

REGULATORY POLICY REVIEW

REGULATORY POLICY REVIEW

- Contents -

- A. Cover Memorandum
- B. Memorandum from the Vice President
- C. Proposed Meeting Schedule
- D. Guiding Principles
- E. Guidance for Regulatory Policy Reviews
- F. Worksheet & Instructions
- G. Regulatory Options Outline
- H. REGnet
- I. Index to *Regulation* magazine (1977-94)
- J. Selected Articles on Regulatory Reform
- K. Other Articles of Interest
- L. Personnel Roster

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December 19, 1994

MEMORANDUM FOR THE REGULATORY POLICY ADVISORS TO THE PRESIDENT

SUBJECT: ATTACHED MATERIALS TO ASSIST IN PLANNING FOR THE
REGULATORY REVIEW SESSIONS

To assist you in preparing for the twice-weekly sessions with the Vice President on regulatory issues, my NPR staff has assembled this notebook of materials.

- A set of guiding principles that I believe sets an appropriate framework for the effort.
- A memorandum to stimulate your thinking as you seek bold new ideas.
- A worksheet (with accompanying explanation) that sets out various alternative regulatory approaches (ranging from most to least intrusive). The purpose of the worksheet is to allow you to compare the regulatory programs under your purview according to the spectrum of alternative approaches.
- A brief description of an exciting new NPR initiative (REGnet) which is designed to build a comprehensive and user-friendly on-line regulatory information system.
- The indices and tables of contents for *Regulation* magazine, from 1977 to 1994.

It is my hope and expectation that as the meetings are scheduled, we will be able to provide you with helpful, relevant ideas in your respective areas.

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MTW W/VI
Monday, Nov. 28 7:15 P.
OEOB - ceremonial office



Use 11400 or 21400
is related to the virtual
dept of business, state,
et al.

B.

OFFICE OF THE VICE PRESIDENT
WASHINGTON

November 17, 1994

MEMORANDUM FOR THE REGULATORY POLICY ADVISORS TO THE PRESIDENT

FROM: THE VICE PRESIDENT

SUBJECT: REGULATORY REFORM

In the months since the President charged us with implementing his Executive Order on regulatory planning and review, we have made great progress in bringing a new sense of accountability and order to the regulatory review process. It is now time to take the next steps and develop for the President options for further reforms in the regulatory area.

Set forth below is a process by which I suggest we undertake to develop these various options. The process will focus on a series of "regulatory policy reviews" in which we can explore innovative approaches to achieve regulatory objectives in cost-effective and reasonable manners. These reviews will examine -- with the help of innovative and interesting thinkers and experts -- a variety of sectoral and cross-cutting issues so to enable us to make well-considered recommendations to the President early next year.

In addition, there are several issues closely related to the regulatory issues noted below which, as you know, have already been the object of excellent work by several White House offices. I refer to risk, takings and unfunded mandates. These issues should be considered in a coordinated, but expedited, manner by the same group that will look at the broader regulatory agenda. To that end, I propose that the Regulatory Policy Advisors also coordinate (through an inter-office process) the development of options to address these issues. Specifically, I propose that, over the next three weeks, the DPC and OEP lead a review of the takings issue, OIRA and OSTP take the lead on risk, and the DPC coordinate the development of a proposed response to the unfunded mandates issue. Ideally, these offices would prepare recommendations to be considered by the Regulatory Advisors on or before December 12, 1994. We would then forward a decision memorandum to the President.

For the remaining regulatory-related issues, I suggest the following schedule:

November - December 1994

During this period, we will discuss with affected agency heads and each other the format and process for regulatory policy reviews. We will also finalize a schedule for the policy review sessions.

December 1994 - February 1995

During this period, we will conduct the review sessions. Each review session will be organized by the relevant White House office. I will co-chair the sessions with the head of the office that organizes the session. My office will coordinate the overall schedule of the sessions and provide additional assistance as necessary.

Subject to our further discussion, suggested topics and leaders for the review sessions would include:

- General regulatory and cross-cutting regulatory issues -- OIRA
- Environment, energy and other natural resources -- OEP
- Financial institutions -- NEC and CEA
- Small business regulation -- CEA
- Information technology -- OSTP
- Customer service in the regulatory environment -- OVP
- Food and drug -- DPC
- Health industry regulation -- DPC
- Transportation -- NEC
- Equal opportunity -- White House Counsel
- * • Workplace safety and labor issues -- DPC
- Agriculture -- NEC

February - March 1995

At the end of the review process, the Regulatory Advisors will hold a series of meetings to determine (after appropriate consultation with affected agency heads) which of the options developed during the first phase should be presented to the President. The proposals chosen will then be drafted by the relevant policy office. These drafts will form the basis of the options memorandum to the President.

March 1995

Present options memorandum to the President.

* * *

Please review these proposed assignments (which I assume we will need to modify) and schedule and be prepared to discuss it at a meeting on the Regulatory Policy Advisors, which we will convene shortly.

Please feel free to contact Jack Quinn if you have any questions regarding the process outlined above or the meeting itself.

Distribution: The Director of the Office of Management and Budget *Alice*
The Chair of the Council of Economic Advisors *Laura Tyson*
The Assistant to the President for Science and Technology *Jack Gribb*
✓ The Assistant to the President and Chief of Staff *Jack Q*
to the Vice President
The Assistant to the President and Counsel *Ab Mikva*
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The Assistant to the President for
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The Assistant to the President for Economic Policy *Bob R*
The Assistant to the President for National Security *Tony Lake*
The Assistant to the President and Staff Secretary *John Podeste*
The Deputy Assistant to the President and Director
of the Office of Environmental Policy *Katie McGrath*
The Administrator of the Office of Information and
Regulatory Affairs *Sally Katzen*

Phone & E-mail



OFFICE OF THE VICE PRESIDENT
WASHINGTON

January 4, 1995

MEMORANDUM FOR THE REGULATORY POLICY ADVISORS TO THE PRESIDENT

**DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET
CHAIR OF THE COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR SCIENCE AND TECHNOLOGY
ASSISTANT TO THE PRESIDENT AND CHIEF OF STAFF TO THE VICE PRESIDENT
ASSISTANT TO THE PRESIDENT AND COUNSEL
ASSISTANT TO THE PRESIDENT FOR DOMESTIC POLICY
ASSISTANT TO THE PRESIDENT FOR INTERGOVERNMENTAL AFFAIRS
ASSISTANT TO THE PRESIDENT FOR ECONOMIC POLICY
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY
ASSISTANT TO THE PRESIDENT AND STAFF SECRETARY
DEPUTY ASSISTANT TO THE PRESIDENT AND DIRECTOR OF THE OFFICE OF
ENVIRONMENTAL POLICY
ADMINISTRATOR OF THE OFFICE OF INFORMATION AND REGULATORY AFFAIRS**

FROM: ELAINE KAMARCK

SUBJECT: REGULATORY REFORM

The Vice President will hold the next regulatory review session on Thursday, January 5 in the Ceremonial Office from 4 pm - 6 pm.

At the January 5th meeting we will address the remaining cross-cutting issues and the takings strategy. As time allows, we will take up the issues of customer service and the use of information technology in the regulatory arena.

A tentative schedule for the rest of the meetings was distributed with the last meeting announcement -- however, due to the complexity of these issues and the large number of individuals and offices involved, this schedule will need to be modified.

It is important that we address important aspects of regulation which might not have been indicated on our earlier listings (ADA, for example). I need your help in ensuring that we're as comprehensive as possible, and that we all know who the lead will be on each subtopic. So, looking at the old schedule, please identify more specifically what subtopics you think fall under

the sector headings, as well as who you think should be taking the lead. Please send your suggestions to Jean Logan at NPR. Her fax number is 632-0390.

In seeking bold ideas, we need to speak to experts outside of the federal government. As you know, the Vice President has spoken publicly on several occasions about revamping the regulatory process. In preparing for these meetings, you should feel free to contact people outside this process to seek advice and input. However, the discussions with the Vice President and the ideas presented to him should remain in confidence.

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PROPOSED MEETING SCHEDULE
1/5/95 (version 2)

*	December 21 (Wed.)	Cross-cutting issues & general approaches	OIRA
[1.]	January 3 (Tues.)	No meeting	[]
2.	January 5 (Thurs.)	Takings, remaining cross-cutting issues, and, as time allows, customer service & use of information technology in regulation	OIRA; OVP
[3.]	January 10 (Tues.)	No meeting	[]
4.	January 12 (Thurs.)	Customer service & use of info. tech. in regulation	OVP
5.	January 17 (Tues.)	Financial institutions	NEC & CEA
6.	January 19 (Thurs.)	Environment, energy, and other natural resources	OEP
7.	January 24 (Tues.)	Small business	OIRA
[8.]	January 26 (Thurs.)	TBA	[]
9.	January 31 (Tues.)	Food and drugs, and consumer product safety	DPC/CEA (?)
10.	February 2 (Thurs.)	Health industry regulation	DPC
11.	February 7 (Tues.)	Workplace safety, education, and labor issues	DPC
12.	February 9 (Thurs.)	Equal employment opportunity	WH Counsel
13.	February 14 (Tues.)	Regulation of science, technology, and info.tech.	OSTP
[14.]	February 16 (Thurs.)	TBA	[]
15.	February 21 (Tues.)	Customer and info.tech. issues summary	OVP
[16.]	February 23 (Thurs.)	TBA	[]
[17.]	February 28 (Tues.)	TBA	[]
18.	March 1 (Wed.)	Reprise	[]

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GUIDING PRINCIPLES

WE WILL MOVE FROM GOOD INTENTIONS, TO GOOD REGULATIONS, by encouraging participation, by simplifying the process and the resulting regulations, and by adopting a new strategy to ensure that national interests are protected.

