of discretion, consistent with fully implementing the law, in developing particular regulations. Agencies exercise their regulatory authority using the record-keeping and rulemaking processes clearly outlined in the Administrative Procedure Act. These are widely known and include public participation. The President has directed that, when Executive agencies exercise their regulatory

authority and discretion, they adhere, to the extent permitted by law, to the principles set forth in E.O. 12291. The Council provides a forum for discussion and resolution of policy issues that arise in this process, and its views are communicated to agencies through the forum and discussions and through OIRA.

4. In what manner and under what circumstances does the Council solicit or receive comments on agency regulatory activities from persons outside the Council? What records are kept of such communications and what is done with the comments?

The distinction between agencies' formal regulatory authority and the Council's policy coordination function is also relevant to the Council's communications with the public. To illustrate the point, it is useful to compare the two functions to a congressional committee's activities. The outcome of the committee's deliberations is a vote or other committee action, usually accompanied by a committee report. The outcome of deliberations in the Executive Branch regarding regulatory issues is ultimately the regulatory action taken by the agency. In the same way that the committee vote and accompanying report are matters of public record, the agency action is recorded in the Federal Register and there is a substantial public record maintained pursuant to Administrative Procedure Act requirements.

Similarly, just as members of your Committee and its staff interact informally with government agencies, private sector organizations, interest groups and individuals on legislative and oversight matters before the Committee, members of the Council and its staff interact with such groups and individuals as they gather information on major regulatory proposals. The Vice President, in meeting with people around the country, routinely invites them to send him information about regulatory and competitiveness issues. The Council staff has a policy of meeting with any group that requests an appointment to discuss a regulatory issue, including representatives of workers, consumers, businesses and citizens. This information gathering is necessary to the Executive Branch's deliberative process.

Since the Council on Competitiveness is a Cabinet-level body, there are no formal procedures for how its members receive information from sources outside the Council. This practice is consistent with the Administrative Procedure Act, which does not, and should not, limit the ability of senior Executive Branch officials to seek information needed to deliberate on and resolve policy questions that necessarily arise when major regulatory issues are under consideration.

5. For each regulatory activity reviewed or otherwise discussed (including those currently under review) by the Council, please identify:

- The proposal;
- The dates and length of review;
- The action taken by the Council (whether informal discussion or formal decision); and
- Any record that exists of the Council's deliberations.

There were Council meetings held on June 28, 1990; September 27, 1990; December 19, 1990; February 11, 1991; May 6, 1991; May 14, 1991; June 27, 1991; July 22, 1991; and July 29, 1991. At these meetings, the Council discussed various regulatory issues, including: the general problem of the burden of unnecessary regulation on the American economy, protection of constitutionally ensured private property rights which are threatened by excessive government regulation, analysis of regulatory burdens on the transfer of research from government laboratories to the market place, the principles to be used by the agencies in developing biotechnology regulations, the recycling requirement in the Municipal Waste Combustors Rule, regulations implementing the statutory exemption for secured parties from Superfund cleanup liability, review of the wetlands delineation manual, review of the federal ban on homeworkers in the women's apparel industry, reform of regulations governing pension plans, and response to public concern over Clinical Laboratory Inspection Act (CLIA) rules.

In my previous letter, I attached all of the publicly available documentation of these meetings. To bring you up to date, attached are the fact sheets covering the meetings since my April 25 letter. While these meetings addressed other regulatory issues as part of the deliberative process of the Executive Office of the President and the Cabinet, the Council did not set out Administration policies in these areas. Needless to say, Council staff also discuss regulatory matters on an ongoing basis.

Any decisions about a particular regulation are made by the agency head responsible for issuing the regulation, and, in so doing, implementing the policies of the President. His or her decisions would be reflected in the public record as required by the Administrative Procedure Act.

6. To what extent was your March 22, 1991, Memorandum for Heads of Executive Departments and Agencies based on problems the Council has experienced in its review of regulatory activities? If so, what were those problems and how were they addressed by the Memorandum? Also, please explain how the Memorandum's delineation of the scope of OMB regulatory

review is consistent with the Administrative Procedure Act's definition of "rule" and "rule making."

The purpose of the Vice President's March 22, 1991, memorandum to the heads of the executive departments and agencies was to enlist their help to make sure that the regulatory review process operates to minimize the burden on the economy of all Federal regulations. He noted in the memorandum that several agencies had raised questions about the scope of Executive Order 12291 and which agency actions must be submitted to OMB for review. The Vice President also noted questions had been raised with regard to the scope of Regulatory Impact Analyses when an agency is implementing a statute.

1. In the memorandum, the Vice President indicated that the Administration has consistently interpreted the Executive Order to include all agency policy guidance that affects the public. Such policy guidance includes not only regulations that are published for notice and comment, but also strategy statements, guidelines, policy manuals, grant and loan procedures, Advance Notices of Proposed Rule Making in limited instances, press releases and other documents that themselves announce or implement new regulatory policy that affects the public. The Vice President reminded the agencies that the Executive Order makes certain exceptions for adjudications or agency actions that are involved in military or foreign affairs, and internal agency organization.

E.O. 12291 applies, with certain exceptions, to any "agency **statement** of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice requirements of an agency" (emphasis added.) Therefore, OIRA reviews various types of documents in order to implement the policies contained in Executive Order No. 12291.

2. The Vice President's memorandum drew attention to the Executive Order's requirement that a Regulatory Impact Analysis be done for all major rules. The memorandum stated the analysis should review the costs and benefits of the proposed rule or action and a variety of regulatory and non-regulatory alternatives, including innovative approaches such as market-based incentives, information disclosure, and a "no regulation" alternative (for programs largely regulatory in nature) or a "zero-based" option (for budgetary programs implemented through regulation).
3. The memorandum also addressed the scope of the Regulatory Impact Analysis when the agency is implementing a statute. It stated the Analysis should fully address the costs and benefits of actions mandated by legislation as well as

actions that are a matter of agency discretion. The Vice President asked the agencies to make sure that all appropriate agency actions are included in the regulatory review process, and that any Regulatory Impact Analysis fully assesses the economic impact of regulations in accordance with OIRA guidance.

7. Please describe the functions, responsibilities, and authority of the Council's Working Groups.

The Vice President has established six working groups to assist the Council in implementing its mission to review regulatory issues, and such other issues as may be referred by the President, bearing on competitiveness. These include:

- Working Group on Biotechnology
- Working Group on Civil Litigation Reform
- Working Group on Deregulation
- Working Group on the Drug Approval Process
- Working Group on Product Liability Reform
- Working Group on Commercialization of Government Research

The Vice President has asked these working groups to make recommendations to the Council regarding particular policy and regulatory issues that arise in their respective areas.

In closing, I would like to thank you again for your interest in the Council's work. Additionally, I want to emphasize that, while I am sure you understand that I cannot provide certain information that is part of the deliberative and decision making process of the Administration, I would be happy to meet with you personally to discuss in more detail the role the Council plays in the regulatory review process.

Sincerely,


Allan B. Hubbard
Executive Director
Council on Competitiveness

cc: Senator William Roth



OFFICE OF THE VICE PRESIDENT
WASHINGTON

October 22, 1991

Senator Carl Levin
United States Senate
Washington, D.C. 20510

Dear Senator Levin:

The Vice President has asked me to respond to your letters requesting additional information about the Council on Competitiveness. As you know, the Vice President has met with you and Senator Glenn to discuss the Council and its mission. Additionally, our staff has met with committee staff to discuss the Council's operations.

Let me make two basic points about the Council and its mission:

First, in implementing one of the Council's primary assignments from President Bush--to reduce the regulatory burden on our economy--the Vice President seeks to promote the general interest of all Americans. We are committed to reducing and--wherever possible--eliminating excessive, burdensome and unnecessary regulations that:

- o Threaten the loss of American jobs,
- o Raise the cost of products to American consumers,
- o Impose needless government paperwork on America's small business women and men, and
- o Impose unnecessary federal mandates on our cities, counties and towns.