We will:

1. adopt a customer service orientation
2. seek input and involvement from all interested parties
3. fairly balance competing interests
4. consider whether direct federal involvement is necessary
5. use innovative approaches such as market mechanisms
6. use consensual decision making where possible
7. write regulations that are simple, clear and understandable
8. coordinate to avoid duplication and inconsistency
9. interpret and enforce regulations in a reasonable way
10. measure results to check our effectiveness

And we will take advantage of information technology everywhere we can to meet these goals.

E

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Guidance for Regulatory Policy Reviews

The Focus of the Policy Reviews. The Regulatory Policy Reviews will focus on alternative forms of regulation and alternatives to regulation. We are not trying to change the goals of regulation, such as increased worker safety, improved markets, or environmental restoration.

As guiding principles, we should consider (1) how our present goals can be furthered, using (2) regulatory or other actions that are less intrusive in the day-to-day activities of the public and private sectors. We should also (3) bring a customer service perspective* to regulatory activities.

Background and Scope of the Reviews. The term "regulation" covers a broad range of governmental activity, from the regulatory structure that evolved to create and protect the American aviation industry to the Consumer Product Safety Commission's mandate to put the striker surface on the back of matchbooks. Most laws are implemented through regulation, and most of these are not solely the province of the independent regulatory agencies, such as FTC, CFTC, SEC, FCC, etc. In fact, the term "regulation" is no more descriptive than the term "program" today.

Regulations are only one way government attempts to change behavior -- largely the behavior of organizations, especially businesses; individual behavior is more often channeled by civil and criminal law. Violators of regulations may incur civil penalties, however, just like defendants in civil law suits. Regulations may be used to mandate desired behavior based upon a variety of rationales, including (1) science, as in EPA's Clean Air Act Amendments; (2) good practice, as in OSHA's rules to minimize workplace accidents; (3) perceived market imperfections (the need for a "level playing field," hence the SEC's disclosure requirements for corporations).

Much regulation, however, is aimed not at business, but at state and local governments and third party service providers as part of creating systems through which all parties will act in concert to achieve mutual goals, often in the social services arena. While these regulations do impose costs on the intermediary parties, they are not the primary subject of the Regulatory Policy Reviews. The Reviews will be focused on regulations as they affect industry and commerce in America. Regulation that affects the private sector is often thought of as economic regulation on the one hand, and health and safety regulation on the other. The Policy Review will consider both economic and health and safety regulation.

* A customer perspective will require us to look at how we might increase the involvement of industries and individual plants with the Federal government, in both the development and enforcement of regulations. We must also look at how government and industry can create partnerships that lead to safer workplaces, a cleaner environment, etc. See "Customer Service in Regulation," below.

Outside the Box but On the Table. Bold new ideas on how better to achieve our goals are welcome from any source. As we look for alternatives to existing regulatory structures, however, it is highly probable that the new approaches will be found among known governmental interventions. These are the interventions that are "on the table." Proposing to change approaches to a constant goal is thinking "outside the box."

Worker safety example: For most of us, replacing a command and control approach to worker safety (OSHA) with an insurance approach now would be as unthinkable as supplementing an administrative law approach (workmans compensation) with a command and control approach when OSHA was created, or supplementing the civil law of negligence with workmans compensation when that was tried. Yet any of these four approaches (command and control, insurance, administrative law, or civil tort) may be the appropriate choice for reaching our goals today.

The Government's Tools. Government's means of changing societal outcomes include the police powers, the criminal law, the civil law, government ownership, command and control regulation (i. e., process requirements), insurance-based regulation, market-based incentives, regulation of market conditions, information dissemination, education, and the bully pulpit. Those that are relevant to the Regulatory Policy Review are arrayed in more detail in the Regulatory Options Outline (ROO) in this binder.

Look first at the ROO and its accompanying worksheet. The approaches are arrayed in decreasing order of intrusiveness. Try to fit a less intrusive approach to the regulatory goals and systems you are reviewing. Obviously, if the same goals can be achieved through a less intrusive approach, the goals and the approach will be greeted more warmly by all concerned. Similarly, an enforcement approach that does not require large numbers of Federal employees is more than welcome.

Four other factors are important to our regulatory review. Any new solutions must be constitutional, they must be politically acceptable, they must be administratively feasible, and they must be reliable. Confiscating a chemical plant for impermissible emissions is neither legally nor politically acceptable today, although confiscating a car used in a drug offense is. Inspecting each workplace only once in every 20 years is neither a feasible nor a reliable way to protect workers. These four factors change and evolve over time. The political climate, our experience with existing programs, and our basic knowledge are all different in 1994 from what they were in 1964, or in 1934.

A Closer Look (I). One way of analyzing a regulatory structure is to examine (1) the science used to determine the action required, (2) the standard developed to meet the goal established by the science, (3) the approach taken to achieve the standard, and (4) the enforcement practices used to monitor compliance with the approach, and trigger further action if needed. Obviously, standards can be

developed using good practice or the goal of more perfect markets as well as science.

- **Example: Asbestos.** For example, science has shown that asbestos causes lung damage and cancer (mesothelioma) in humans. Asbestos was banned except where no substitute was available, and standards of exposure were developed for its use and for its removal from buildings and ships. Detailed rules on the use, capture, and removal of asbestos were developed, and are enforced via workplace inspection as a part of a command and control regulatory approach.

Most of the debate about regulations centers on the approach taken and the resulting enforcement actions. Less attention is paid to the standards, and still less to the underlying science. Asbestos exposure could have been controlled by a set of voluntary industry standards or the creation of a specific civil action -- a tort -- to be enforced in the courts upon petition by an injured party. The underlying science remains unchallenged: Hippocrates noted that asbestos miners died young over 2000 years ago, and Dr. Kenneth Lynch linked asbestos to mesothelioma in 1938.

A Closer Look (II). A further level of analysis can aid the development of new solutions. Take the creation of a tort as an example of an intervention or approach. A tort assumes a standard of behavior. A tort also contains a price for a violation, a pricing system for risk (risk of being caught, risk of being found guilty), and a bounty system for enforcement -- the plaintiff's right of action and potential judgment.

Every viable approach must have (1) a clear standard that potential violators have access to, (2) a way of complying, (3) a reward or penalty structure, and (4) a means of enforcing the reward or penalty.

- **Example: Control Trading.** During the 1970's EPA created "control trading." If one firm can decrease a controlled emission from a plant to a level below a set standard, that firm can sell the "right to pollute" with that emission to another plant within a defined geographic territory. This regulatory concept offers an enormous advantage over a simple "command and control" structure. Under control trading, firms have an economic incentive to innovate, to finding newer, better, cheaper ways to reduce emissions. Simple command and control structures "freeze" whole industries into compliance with a static standard. Control trading offers a way of complying that includes incentives to innovate.

- **Example: Public Disclosure.** Several years ago EPA put out a regulation that distinguishes between a penalty for non-compliance with the regulation and a penalty for non-compliance with good environmental practice. Firms are required to publish a list of chemicals they release into the environment, by location. There is a penalty for non-compliance, of course, but the real penalty will be imposed by the neighbors or customers of the plant and firm in response to the published list.

Information Exchange. Of all the government approaches to effecting behavior change, command and control regulation is by far the most information intensive. Once having chosen to enforce detailed regulations directly, the government must provide great quantities of information about what is required, and must in turn inspect and report in detail the results of the inspections. A great deal of the friction between the government regulators and the industries that are regulated is exactly that: friction. Activity that is peripheral to the goals of regulation. Filling out forms does not provide clean air or a safe workplace. Filling out forms is just filling out forms, and it is expensive.

One overarching objective of the Regulatory Policy Review should be to gain recognition of the high costs of information exchange inherent in command and control regulation. Then, as in so many other areas, we need to bring the power of information technology to bear on minimizing the costs of the information exchange where it cannot be reduced. There are a number of efforts underway, both within government and without, to automate parts of this information exchange. They have been brought together for discussion by the National Performance Review's REGnet project. If properly integrated and implemented, they offer the potential for a "virtual department of regulation," or indeed a "virtual department of DuPont," parallel to the virtual departments of social services and of Mary Washington envisioned by the Vice President during the National Performance Review.

Consensual Development, Compliance, & Enforcement. We need to explore more consensual development, compliance, & enforcement of regulations. At the front end, we need to find ways to encourage collaboration between industry and government in the development of most regulatory schemas. These should include, but not be limited to, regulatory negotiation, or "reg-neg."

At the compliance and enforcement end, we must learn from the experience of other nations having a less confrontational relationship between government and industry; we should consider changing the models of compliance and enforcement. As James Q. Wilson says in *Bureaucracy*, "There was no clear relationship between how each nation [Great Britain, Germany, France, Japan, and America] managed its regulatory process and the laws it enforced or the results it achieved; the consensual European [and Japanese] administrative practices essentially served the same goals and produced the same outcomes as the adversarial American practices." (p. 297) Wilson also quotes the results of a study by Steven Kelman of America's OSHA and Sweden's Arbetskyddsverket (Worker Protection Board): "As far as Kelman could tell, the informal and cooperative Swedish system produced a level of compliance with safety and health rules that was as high or higher than that achieved by the formal and punitive American system." (p. 296)

The distinction between the two models is best captured in the distinction between a management consultant and an inspector general. It is much easier to be an inspector general: there are defined rules to be obeyed, and if we catch you violating them there will be hell to pay. A management consultant has far fewer

defined rules: the job is to increase the organization's efficiency and effectiveness, the health and safety of its employees, neighbors, and customers. A far different set of skills and a more extensive knowledge base are required for the management consultant role. We need to explore this model.