Second, I understand that there is some concern that the Council is a "secret, backdoor channel" for deciding regulatory issues. Let me assure you that this is definitely not the case. Citizens from around the country are invited to bring regulatory problems to the Council's attention. Whenever there is a policy issue, our staff welcomes representatives of all sides of the debate to come in and present their arguments. In so doing, we always encourage them to present their arguments to the regulatory agency responsible for issuing the regulation.

The agency is responsible for compiling a record available to the public of the pertinent factual information on which the agency relies to support its rulemaking decisions. The Council

on Competitiveness uses this record, together with the analyses of the regulation prepared by professionals at the regulatory agency, OMB, and other government agencies, in its deliberations regarding policy issues. As the attached Fact Sheets and Press Releases demonstrate, the Council publicly announces its regulatory initiatives.

We look forward to working with you to reduce the regulatory burden on all Americans. Attached is a copy of my April 25th response to your first letter that includes the basic information about the Council. In addition, the following information addresses the specific questions you raised in your first letter.

1. **What specific role does the Council play in reviewing agency regulatory activities? Through what specific legal authority and through which executive orders or directives does the Council perform those functions?**

Executive Order Nos. 12291 and 12498 set forth the specific procedures for the regulatory review process. On June 15, 1990, President Bush directed the Council on Competitiveness to exercise the same authority over regulatory issues as did the Presidential Task Force on Regulatory Relief under Executive Order 12291. The President also designated the Council on Competitiveness, chaired by Vice President Quayle, as the appropriate council to review issues raised in conjunction with the regulatory program under Executive Order 12498.

2. **What is the relationship of the Council to OMB's Office of Information and Regulatory Affairs (OIRA) and to the Office of the OMB Deputy Director for Management (established by the Chief Financial Officers Act of 1990)?**

Executive Orders 12291 and 12498 vest responsibility for their implementation in the Director of the Office of Management and Budget, subject now to the review of the Council on Competitiveness. The Office of Information and Regulatory Affairs (OIRA) reviews regulations under these Executive Orders. OIRA staff keeps the Council staff informed about the regulatory review process and the status of particular issues under review. The Chief Financial Officers Act of 1990 provides that OMB's Deputy Director for Management is to, inter alia, "perform all functions of the Director, including all functions delegated by the President to the Director. . . [relating to] regulatory affairs." (Sec. 503(b)(2))

3. **Please describe the council's regulatory review activities. How are regulatory activities referred to or selected by the**

Council for review? What procedures are followed and what standards are used to review those regulatory activities? How are Council decisions or comments communicated to agencies?

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"The Director [of OMB], subject to the direction of the Task Force, which shall resolve any issues raised under this Order or ensure that they are presented to the President, is authorized to review any preliminary or final Regulatory Impact Analysis, notice of proposed rulemaking, or final rule based on the requirements of this Order." (E.O. 12291 Section 3 (e)(1))

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"The Director [of OMB], subject to the direction of the Task Force, may designate currently effective rules for review in accordance with this Order, and establish schedules for reviews and Analyses under this Order." (E.O. 12291 Section (3)(i))

"The Director, subject to the direction of the Task Force, may, to the extent permitted by law: (1) Require agencies to provide additional information in an agenda [published every 6 months of proposed regulations that the agency has issued or expects to issue, and currently effective rules that are under agency review]; and (2) Require publication of the agenda in any form." (E.O. 12291 Section 5(b))

"To the extent permitted by law. . .the Director shall have authority, subject to the direction of the Task Force, to:

- (1) Designate any proposed or existing rule as a major rule in accordance with Section 1(b) of this Order;
- (2) Prepare and promulgate uniform standards for the identification of major rules and the development of Regulatory Impact Analyses;
- (3) Require an agency to obtain and evaluate, in connection with a regulation, any additional relevant data from any appropriate source;
- (4) Waive the requirements of Sections 3, 4, or 7 of this Order with respect to any proposed or existing major rule;
- (5) Identify duplicative, overlapping and conflicting rules, existing or proposed, and existing or proposed rules that are inconsistent with the policies underlying statutes governing agencies other than the issuing agency or with the purposes of this Order, and, in each such case, require appropriate interagency consultation to minimize or eliminate such duplication overlap, or conflict;
- (6) Develop procedures for estimating the annual benefits and costs of agency regulations, on both an aggregate and economic or industrial sector basis, for purposes of compiling a regulatory budget;
- (7) In consultation with interested agencies, prepare for consideration by the President recommendations for changes in the agencies' statutes; and
- (8) Monitor agency compliance with the requirements of this Order and advise the President with respect to such compliance." (E.O. 12291, Section 6 (a))

"The Director, subject to the direction of the Task Force, is authorized to establish procedures for the performance of all functions vested in the Director by this Order."
(E.O. 12291 Section 6 (b))

"In the event of disagreement over the content of the agency's draft regulatory program, the agency head or the Director may raise issues for further review by the President or by such appropriate Cabinet Council or other forum as the President may designate." E.O. 12498

Section 3 (a)

The standards used to review a regulation are also spelled out in E.O. 12291:

"In promulgating new regulations, reviewing existing regulations, and developing legislative proposals concerning regulation, all agencies, to the extent permitted by law, shall adhere to the following requirements:

(a) Administrative decisions shall be based on adequate information concerning the need for and consequences of proposed government action;

(b) Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society;

(c) Regulatory objectives shall be chosen to maximize the net benefits to society;

(d) Among alternative approaches to any given regulatory objective, the alternative involving the least net cost to society shall be chosen; and

(e) Agencies shall set regulatory priorities with the aim of maximizing the aggregate net benefits to society, taking into account the condition of the particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future." (Section 2)

It is important to keep in mind the key distinction between the role of the Council in coordinating with OMB to implement the review of regulations pursuant to the Executive Order and the role of an agency in issuing regulations. The Council serves as a deliberative forum where senior agency officials can gather to discuss and resolve policy issues that affect major regulatory proposals often involving several agencies.

The Council does not have the authority to issue regulations. This authority is vested in the regulatory agencies of jurisdiction, which often have a great deal of discretion, consistent with fully implementing the law, in developing particular regulations. Agencies exercise their regulatory authority using the record-keeping and rulemaking processes clearly outlined in the Administrative Procedure Act. These are widely known and include public participation. The President has directed that, when Executive agencies exercise their regulatory authority and discretion, they adhere, to the extent permitted by law, to the principles set forth in E.O. 12291. The Council provides a forum for discussion and resolution of policy issues

that arise in this process, and its views are communicated to agencies through the forum and discussions and through OIRA.

4. In what manner and under what circumstances does the Council solicit or receive comments on agency regulatory activities from persons outside the Council? What records are kept of such communications and what is done with the comments?

The distinction between agencies' formal regulatory authority and the Council's policy coordination function is also relevant to the Council's communications with the public. To illustrate the point, it is useful to compare the two functions to a congressional committee's activities. The outcome of the committee's deliberations is a vote or other committee action, usually accompanied by a committee report. The outcome of deliberations in the Executive Branch regarding regulatory issues is ultimately the regulatory action taken by the agency. In the same way that the committee vote and accompanying report are matters of public record, the agency action is recorded in the Federal Register and there is a substantial public record maintained pursuant to Administrative Procedure Act requirements.

Similarly, just as members of your Committee and its staff interact informally with government agencies, private sector organizations, interest groups and individuals on legislative and oversight matters before the Committee, members of the Council and its staff interact with such groups and individuals as they gather information on major regulatory proposals. The Vice President, in meeting with people around the country, routinely invites them to send him information about regulatory and competitiveness issues. The Council staff has a policy of meeting with any group that requests an appointment to discuss a regulatory issue, including representatives of workers, consumers, businesses and citizens. This information gathering is necessary to the Executive Branch's deliberative process.

Since the Council on Competitiveness is a Cabinet-level body, there are no formal procedures for how its members receive information from sources outside the Council. This practice is consistent with the Administrative Procedure Act, which does not, and should not, limit the ability of senior Executive Branch officials to seek information needed to deliberate on and resolve policy questions that necessarily arise when major regulatory issues are under consideration.

5. For each regulatory activity reviewed or otherwise discussed (including those currently under review) by the Council, please identify:

- The proposal;

- The dates and length of review;
- The action taken by the Council (whether informal discussion or formal decision); and
- Any record that exists of the Council's deliberations.