The Other Path. The alternative to a less confrontational model is the development of a more confrontational model, eventually absorbing all the trappings of the criminal justice system, and involving an ever-increasing number of lawyers. The courts adjudicating cases involving regulation are already pushing the regulatory system in this direction, and the "Citizens' Bill of Rights" in the Job Creation and Wage Enhancement Act (in the Contract with America) shows where this approach leads.

Customer Service in Regulation. The concept of "customers" in the regulatory environment may seem foreign. Information exchange and consensual development and enforcement, as outlined above, are examples of the customer service perspective. This orientation does not mean asking industry what needs to be regulated. It does, however, mean looking at the entire regulatory structure from the viewpoint of the "user" -- the regulated firm. It also means seeking input and involvement, ensuring consistency, using consensual decision making where possible, providing ready access to information, and measuring all effects of regulating. There are, of course, many customers to consider, including the affected industries, their employees and customers, and members of the public.

Regulation and Complex Systems. Lastly, we must be aware that whatever the past governmental approach to changing industry behavior, industry and other behavior will have been changed by it. Often the changes elicited have not been the changes anticipated. We do not regularly send out "regulation evaluators" to see what the unanticipated consequences of our actions are. We do know that regulation -- any government intervention -- changes the way "the system" works: not least in terms of generating opposition to what should be commonly held goals, such as safer workplaces, healthier Americans, and more perfect markets.

Be bold. Our task during the next few weeks is to propose and discuss many changes -- including radical changes -- in the ways America seeks to achieve our economic and health and safety goals. We have been challenged to look "outside the box" and "off the table" for the best alternatives. Later there will be time to weigh their relative advantages and disadvantages, their possible unintended consequences. We will need to consider what changes our new approaches might bring to the system.

Coda. Government is an artifact; it is designed by human beings. In the Regulatory Policy Reviews we are attempting to redesign government. The challenge and the responsibility are great, as is the need.

"We are as gods, and might as well get good at it." -- Stewart Brand (1968)

December 20, 1994

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WORKSHEET

ALTERNATIVE APPROACHES (From most to least intrusive)	CONSIDERATIONS			
	Advantages	Disadvantages	Resource needs	Compliance methods
1. Gov't ownership/mgmt.				
2. Command & Control				
3. Market-based incentives				
a. allocation of non-salable rights				
i. right-of-way authorizations				
ii. export restrictions				
iii. input requirements				
b. allocation of marketable rights				
i. controlled trading				
c. performance standards				
i. some flexibility in methods				
ii. full flexibility in methods				
d. negative economic incentives				
i. externality taxes (green fees)				
4. Insurance-based				
a. insurance requirements				
i. require particip. in gov't-run				
ii. require private insurance				
b. indemnity requirements				
i. bonding, escrow, rest. funds				
5. Voluntary self-regulation				
a. licensure boards				
b. non-governmental standards				
i. adopted & enforced by gov't				
ii. self-enforced by industry				
6. Common-law				
a. strict liability				
b. product liability				
c. negligence				
d. nuisance				
e. trespass				
7. Deregulation				
a. creating perfect competition				
i. antitrust regulations				
ii. disclosure reqs (education)				
b. devolution to states & locals				
c. total deregulation				
8. Positive incentives				
a. tax credits				
b. procurement				
c. loans & grants				
9. Privatization				

WORKSHEET INSTRUCTIONS

"Intelligent coordination between policy-making and enforcement is, of course, essential in the business of regulating industrial enterprise"

-- James M. Landis (adviser to President Kennedy on administrative reform, and Dean of Harvard Law School), *The Administrative Process* (1938).

Alternative approaches to regulation are arrayed in the worksheet in decreasing order of intrusiveness. The advantages and disadvantages of the different approaches will vary from sector to sector. Consider the relative merits of the various alternatives, and try to fit a less intrusive approach to the regulatory goals and systems that you are reviewing. Obviously, if the same goals can be achieved through a less intrusive approach, the goals and the approach will be treated more warmly by all concerned.

Similarly, an approach that does not require large numbers of Federal employees is more than welcome. For example, consider the differences between direct federal regulation, regulation through an intermediary (e.g., the stock exchange) and other forms of audited self-regulation. Identify the resource needs that various options might entail, including, for example, the question of whether the approach would require personnel with special training or professional skills (such as environmental auditors).

Also consider the compliance methods appropriate for various options. Historically, methods of ensuring compliance have included a range of civil penalties (e.g., license revocation, product seizure, injunctions, tripling damage claims), as well as criminal penalties. However, these penalties do not represent the full scope of possibilities -- in 1938, James Landis wrote of the "usefulness of mere publicity" as a means of directing behavior. Publicity is a tool that can serve as both a "carrot" or a "stick" (contrast the "Good Housekeeping Seal of Approval" with Nathaniel Hawthorne's "Scarlet Letter"). List new ideas in this column.

We do not claim that the spectrum of alternatives is all-inclusive; all ideas are encouraged and welcomed. The worksheet is only intended as a tool for organizing and ordering our thoughts as we fashion new and bold approaches.

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REGULATORY OPTIONS OUTLINE

I. Stephen Breyer, "Analyzing Regulatory Failure," *Harvard Law Review* (1979)

1. Regulated markets policed by antitrust
2. Disclosure regulation
like antitrust, helps achieve a more competitive market (e.g., print alcohol content on alcoholic beverage containers; might also require printing info. on environmental damage incurred in the production, disposal processes, in order to help inform consumer choice)
3. Taxes (e.g. -- excise taxes, or pollution taxes)
4. Market-based incentives or allocation
e.g. -- establish a limited number of rights to engaging in a particular activity (like airport landing slots), then allow these rights to be bought and sold on the free market ("though the system originated to deal with pollution, it might be used whenever it is desired to limit artificially the amount of a certain activity" -- Stephen Breyer, p. 582)
5. Bargaining (this is a process issue, relating to how a regulation is decided upon -- not the form of the final regulation; e.g. -- bargaining in the process of writing the regulation, tailoring rules to special needs in order to make the regulation sensible, voluntary compliance more likely)
6. Changes in liability rules
change tort laws in order to increase the risk of liability
7. Nationalization
eliminates the adversary relationship between regulator and firm (or so intended, e.g., as in old-style Eastern Europe)

II. Michael S. Baram, *Alternatives to Regulation* (1982)

1. Common-Law Alternatives
 - A. Negligence
 - B. Product Liability
 - C. Strict Liability
 - D. Nuisance
 - E. Trespass
2. Private, Voluntary Self-Regulation
 - A. Industrial Self-Regulation
 - B. Licensure and Certification
3. Insurance and other Compensatory Plans
 - A. Workers' Compensation
 - B. Government-subsidized Insurance
 - C. Bonding, Escrow, and Restoration Funds
4. Government Influence
 - A. Government Procurement
 - B. Government Information & Publicity
 - C. Advance Notice of Intent to Regulate

III. James M. Landis, Dean of Harvard Law School, *The Administrative Process* (1938)

1. Approaches

- A. Torts
- B. Licensing power; permits
- C. Standards
- D. "Government as a source of credit, as a source of supply, as a consumer"
(e.g., procurement, other positive incentives)
- E. Taxation
- F. Government ownership, management

2. Enforcement mechanisms

- A. Criminal penalty
- B. Civil penalty
- C. Resort to injunctive side of equity
- D. Tripling of damage claims
- E. Informer's share
- F. Publicity as a means of coercing action
- G. License as a condition of pursuing certain conduct
- H. Confiscation of offending property

IV. David Koplow, *Federal Energy Subsidies* (1993)

1. Tax Subsidies

- A. tax credits (allows proportion of expenditures to be deducted from taxes owed)
- B. reductions in the tax rate
 - i. activities exempt from taxation
 - ii. entities exempt from taxation
- C. reductions in the tax basis
 - i. timing
 - ii. amount
- D. altering the taxable entity
 - i. exceptions to general rules of taxation
 - ii. shifting profits in a vertically-integrated corporation

2. Federal agency activities

- A. federal grants
- B. loans, loan guarantees, and premium-financed insurance programs
- C. federal R&D
- D. federal market planning (strategic petrol. reserve)
- E. direct federal ownership of assets or of service operations (PMA's)
- F. administration and regulatory costs

3. Other interventions

- A. assumption of legal risks, indemnifications (Price-Anderson Act) -- as applied to regulations, includes implicit absorption of legal risks by allowing private operators to underaccrue for expected future events (underaccrual for nuclear decommissioning costs; cap on nuclear accident liability)

- B. changes in market. rules via price regulation, or restrictions on supply- or demand-side alternatives
 - i. price (old petrol. price controls)
 - ii. supply-side
 - (mkt intervention affecting the type, amount or timing of supplies via direct ownership of resources or production capacity, licensing and right-of-way authorizations, export restrictions, and requirements to use (or not use) certain production inputs [transmission and highway rights-of-way, Jones Act restrictions on foreign shipping vessels])
 - iii. demand-side
 - (import restrictions; required purchase of particular energy services import restrictions on oil and uranium)
- C. federal procurement of energy services for internal use
 - i. fed. procurement preference for alternative-fueled vehicles

V. Kenneth Meier, *Regulation: Politics, Bureaucracy & Economics* (1985)

- 1. Antitrust action
- 2. Command & Control mechanisms
- 3. Incentive systems
 - A. tax system
 - B. smokestack emission tax (A.C. Pigou, 1930s)
 - C. injury tax as alternative to OSHA safety regulation (Rob't Smith, 1974)
 - D. taxes on water pollutants (Dales, 1968)
 - E. EPA's bubble, offset, and bankable emissions policies (Hahn & Noll, 1982)
- 4. Nontax incentive systems
 - A. bargaining
 - B. information
 - i. product information
 - ii. insurance
 - iii. bonds
 - C. liability law
 - i. can work in worker safety cases, hazardous product cases, defective goods, environmental damage, etc.
 - D. private insurance
 - i. strict liability

VI. Domestic Council Group on Regulatory Reform, *The Challenge of Regulatory Reform: A Report to the President* (January 1977)

- 1. Government-run operations (direct services, e.g. hospitals to care for disabled veterans)
- 2. Positive incentives
 - A. direct financial assistance
 - B. tax credits and exemptions

- C. special credit treatment
- D. allocation of federal procurement
- 3. Assorted means
 - A. setting or approving prices, fares, profits, interest rates, or wages
 - B. awarding licenses, franchises, certificates or permits
 - C. establishing and enforcing standards of behavior such as worker safety rules, requirements for disclosure of financial information, and prohibitions of discrimination
 - D. control of market behavior
 - E. standards imposed on production processes
 - F. quality control standards
- 4. In some areas, gov't relies on private action (lawsuits) to enforce federal law (e.g. Robinson-Patnam Act -- antitrust)

VII. Lawrence White, *Reforming Regulation: Processes and Problems* (1981)

- 1. Gov't-run
- 2. Common law (regs. enforced by private action)
 - e.g. clearly define property rights in air and water to create openings for private litigation
- 3. Approaches that rely more on economic incentives
 - A. performance standards, not design standards
 - B. alternatives to direct controls and standards
 - C. charge effluent fees to polluters
 - D. auction off rights to produce pollutants
 - E. the fee (or taxation) approach "could be extended to other kinds of social regulation. Fee schedules could be used to encourage firms to achieve safer workplaces and safer products" (p. 42)

VIII. OECD, PUMA Public Management Occasional Papers, "Market-Type Mechanisms Series," No. 1 (Paris, 1992)

- 1. Traditional public delivery
- 2. Market-type mechanisms
 - A. voucher-like instruments in social policy fields
 - B. contracting out in information technology
 - C. non-price competition in and between hospitals
 - D. property rights modifications in the fisheries
 - E. internal markets in the provision of services to central administrations
 - F. tradeable rights in pollution control
- 3. Market-based Instruments
 - A. user charges
 - B. contracting out
 - C. vouchers and their equivalents
 - D. creation or modification of property rights

(e.g. -- in fisheries, environmental protection, and telecommunications)

- E. internal pricing
- F. inter-governmental contracts
- G. intra-governmental and non-price competition
- 4. Levels of government involvement
 - A. government service
 - B. government vending
 - C. intra-governmental agreement
 - D. contract
 - E. franchise
 - F. grant
 - G. voucher
 - H. market
 - I. voluntary
 - J. self-service
- 5. Complete privatization

IX. Michael Kellogg, *Regulation* article (1994)

- 1. Free market
- 2. Market-based
- 3. Command & Control

X. Pres. Carter's U.S. Reg. Council's "Inventory of Innovative Techniques" (1980)

- 1. Enhance Competition
 - achieve regulatory goal through increasing its sensitivity to market forces (e.g. removing barriers to competition)
- 2. Marketable Rights
 - A. in place of detailed government controls, agency limits private-sector rights to engage in a specific activity or to use scarce resources, and allows private parties to exchange, trade, or sell these rights (agency maintains overall control while allowing affected parties to arrange the allocation of rights in the free market); in the case of radio spectrum allocation, options might include: (p. 11)
 - i. free sale and transfer of allocations
 - ii. auction of spectrum assignments
 - iii. imposition of spectrum fees
 - B. marketable permits for CFC production (total permits based on total acceptable amount, based on atmospheric concentration calculations), in which producers receive permits initially either by allocation or by auction; *continuous incentive* to reduce emissions since they could sell any such reduction to other firms for profit (or, could produce more widgets) (p. 12)
 - C. if a geographic area does not meet air quality standards, do not disallow new plants; rather, allow new sources of air pollution to locate there *if* they pay or persuade existing sources of pollution to reduce their emissions -- a process of "controlled trading" (p. 14)

- D. urban demonstration grants to foster "controlled trading", other innovative approaches; such as Boston's "offset banking and trading" and Minneapolis' "emission-density zoning"; also, "redesigned industrial siting policies, emission offset information clearinghouses, unified permit systems" (p. 14)

3. Economic Incentives

the agency provides economic incentives that are supplements or alternatives to government standards and regulations by structuring fees or subsidies to encourage the private sector to achieve regulatory goals. Incentives replace rigidly enforced regulatory standards.

- A. "essential air service subsidy" concentrates on commuter carriers, as opposed to major carriers, since these planes are smaller and better suited (p. 13)
- B. simplify requirements and procedures for licensing applications of energy production methods that are environmentally "clean" (p. 13)
- C. "Offset Banking Permits, Controlled Trades Over Time"
companies which reduce emissions below the level required by law can "bank" such reductions for their own future expansion, or for selling to new sources in "offset transactions," or for cost-saving internal changes in pollution control under the "Bubble policy" (p. 16)
- D. incentives for companies to reduce oil and gas consumption: a trust fund, funded and administered primarily by industry, would be the source of grants and loans for companies to install energy-saving techniques, do energy audits with the fed. gov't sharing half the cost, and undertake R&D activities (p. 17)
- E. "Buy Quiet" program encourages gov't purchasing agencies to buy quieter products as such, create a market for these products w/out mandating the production of these products by law (p. 18)
- F. set fines for noncompliance equal to the amount saved by not complying, including capital, interest, operation and maintenance savings (pp. 19, 40)
- G. pricing -- Fed. Energy Regulatory Commission [FERC] programs aimed at achieving efficient allocation of natural gas when demand exceeds supply:
 - i. incremental price curtailment program which specifies that the high costs of new gas supplies be allocated to industrial users up to the price of alternative and more abundant fuels. (p. 20)

4. Performance Standards

the agency replaces design standards which specify strict means of compliance with more general standards based on overall performance levels. Firms or businesses are free to find the most efficient way of complying with the standards.

A. Concepts

- i. controlled trading
- ii. bubble concept

B. Examples

- i. EPA's consideration of flexibility for auto manufacturers to meet emissions standards
 - a) one requirement: all heavy-duty emissions for manufacturers remain at or below a specified fleet-wide average

- b) allow some heavy-duty vehicle engines to exceed mandated fleet averages, so long as the overall average is not exceeded for the entire heavy-duty fleet (gives manufacturers flexibility to adopt least-cost control strategies by reducing emissions more on engines where control is cheapest) (p. 23)
- ii. OSHA -- used to require fire extinguishers at specific heights and placements; now requires them to be accessible, but gives firms several ways of providing this accessibility (p. 23)
- iii. DOT -- permit manufacturers to accrue fuel-economy "credits" for a three-year period (either retroactively or in future models), permitting manufacturers to make engineering changes more efficiently without sacrificing ultimate gains in fuel economy -- gives the manufacturer the discretion to fall below the average if improvement would be excessively costly -- as long as other models exceed the required standards (p.24)
- iv. EPA application of "bubble concept" (one of a series of "controlled trading" steps designed to reduce pollution control costs while simulating technological innovation. allows existing sources of air pollution to propose alternative mixes of controls that would achieve the required emissions reductions at lower cost; firms have the flexibility to relax controls at emission points with high control costs, in exchange for extra controls on emission points with low control costs, so long as the overall impact on air quality remains the same (p. 24)

5. Information Disclosure

agency requires that users or consumers be provided with information necessary to help them make informed choices among competing goods and services and be free to choose on the basis of that information. The agency may provide information directly to the public

- A. Federal Trade Commission requires eye doctors to provide consumers with copies of their prescriptions, so that they may shop comparatively for glasses (p. 26)
- B. prohibitions against advertising by doctors (p. 26)
- C. requirements that doctors disclose financial interests in laboratories
- D. Truth-in-Lending program (Federal Reserve Board) which requires financial institutions to provide clear disclosure of credit terms to consumers
- E. Commodities Futures Trading Commission operates a toll-free consumer hotline with information on registration status and enforcement record of commodity professionals (p. 29)
- F. regulation by Bureau of Alcohol, Tobacco and Firearms requiring label on alcoholic beverage containers alerting the public to the risks of alcohol consumption by pregnant women (p. 30)

6. Voluntary Standard Setting

agency supplements or substitutes direct federal regulation with voluntary standards developed and enforced by the regulated sectors

- A. Examples

- i. NRC accepted voluntary standards in regulating medical use of radio isotopes (p. 32)
- ii. EPA encourages voluntary labeling of products emitting noise capable of adversely affecting public health (p. 33)
- iii. FDA involved in the development, support, endorsement, and use of voluntary performance standards for medical devices, while reserving the right to issue mandatory standards when necessary. Policy encourages manufacturers, voluntary standards organizations, and others to develop performance standards, which FDA then evaluates, and endorses those which are found to be adequate. (p. 33)
- iv. Consumer Product Safety Commission implemented voluntary approach to reduce furniture fires -- considered imposing a mandatory flammability standard, but industry pretested that it would add substantially to manufacturing costs; industry groups proposed a voluntary standard, which CPSC accepted, for one year, and monitored the less burdensome voluntary practice to ensure that the furniture met the safety standards.