There were Council meetings held on June 28, 1990; September 27, 1990; December 19, 1990; February 11, 1991; May 6, 1991; May 14, 1991; June 27, 1991; July 22, 1991; and July 29, 1991. At these meetings, the Council discussed various regulatory issues, including: the general problem of the burden of unnecessary regulation on the American economy, protection of constitutionally ensured private property rights which are threatened by excessive government regulation, analysis of regulatory burdens on the transfer of research from government laboratories to the market place, the principles to be used by the agencies in developing biotechnology regulations, the recycling requirement in the Municipal Waste Combustors Rule, regulations implementing the statutory exemption for secured parties from Superfund cleanup liability, review of the wetlands delineation manual, review of the federal ban on homeworkers in the women's apparel industry, reform of regulations governing pension plans, and response to public concern over Clinical Laboratory Inspection Act (CLIA) rules.

In my previous letter, I attached all of the publicly available documentation of these meetings. To bring you up to date, attached are the fact sheets covering the meetings since my April 25 letter. While these meetings addressed other regulatory issues as part of the deliberative process of the Executive Office of the President and the Cabinet, the Council did not set out Administration policies in these areas. Needless to say, Council staff also discuss regulatory matters on an ongoing basis.

Any decisions about a particular regulation are made by the agency head responsible for issuing the regulation, and, in so doing, implementing the policies of the President. His or her decisions would be reflected in the public record as required by the Administrative Procedure Act.

6. To what extent was your March 22, 1991, Memorandum for Heads of Executive Departments and Agencies based on problems the Council has experienced in its review of regulatory activities? If so, what were those problems and how were they addressed by the Memorandum? Also, please explain how the Memorandum's delineation of the scope of OMB regulatory review is consistent with the Administrative Procedure Act's definition of "rule" and "rule making."

The purpose of the Vice President's March 22, 1991, memorandum to the heads of the executive departments and agencies

was to enlist their help to make sure that the regulatory review process operates to minimize the burden on the economy of all Federal regulations. He noted in the memorandum that several agencies had raised questions about the scope of Executive Order 12291 and which agency actions must be submitted to OMB for review. The Vice President also noted questions had been raised with regard to the scope of Regulatory Impact Analyses when an agency is implementing a statute.

1. In the memorandum, the Vice President indicated that the Administration has consistently interpreted the Executive Order to include all agency policy guidance that affects the public. Such policy guidance includes not only regulations that are published for notice and comment, but also strategy statements, guidelines, policy manuals, grant and loan procedures, Advance Notices of Proposed Rule Making in limited instances, press releases and other documents that themselves announce or implement new regulatory policy that affects the public. The Vice President reminded the agencies that the Executive Order makes certain exceptions for adjudications or agency actions that are involved in military or foreign affairs, and internal agency organization.

E.O. 12291 applies, with certain exceptions, to any "agency **statement** of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice requirements of an agency" (emphasis added.) Therefore, OIRA reviews various types of documents in order to implement the policies contained in Executive Order No. 12291.

2. The Vice President's memorandum drew attention to the Executive Order's requirement that a Regulatory Impact Analysis be done for all major rules. The memorandum stated the analysis should review the costs and benefits of the proposed rule or action and a variety of regulatory and non-regulatory alternatives, including innovative approaches such as market-based incentives, information disclosure, and a "no regulation" alternative (for programs largely regulatory in nature) or a "zero-based" option (for budgetary programs implemented through regulation).
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accordance with OIRA guidance.

7. Please describe the functions, responsibilities, and authority of the Council's Working Groups.

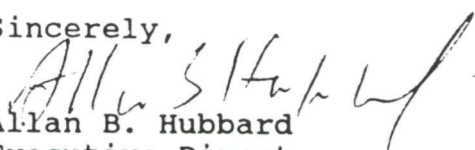
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OFFICE OF THE VICE PRESIDENT

WASHINGTON

October 22, 1991

Senator Herbert Kohl
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Executive Director
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THE WHITE HOUSE

Nov. 4 '91

Dear Mr. -

Many thanks for the copy of your
excellent letter to the Senate
Government Operations Committee.