7. Compliance Reform

agency replaces or supplements government compliance monitoring and enforcement with other mechanisms, such as third-party monitoring, supervised self-certification, and economically-based penalties.

A. Examples

- i. consistency in imposition of money penalties (27 federal departments and agencies can assess some 348 civil money penalties) (p. 36)
- ii. labor-management committees as alternative to on-site compliance inspections (OSHA examined) (p. 37)
- iii. self-inspections (FAA eliminated annual recertification requirement for exhibition, racing and amateur-built aircraft; certificates valid for 3 years, allows builders to perform their own "condition inspections" to determine whether they meet FAA certification standards (p. 37)
- iv. train employers and workers to identify safety and health hazards (OSHA) (p. 37)
- v. certification by third parties -- US Coast Guard permits inspection of pressure vessels by the American Society of Mechanical Engineers in place of USCG. (p. 38)
- vi. certification by local governments -- HUD certifies a local government's standards for residential subdivision construction; if the environmental criteria and construction standards are acceptable, HUD certifies the local jurisdiction so that subdivisions need not obtain environmental assessments or impact statements.

8. Tiering

The agency takes into account the size and nature of regulated organizations when it develops or revises its regulations

H

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Visions

Today, in Miami, importers are able to have their cargoes clear customs while their ships are still at sea, incoming passengers take less than five minutes to clear customs, customer satisfaction is high--and compliance levels are up. The Miami Customs team was able to do this by focusing on customer service, by exploiting information technology and by coordinating the activities of related agencies and departments.

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The day after tomorrow, information technology and multi-agency management teams will permit the ultimate in customer service--**The Virtual Department of [your name here]**. Intelligent interfaces will permit businesses and individuals to have point-and-click access to "their" government team--the regulators, benefit providers and information sources who are the assigned or appropriate points of contact for the myriad of government activities affecting them.

Mission

REGnet, a multi-agency reinvention lab, has been working to improve customer service in the regulatory arena through the use of new and emerging information and communication technologies. If supported as an administration initiative, REGnet can make government work better and cost less in the regulatory arena by:

1. Assisting agencies to exploit information technology to provide better customer service and easy access to regulatory information to all regulatory stakeholders--including businesses, local governments, federal regulators and the people.
2. Guiding the development of an "intelligent interface" to help locate, interpret and identify duplication and conflicts existing in current and proposed regulations.
3. Sponsoring or supporting inter-agency team-based efforts to streamline regulatory processes, reduce regulatory burdens and improve regulatory outcomes.
4. Facilitating communication among and between stakeholders in regulatory processes to assist in rule development, diffusion of innovation, and clarification of costs, requirements and opportunities.

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Regulation

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Volumes 1 through 8

**July/August 1977 through
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This index includes all articles, book reviews, perspectives (P), and readings (R) published to date in *Regulation* magazine. Articles and reviews are indexed by their authors and subjects. Perspectives and readings are indexed by subject only, with readings being listed by the title of the book or article summarized.

Please note that September/December 1984 was a double issue.

**SPECIAL
FEATURE**

CUMULATIVE INDEX

Abbott, Alden

"Missing the Boat on Export Trading Companies." N/D 82: 39-44

Adelman, Kenneth L.

"Biting the Hand That Cures Them." J/A 82: 16-18, 35

Advertising

- "Advertising and Free Speech," R. H. Coase. (R) J/F 78: 53
 "Advertising, Concentration, and Price-Cost Margins," A. D. Strickland and L. W. Weiss. (R) J/A 77: 46
 "Cost of Getting Nowhere at the FTC, The," B. Yandle. J/A 81: 43-47
 "Effects of FTC Advertising Regulation, The," S. Peltzman. (R) M/J 82: 52-54
Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry. R. S. Bond, J. E. Kwoka, Jr., J. J. Phelan, and I. T. Whitten. (R) J/A 80: 49-50
 "'Excess Gastric Acidity?'" (P) S/O 77: 4-5
 "FTC and Children's Advertising, The," (P) M/J 78: 5-6
 "FTC's Eyeglass Rule, The," (P) S/O 78: 9-11
 "FTC Tantrum against Children's Television, The," C. C. DeMuth. (R) J/A 79: 54-56
 "Grass-Roots Lobbying: Propaganda Non Grata," (P) M/J 81: 8-11
 "How Smoking Increased When TV Advertising of Cigarettes Was Banned," G. Doron. M/A 79: 49-52
Industrial Concentration and Advertising Intensity. S. I. Ornstein. (R) J/A 77: 46
 "'Junk' Telephone Calls," (P) S/O 78: 4-5
Political Economy of Advertising. The, D. G. Tuerck, ed. (R) J/A 78: 60-61
 "Truth vs. Provability at the FTC," (P) J/F 83: 4-6
 "Wages of Zealotry, The: The FTC under Siege," E. Gellhorn. J/F 80: 33-40

Aerospace Industry

"'Heavy Landing' for Canadair: A Tale of Industrial Policy," (P) S/D 84: 4-7

Age

- "Graying of Civil Rights Law, The: The Age Discrimination Act of 1975," P. H. Schuck. (R) M/J 80: 54-55
 "Putting the Skids to Meals on Wheels," M. Balzano. S/O 79: 52-54
 "Regulating Retirement," G. Horwich. M/J 78: 27-36
 See also Pensions and annuities

Agriculture

- "Apples and Aliens: Growers Challenge Feds over Who Does the Picking," E. Cowan. N/D 78: 40-45
 "Canada's Chicken-and-Egg Problem: The High Cost of Price and Output Controls," P. K. Gorecki. M/A 82: 28-36
 "Cost of the U.S. Dairy Price Support Program: 1949-1974, The," D. Heien. (R) S/O 77: 47
 "Dispatch from the Nut Wars," (P) J/F 82: 8-10
Federal Milk Marketing Orders and Price Supports. P. W. MacAvoy, ed. (R) M/J 78: 54
 "Garden of Earthly Toxics, A," (P) N/D 83: 5-7
 "Gasohol Hangover, The," (P) N/D 81: 12-14
 "Give Us This Day . . .," W. D. Reekie. (R) S/O 78: 61-62
 "If You Believe in Peanut Butter, Read This," (P) N/D 78: 5-7
 "Impact of Rail Deregulation on the Movement of Fresh Fruit and Vegetables, The," H. W. German and M. W. Babcock. (R) M/J 83: 43-44
 "Reconstituted Threat to the Milk Cartel, A," (P) M/J 83: 5-7
 ". . . and Saving the Country," (P) S/O 81: 11-13
 "Sugar Quotas: A Guide for the Economically Perplexed," (P) J/A 82: 4-6
 "Urbanization of Agricultural Land, The: A Review of the National Agricultural Lands Study," W. A. Fischel. (R) J/A 82: 50-51

Airlines

- "Advice for the President-Elect: Aviation Regulatory Policy," J. C. Miller III. N/D 80: 32-33
 "Airline Competition and the Slot Market," (P) S/O 82: 8-10
 "Airline Deregulation IS Working," D. R. Graham and D. P. Kaplan. M/J 82: 26-32
Airline Deregulation—The Early Experience. J. R. Meyer, C. V. Oster, I. P. Morgan, B. A. Berman, and D. L. Strassmann. (R) S/O 81: 53-54
 "Airline Productivity under Deregulation," D. W. Caves, L. R. Christensen, and M. W. Tretheway. N/D 82: 25-28

Airport Access Problems: Lessons Learned from Slot Regulation by the FAA: An Economic Policy Analysis. D. Koran and J. D. Ogur. (R) N/D 83: 52-53

- "Antitrust and Travel Agents: Immunity with Reservations?" (P) J/A 82: 8-10
 "Applying Economics to an Imperfect World," A. E. Kahn. N/D 78: 17-27
 "Bermuda II: A Footnote," (P) M/J 78: 13
 "CAB + ICC + FMC = NTC?" (P) M/J 83: 10-11, 50
 "CAB, the Congress, and Competition for the Airlines, The," (P) J/A 78: 15-16
 "Carter Administration Stumbles at Bermuda," J. W. Barnum. J/F 78: 18-30
 "Charges to Control Aircraft Noise," D. C. Cell. (R) J/A 82: 53-54
 "Competition in the Airlines," E. M. Kennedy, A. V. Casey, M. L. Muse, E. I. Colodny, and J. E. Robson. N/D 77: 24-35
 "Deregulating Transportation," T. G. Moore. M/A 78: 37-44
 "Issues in Airline Regulatory Reform," (P) J/A 77: 3
 "Legislative History Reconsidered," (P) S/O 80: 10-12
 "Presidents and International Aviation," J. W. Barnum. M/J 78: 43-44
 "Regulation—The First Year: Transportation," T. G. Moore. J/F 82: 27-29
 "Reforming International Airline Regulation," (P) N/D 79: 7-10
Regulatory Reform in Air Cargo Transportation. L. S. Keyes. (R) J/A 80: 48-49
 "Report on Harbridge House Survey of the Impact of Transportation Deregulation on Major U.S. Manufacturing Firms," (R) M/A 82: 52
 "Should Consumers Pay for Lobbying Expenses?" (P) J/F 78: 7-8
Transition to a Free Market: Deregulation of the Air Cargo Industry. A. S. Carron. (R) M/A 82: 51-52
Transportation Policy: Regulation, Competition, and the Public Interest. K. M. Ruppenthal and W. T. Stanbury, eds. (R) M/J 78: 52-54
 "What Makes Reform Happen?" R. G. Noll and B. M. Owen. M/A 83: 19-24

Air pollution

- "Acid Test for Congress, An," R. W. Crandall. S/D 84: 21-28
 "Advice for the President-Elect: Auto Regulation," W. A. Niskanen. N/D 80: 24-27
Air Pollution and Human Health. L. B. Lave and E. P. Seskin. (R) M/J 79: 63-64
 "Beyond the New Deal: Coal and the Clean Air Act," B. A. Ackerman and W. T. Hassler. (R) M/A 81: 51-53
 "Blowing Bubbles at EPA," (P) M/A 79: 5-6
 "Bubbles and Efficiency: Cleaner Air at Lower Cost," M. T. Maloney and B. Yandle. M/J 80: 49-52
 "Bubble Upheld, The," (P) M/J 84: 5-7
Controlling Industrial Pollution: The Economics and Politics of Clean Air. R. W. Crandall. (R) J/F 84: 41-42
 "Diesel Automobiles: A Mixed Blessing?" (P) M/J 80: 13-14, 52
 "Direct Federal Regulation of Stationary Sources under the Clean Air Act," D. P. Currie. (R) M/A 81: 53-54
 "Economic Impacts of Environmental Regulations on the U.S. Copper Industry, The," R. S. Hartman, K. Bozdogan, and R. M. Nadkarni. (R) S/O 80: 54
 "Emerging Market in Air Pollution Rights, The," B. Yandle. J/A 78: 21-29
Health and Air Quality: Evaluating the Effects of Policy. P. E. Graves and R. J. Krumm. (R) S/O 81: 55
 "How Not to Create a Job," P. R. Portney. N/D 82: 35-38
 "I Ching of Acid Rain, The," P. Huber. S/D 84: 15-20, 56-65
 "Making Ready for the Clean Air Act," D. Harrison, Jr., and P. R. Portney. M/A 81: 24-31
 "On a Clear Day You Could Pay Forever," (P) M/A 81: 12-13
 "Ozone Depletion Revisited—EPA Regulation of Chlorofluorocarbons," R. L. Rabin. M/A 81: 32-38
Regulation and the Courts: The Case of the Clean Air Act. R. S. Melnick. (R) J/F 84: 42-44
Regulation of Air Pollutant Emissions from Motor Vehicles, The. L. J. White. (R) M/A 83: 46-47

Air Traffic Control

- "Close Encounters in the Skies: A Paradox of Regulatory Incentives," M. E. Staten and J. R. Umbeck. M/A 83: 25-31
 "Public Employee Strikes, Executive Discretion, and the Air Traffic Controllers," B. D. Meltzer and C. R. Sunstein. (R) N/D 83: 50-52

Alexander, Herbert E.

"Public Financing of Congressional Campaigns" J/F 80: 27-32

- "How Liberal Are Bureaucrats?" S. Rothman and S. R. Lichter. N/D 83: 16-22
 "Invisible Bureaucracy." (P) J/F 80: 5-6
Red Tape: Its Origins, Uses, and Abuses, H. Kaufman. (R) N/D 77: 40-41
Report of the Commission on Federal Paperwork, F. Horton, Chm. (R) J/F 78: 52-53

Buses: see Transportation

Business and Industry

- "Analysis of the Effect of State Acquisition Laws on Managerial Efficiency, An: The Case of the Bank Holding Company Acquisitions," C. James. (R) M/J 84: 47
Business, Government, and the Public, M. L. Weidenbaum. (R) M/A 78: 48-49
 "Capitalism and the Intellectuals," R. Nisbet (review of P. Johnson, *The Enemies of Society*). N/D 77: 38-39
 "Causes of Increased Competition in the U.S. Economy, 1939-1980," W. G. Shepherd. (R) M/A 83: 45-46
 "Counting the Costs: The Business Roundtable Study," M. H. Kusters. J/A 79: 17-19, 22-25
 "Dubious Bill of Divorcement, A: The Case of Oil Refiners and Gas Stations," J. Barron and J. R. Umbeck. J/F 83: 29-33
 "Economic Effects of Federal and State Regulations of Cash Tender Offers, The," G. A. Jarrell and M. Bradley. (R) M/A 81: 54-56
 "Effects of Selected Changes in the Institutional and Human Environment upon Output per Unit of Input," E. F. Denison. (R) M/J 78: 47-48
 "Enterprise Zones: The New Fluoride for Urban Decay." (P) S/O 80: 4-6
 "Foreign Investors under Fire." (P) M/A 82: 5-7
 "Frustrating Business Mobility," R. B. McKenzie. M/J 80: 32-38
Future of Business Regulation, The, M. L. Weidenbaum. (R) S/O 79: 55
 "Giving Minorities the Business." (P) J/A 79: 12-13
Government and the Corporation, R. K. Winter. (R) M/J 79: 57-58
Government Controls and the Public Interest: An International Survey of Business Opinion and Experience, M. Duerr and J. Greene. (R) S/O 77: 43
 "How's Business: What the Public Thinks," S. M. Lipset and W. Schneider. (R) N/D 78: 56-57
Impact of Tax and Financial Regulatory Policies on Industrial Innovation, The, J. J. Cordes. (R) S/O 80: 49-50
In Defense of the Corporation, R. Hessen. (R) S/O 79: 59-60
 "Large Changes for Small Business." (P) N/D 79: 11-14
 "Myth of De-industrialization, The," W. H. Branson. S/O 83: 24-29, 53-54
 "Note on the Optimal Investment Policy of the Regulated Firm, A," D. Peterson and J. Vander Weide. (R) J/A 77: 44
 "On the Corporate Democracy Act," articles by M. Green, M. L. Weidenbaum, and R. K. Winter. M/J 80: 20-31
 "On the Neoliberal Frontier: A Review of Robert Reich's *The Next American Frontier*," W. Kristol. M/J 83: 38-40
 "Overseas Ethics, Four Years Later." (P) J/A 81: 11-12, 59
 "Public Policy toward Bankruptcy: Me-First and Other Priority Rules," M. J. White. (R) M/A 81: 56-57
Regulating Business: The Search for an Optimum, Institute for Contemporary Studies. (R) S/O 78: 62-63
Small Business Performance in the Regulated Economy, K. W. Chilton and M. L. Weidenbaum. (R) M/J 80: 55-56
 "Social Performance Index and Corporate Responsibility, The." (P) S/O 78: 7-8
 "Standards and Industry Self-Regulation," E. S. Rosenberg. (R) S/O 77: 47-48
 "State Taxes and Federal Dilemmas." (P) M/J 82: 10-12, 38
 "Theory of Competition, A," G. W. Nutter and J. H. Moore. (R) J/A 77: 42
 "Theory of Expropriation and Deviations from Perfect Capital Mobility, A," J. Eaton and M. Gersovitz. (R) S/D 84: 71-72
Two Cheers for Capitalism, I. Kristol. (R) S/O 78: 58-59
 "Two Lies Are Better Than One." (P) M/J 80: 9-10
 "What We Did: The Business Roundtable Study," M. E. Simon. J/A 79: 20-21
 See also Antitrust; Campaigns and elections; Nationalization; Regulation, international

Butters, Gerard

- "Defending Cost-Benefit Analysis: Replies to Steven Kelman" (with J. Calfee and P. Ippolito). M/A 81: 41-42

Calfee, John

- "Defending Cost-Benefit Analysis: Replies to Steven Kelman" (with G. Butters and P. Ippolito). M/A 81: 41-42

Campaigns and elections

- "Conference on the Parties and the Nominating Process, A," in *Commonsense*. (R) M/J 82: 55-56
 "Does Campaign Spending Really Matter?" L. Shepard. (R) M/J 78: 48-49
 "Economic Theory of Regulation and Public Financing of Presidential Elections, The," B. A. Abrams and R. F. Settle. (R) J/A 78: 56
 "Federal Election Commission, The: A Rebuttal," J. G. Murphy, Jr. S/O 78: 42-51
 "Government Astride the Political Process: The Federal Election Commission," J. R. Bolton. J/A 78: 46-55
 "Irony of Electoral Reform, An: The Business PAC Phenomenon," E. M. Epstein. M/J 79: 35-41
 "Neither a Mountain Nor a Molehill: The Business PAC Phenomenon," M. J. Malbin. M/J 79: 41-43
 "Public Financing of Congressional Campaigns," H. E. Alexander. J/F 80: 27-32
 "Reflections on the Election Commission: An Interview with Neil O. Staebler," N. J. Muller. M/A 79: 33-38
 "Reply," (to "The Federal Election Commission: A Rebuttal"), J. R. Bolton. S/O 78: 48-49
 "What Should Be Done about Independent Campaign Expenditures?" M. J. Malbin. J/F 82: 41-46

Canada

- "Canada's Chicken-and-Egg Problem: The High Cost of Price and Output Controls," P. K. Gorecki. M/A 82: 28-36
Compensation for Pollution Damage. (R) M/A 82: 54-55
Crown Corporations in Canada: The Calculus of Instrument Choice, J. R. S. Prichard, ed. (R) S/D 84: 72-73

Correction

In "Readings," September/December 1984, the title of J. R. S. Prichard's anthology was misstated. The correct title is as listed above.