It is an admirably clear
statement of purpose and I
congratulate you on it.

Osgood and I stand ready
to help in any way we can
with all best wishes

Sincerely
Dylan

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FROM: RASH, Kris D.

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 09/25/91

SUBJECT: CONCERN AND QUESTIONS REGARDING THE ECONOMIC FUTURE
OF THE U.S. AND A REQUEST FOR ANY AVAILABLE
INFORMATION ON THE SUBJECT.

DIRECTORATE STAFF
ASSIGNED: INDUSTRIAL ASSIGNED:

ACTION STAFF
REQUIRED: DIRECT REPLY ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: 10/16/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

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9/25/91

White House Science Adviser

White House

Washington D.C. 20500

OFFICE OF THE
DIRECTOR

I am concerned about the economic future of the United States, and I have some questions regarding research and development. Many educated people have expressed many conflicting ideas and opinions on this subject. Most of these opinions seem to be frosted with ulterior motives and personal interests. For instance: private research institutions want government funding-claiming this as the way to remain competitive; and governmental research institutions want private funding-claiming this as the solution.

Of course, being a concerned citizen, I wish for the best possible outcome in decisions such as government grants, and subsidies. Understanding that the private sector stands only to gain from such a subsidy, it stands to reason that they would want funding-technology-profit-money in the pocket. Realizing that the U.S. Government has obligations such as the national debt, it would seem foolish to leave such things un-resolved.

Leaving the motives for seeking governmental funding aside-whether they are for the good of the country or for personal interest and profit-in your understanding, is governmental funding for private research a solution to potentially falling behind in the technology race, or will it just waste tax dollars? Please explain your answer. Any pamphlets you might have that would enlighten me further would be appreciated. Thank you for your time.

Kris D Rash

Kris D. Rash

460 S., 2nd W. #43

Rexburg, ID 83440

9/25/81
White House Science Advisor
White House
Washington D.C. 20500

I am concerned about the economic future of the United States, and I have some questions regarding research and development. Many educated people have expressed many conflicting ideas and opinions on this subject. Most of these opinions seem to be rooted with ulterior motives and personal interests. For instance: private research institutions want government funding- claiming this as the way to remain competitive; and governmental research institutions want private funding- claiming this as the solution.

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Kris D. Rash
460 S. 2nd W. #43
Bespurg, ID 83440

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

October 28, 1991

Dear Ms. Rash:

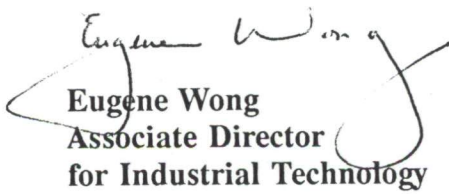
Thank you for your thoughtful letter concerning federal funding of research and its effect on the economic future of the United States.

You ask: "...is government funding for private research a solution to potentially falling behind in the technology race, or will it just waste tax dollars?" The second part is easy to answer. Based on past experiences, government funding for private research will not be a waste of tax dollars. Research-technology-industry form the food chain for economic growth. Nearly all the high-growth industries and the industries that contribute to a favorable balance of trade have been the result of research, much of it government supported and most of it done at private laboratories, industrial or academic. These industries include electronics, computers, telecommunications, biotechnology and pharmaceutical, to name only a few.

The first part of your question is more complex but no less clear. Thanks to the vigor of basic research in the U.S., much of which government supported, we are not falling behind in the creation of technologies, but we may not be as effective in using technology to generate industrial growth. How to use the technologies that we create more effectively should be a major focus for the nation. Reducing government support for research will not help in this regard. It can only hurt.

All in all, government support for research has been an outstanding investment in every way, and will continue to be. Informed citizens like you are critical in building the base of support that an effective and wise public policy requires. I am grateful to you for your interest and concern, and I am enclosing a statement on U.S. Technology Policy which this office issued last year.

Sincerely yours,


Eugene Wong
Associate Director
for Industrial Technology

Ms. Kris D. Rash
460 South 2nd West, #43
Rexburg, Idaho 83440