- "Foreign Investors under Fire." (P) M/A 82: 5-7
 "Heavy Landing for Canadair: A Tale of Industrial Policy." (P) S/D 84: 4-7
 "High Cost of Regulating U.S. Railroads, The," D. W. Caves, L. R. Christensen, and J. A. Swanson. J/F 81: 41-46
National Health Insurance in Ontario—The Effects of a Policy of Cost Control, W. S. Comanor. (R) J/A 80: 42-43
Railway Pricing under Commercial Freedom: The Canadian Experience, T. D. Heaven and J. C. Nelson. (R) M/J 78: 50-51
Regulatory Reform in Canada, W. T. Stanbury and F. Thompson. (R) J/A 83: 58-59
Transportation Rates and Economic Development in Northern Ontario, N. C. Bonsor. (R) S/O 77: 41-42
 "UNESCO of the North: The Coming of Press Regulation in Canada," M. Laws. S/O 83: 37-42
 "U.S.-Canadian Railroads: Bordering on Frustration." (P) J/A 83: 12-13, 52
 "Wage Controls in Canada," A. M. Maslove and G. Swimmer. J/F 79: 31-36

Cancer

- "Batting Carcinogens Systematically: New Strategies at OSHA and CPSC." (P) J/F 79: 7-9
 "Benzene and Worker Health." (P) N/D 77: 7-9
 "Cancer and Ideology: A Review of Edith Efron's *The Apocalypitics: Politics, Science, and the Big Cancer Lie*," R. Nisbet. M/A 84: 41-44
 "Contribution of the Environment to Cancer Incidence: An Epidemiologic Exercise," E. L. Wynder and G. B. Gori. (R) S/O 77: 45-46
 "EDB and the Marigold Option," W. R. Havender. J/F 84: 13-17
 "Environment, Health, and Economics—The Case of Cancer," A. V. Kneese and W. D. Schulze. (R) J/F 78: 51-52
Food Safety Policy: Scientific and Social Considerations, Committee for a Study on Saccharin and Food Safety Policy. (R) M/J 79: 61-62
 "Food Safety: Revising the Statute," D. A. Kessler. (R) M/J 84: 45-46
 "Garden of Earthly Toxics, A." (P) N/D 83: 5-7
 "Hair Dyes, Cancer, and the FDA." (P) M/A 78: 5-6
 "How Smoking Increased When TV Advertising of Cigarettes Was Banned," G. Doron. M/A 79: 49-52
 "Lactile: A Forbidden Fruit." (P) J/F 78: 9-11

CUMULATIVE INDEX

- "Perils of Risk Avoidance, The," P. Johnson. M/J 80: 15-19
 "Politicians Make Bad Scientists: A Review of Richard Doll and Richard Peto's 'Causes of Cancer,'" W. Havender. N/D 81: 46-48
 "Regulating Cancer—Fast, Fast, Fast Relief!" (P) M/A 80: 4-7
 "Revision without Revolution in Carcinogen Policy." (P) J/A 84: 5-7
 "Ruminations on a Rat: Saccharin and Human Risk," W. R. Havender. M/A 79: 17-24
 "Saccharin and the Public Interest." (P) J/A 77: 10-11
 "Tighter Standards for Drinking Water." (P) M/A 78: 9-10
 "Tris and Children's Sleepwear: A Two-Edged Sword." (P) S/O 77: 5-6
- Carlson, Allan C.**
 "Regulators and Religion: Caesar's Revenge." M/J 79: 27-34, 64
- Casey, Albert V.**
 "Competition in the Airlines" (with E. I. Colodny, E. M. Kennedy, M. L. Muse, and J. E. Robson). N/D 77: 24-35
- Caves, Douglas W.**
 "Airline Productivity under Deregulation" (with L. R. Christensen and M. W. Tretheway). N/D 82: 25-28
 "High Cost of Regulating U.S. Railroads, The" (with L. R. Christensen and J. A. Swanson). J/F 81: 41-46
- Censorship:** see First Amendment
- Cervero, Robert**
 "Revitalizing Urban Transit—More Money or Less Regulation?" M/J 84: 36-42
- Charitable organizations**
 "Charitable Giving and 'Excessive' Fundraising," S. Rose-Ackerman. (R) N/D 82: 50-51
 "Charity War in Washington." (P) N/D 82: 11-14
- Christensen, Laurits R.**
 "Airline Productivity under Deregulation" (with D. W. Caves and M. W. Tretheway). N/D 82: 25-28
 "High Cost of Regulating U.S. Railroads, The" (with D. W. Caves and J. A. Swanson). J/F 81: 41-46
- Chrysler Corp.:** see Autos and auto industry
- Civil Aeronautics Board:** see Airlines
- Civil rights**
 "Academic Freedom Misapplied." (P) S/O 80: 6-7
 "Affirmative Action after *Teal*: A New Twist or a Turn of the Screw?" M. W. McConnell. M/A 83: 38-44
 "Bilingual Education: The New Accent in Civil Rights Regulation." (P) N/D 80: 5-8
 "Bob Jones University v. United States: Public Policy in Search of Tax Policy." P. B. Stephan III. (R) J/A 84: 50-51
 "Building Access: Cost No Barrier?" (P) S/O 82: 5-8
 "... But Not Everywhere: Hew-ing at Hillsdale." (P) J/F 79: 11-12
 "Captive of the Court: A Federal Agency in Receivership," J. Rabkin. M/J 84: 16-26
 "Constitutional Litigation for Fun and Profit." (P) J/A 80: 9-10
 "Democracy and Due Process: The Case of Handicapped Education," J. E. Haynes. N/D 82: 29-34
 "Department of Anticipated Consequences." (P) J/F 81: 6-8
 "Dress Codes and Sports: HEW Applies Some 'Common Sense' ..." (P) J/F 79: 10-11
 "Dress Codes Decontrolled." (P) S/O 82: 12-13, 26
 "Exploitation in the Jim Crow South: The Market or the Law?" J. Roback. S/D 84: 37-43
 "From Bad to Comparable Worth," C. Krauthammer. J/A 84: 31-34
 "Graying of Civil Rights Law, The: The Age Discrimination Act of 1975," P. H. Schuck. (R) M/J 80: 54-55
 "Locking the Rascals In." (P) M/J 81: 4-5
 "Mount Laurel II: State Courts Rush In ..." (P) M/A 83: 6-8
 "Multiple Regression in Legal Proceedings," F. M. Fisher, and "Judicial Reception of Multiple Regression Studies in Race and Sex Discrimination Cases, The," M. O. Finkelstein. (R) J/F 81: 52
 "Private Schools, Tax Exemption, and the IRS" (P) J/F 82: 5-8
 "Race, Ratchets, Redistricting, and the Voting Rights Act." (P) J/A 84: 11-13, 38
 "Racial Reasoning in Unfree Markets: Preference, Prejudice, and Difference," W. E. Williams. M/A 79: 39-48
- Reasoning about Discrimination: The Analysis of Professional and Executive Work in Federal Antibias Programs*, R. A. Lester. (R) M/J 81: 53-54
 "Regulators and Religion: Caesar's Revenge," A. C. Carlson. M/J 79: 27-34, 64
 "Sears Catalog of Litigation, The." (P) M/A 79: 6-9
 "Sex Discrimination in Employer-Sponsored Insurance Plans: A Legal and Demographic Analysis," L. Brilmayer, R. W. Hekeler, D. Laycock, and T. A. Sullivan. (R) J/F 81: 49-50
 "Stroke of a Pen, The," J. Rabkin. M/J 81: 15-18
See also Bakke case
- Civil service**
 "Locking the Rascals In." (P) M/J 81: 4-5
 "Revamping the Civil Service." (P) M/J 78: 10-11
- Clark, Timothy B.**
 "Regulation Gone Amok—How Many Billions for Wheelchair Transit?" M/A 80: 47-52
- Clarkson, Kenneth W.**
 "Regulating Chrysler Out of Business?" (with C. W. Kadlec and A. B. Laffer). S/O 79: 44-49
- Claybrook, Joan**
 "Crying Wolf." N/D 78: 14-16
- Clean Air Act**
 "How Not to Create a Job," P. R. Portney. N/D 82: 35-38
 "Reagulation—The First Year: The Environment," R. W. Crandall. J/F 82: 29-32
See also Environment
- Coal**
 "Acid Test for Congress, An," R. W. Crandall. S/D 84: 21-28
 "Bottomless Pit for Federal Coal Revenues. A?" (P) J/F 84: 7-10
 "Coal Leasing Scandals, The." (P) M/A 84: 5-9
 "Energy Independence Down the Tube?" (P) S/O 80: 7-10
 "Hobbling Coal—Or How to Serve Two Masters Poorly," R. L. Gordon. J/A 78: 36-45
 "How Not to Create a Job," P. R. Portney. N/D 82: 35-38
 "I Ching of Acid Rain, The," P. Huber. S/D 84: 15-20, 56-65
Making of Federal Coal Policy, The, R. H. Nelson. (R) S/D 84: 67-68
 "Politics and Economics of Senate Voting on Coal Strip Mining Policy, The," J. P. Kalt and M. A. Zupan. (R) N/D 83: 49-50
 "Safety Regulation and Firm Size: Effects of the Coal Mine Health and Safety Act of 1969," G. R. Neumann and J. P. Nelson. (R) J/F 83: 46-48
 "Undue Diligence—The Mine-It-or-Lose-It Rule for Federal Coal," R. H. Nelson. J/F 83: 34-38
See also Energy, Mining
- Coase, Ronald H.**
 "George J. Stigler: An Appreciation." N/D 82: 21-24
- Cohen, Robert L.**
 "Nuclear Power—The Decision Makers Speak" (with S. R. Lichter). M/A 83: 32-37
- Collier, Calvin J.**
 "Republican Looks at the Democratic Platform, A." S/O 80: 15-18
- Colodny, Edwin I.**
 "Competition in the Airlines" (with A. V. Casey, E. M. Kennedy, M. L. Muse, and J. E. Robson). N/D 77: 24-35
- Comanor, William S.**
 "Health Manpower and Government Planning." M/J 81: 47-49
- Commerce Department**
 "Missing the Boat on Export Trading Companies," A. Abbott. N/D 82: 39-44
- Consent decrees:** see Law and legal issues
- Consumer Product Safety Commission:** see Product safety and liability

Copyright and patents

- "Betamax Goes Free." (P) J/F 84: 10-12
 "Less Paperwork for Generic Drugs?" (P) M/J 81: 5-7
 "Making Cable TV Pay? The Copyright Controversy." H. Geller. M/J 81: 35-39, 58
 "Software Piracy and the Law." (P) N/D 83: 12-15

Cornell, Nina W.

- "Rate-of-Return Regulation: Protecting Whom from What?" N/D 80: 36-41, 49
 "Toward Competition in Phone Service: A Legacy of Regulatory Failure" (with S. R. Brenner and M. D. Felcovits). J/A 83: 37-42

Corporate Democracy Act

- "Frustrating Business Mobility." R. B. McKenzie. M/J 80: 32-38
 "On the Corporate Democracy Act," articles by M. Green, M. L. Weidenbaum, and P. K. Winter. M/J 80: 20-31

Costs and benefits, general regulatory

- "Advice for the President-Elect: Reforming Government Regulation." M. L. Weidenbaum. N/D 80: 15-18
 "Benefit-Cost Analyses of Social Regulation." J. C. Miller and B. Yandle. (R) S/O 79: 55-56
Benefits of Health and Safety Regulation. The, A. R. Ferguson and E. P. LeVeen, eds. (R) J/F 82: 48
 "Bureaucrats and the Cost-Benefit Chameleon." G. D. Nager. S/O 82: 37-42
 "Constraining Regulatory Costs—Part I: The White House Review Programs; Part II: The Regulatory Budget." C. C. DeMuth. J/F 80: 13-26; M/A 80: 29-39, 42-44
 "Cost-Benefit Analysis—An Ethical Critique." S. Kelman. J/F 81: 33-40
 "Cotton Dust Case, The." (P) J/F 81: 5-6
 "(Cotton) Dust Settles, The." (P) J/A 81: 4-6
 "Counting the Costs: The Business Roundtable Study." M. H. Kusters. J/A 79: 17-19, 22-25
 "Defending Cost-Benefit Analysis: Replies to Steven Kelman." J. V. DeLong, R. M. Solow, G. Butters, J. Calfee, P. Ippolito, and R. A. Nisbet. M/A 81: 39-43
Economic Effects of Government-Mandated Costs, R. F. Lanzillotti, ed. (R) J/A 79: 59
 "Effects of Selected Changes in the Institutional and Human Environment upon Output per Unit of Input." E. F. Denison. (R) M/J 78: 47-48
 "Enforcement Costs in Environmental and Safety Regulation." R. N. McKean. (R) M/A 81: 58-59
 "Fuel Efficiency by Government Mandate: A Cost-Benefit Analysis." B. Yandle. (R) N/D 80: 60-61
 "How Large and Small Plants Fare under Environmental Regulation." B. P. Pashigian. S/O 83: 19-23
Incentives for Environmental Protection, T. C. Schelling, ed. (R) S/O 83: 49-50
 "Inhaber and the Limits of Cost-Benefit Analysis." S. Weaver. J/A 79: 14-16
 "Legislative Boost for Risk Assessment, A?" (P) M/J 84: 10-12
 "Market for Risk, The." P. Huber. M/A 84: 33-39
 "New Federal Budget Calls for More Regulators." (P) M/A 78: 6-7
 "On Estimating Regulatory Costs." M. L. Weidenbaum. M/J 78: 14-17
 "Perils of Risk Avoidance, The." P. Johnson. M/J 80: 15-19
 "Protecting Workers' Hearing: An Economic Test for OSHA Initiatives." J. C. Miller III and T. F. Walton. S/O 80: 31-37
 "Protection at Any Price?" M. Munger and M. L. Weidenbaum. J/A 83: 14-18
 "Reagan Record, The: A Strategy for Regulatory Reform." C. C. DeMuth. M/A 84: 25-30
 "Reagulation—The First Year: Health and Safety." W. K. Viscusi. J/F 82: 34-36
 "Reagulation—The First Year: Regulatory Review and Management." A. Scalia. J/F 82: 19-21
Reducing Risks to Life: Measurement of the Benefits, M. J. Bailey (R) M/J 80: 57
Regulated Industries and the Economy, The, P. W. MacAvoy. (R) J/A 80: 43, 46-48
 "Regulatory Calendar, R.I.P.?" (P) M/A 82: 7-9
 "Regulatory Calendar, The: A Catalog without Prices." (P) J/F 80: 3-5
Risk/Benefit Analysis, R. Wilson and E. Crouch. (R) S/O 82: 48-49
Risk by Choice, W. K. Viscusi. (R) M/J 83: 42-43
 "Study of the Regulatory Impact of the Medical Device Amendments,

- A: A Survey of Medical Device Manufacturers," Louis Harris and Associates. (R) M/A 83: 50-51
 "Survey of the Mortgage Banking Industry Concerning Costs and Benefits of Regulations, A," Louis Harris and Associates. (R) J/A 83: 54-55
 "Truth in Regulatory Budgeting." L. J. White. M/A 80: 44-46
 "What We Did: The Business Roundtable Study." M. E. Simon. J/A 79: 20-21

Cotton dust: see Occupational safety and health

Courts: see *Bakke* case; Law and legal issues

Cowan, Edward

- "Apples and Aliens: Growers Challenge Feds over Who Does the Picking." N/D 78: 40-45

Crandall, Robert W.

- "Acid Test for Congress, An." S/D 84: 21-28
 "Advice for the President-Elect: Environmental Protection Agency." N/D 80: 20-22
 "Has Reagan Dropped the Ball?" S/O 81: 15-18
 "Reagulation—The First Year: The Environment." J/F 82: 29-32
 "Regulation of Television Broadcasting." J/F 78: 31-39
 "Steel Imports—Dumping or Competition?" J/A 80: 17-24

Daly, John C.

- "Competition in the Airlines." N/D 77: 24-35

Davidson, Michael

- "After the Legislative Veto: Reflections from the Losing Side." J/A 83: 23-26

DeLong, James V.

- "Defending Cost-Benefit Analysis: Replies to Steven Kelman." M/A 81: 39-40
 "How to Convince an Agency: A Handbook for Policy Advocates." S/O 82: 27-36
 "Repealing Rules." M/J 83: 26-30

Democratic party

- "Republican Looks at the Democratic Platform, A." C. J. Collier. S/O 80: 15-18

DeMuth, Christopher C.

- "Constraining Regulatory Costs—Part I: The White House Review Programs; Part II: The Regulatory Budget." J/F 80: 13-26; M/A 80: 29-39, 42-44
 "Reagan Record, The: A Strategy for Regulatory Reform." M/A 84: 25-30
 "Strong Beginning on Reform, A." J/F 82: 15-18

Deregulation

- "Achieving Deregulation—A Public Choice Perspective." G. Tullock. N/D 78: 50-54
 "Active Judges and Passive Restraints." (P) J/A 82: 10-15
 "Airline Deregulation IS Working." D. R. Graham and D. P. Kaplan. M/J 82: 26-32
Airline Deregulation—The Early Experience, J. R. Meyer, C. V. Oster, I. P. Morgan, B. A. Berman, and D. L. Strassmann. (R) S/O 81: 53-54
 "Airline Productivity under Deregulation." D. W. Caves, L. R. Christensen, and M. W. Tretheway. N/D 82: 25-28
Alternatives to Regulation: Managing Risks to Health, Safety and the Environment, M. S. Baram. (R) M/A 82: 53
 "Banking on Deregulation?" (P) J/A 79: 7-8
 "Boxcar Decontrol: No Empty Gesture." (P) S/O 83: 8-11
 "Charter for Bus Reform, A." (P) J/A 82: 6-8
 "Competition and Health Care: Planning for Deregulation." C. C. Havighurst and G. M. Hackbarth. M/J 80: 39-43, 46-48
 "Deregulating Telecommunications." S. M. Besen. M/A 78: 30-36
 "Deregulating Transportation." T. G. Moore. M/A 78: 37-44
 "Deregulation—A Green Light for Trucking Efficiency." R. E. Mabley and W. D. Strack. J/A 82: 36-42, 56
 "Deregulation—Is It Happening in Banking?" H. Guenther. N/D 80: 42-49
 "Deregulation and Oligopolistic Price-Quality Rivalry." J. Vander Weide and J. H. Zalkind. (R) M/J 81: 56-57
 "Deregulation and the Theory of Contestable Markets." E. F. Bailey and W. J. Baumol. (R) S/D 84: 70-71

- "Dress Codes Decontrolled." (P) S/O 82: 12-13, 26
 "Electric Utilities—Next Stop for Deregulators?" I. M. Stelzer. J/A 82: 29-35
 "HUD Relaxes Its Property Code." (P) N/D 82: 6-8
 "Impact of Rail Deregulation on the Movement of Fresh Fruit and Vegetables, The." H. W. German and M. W. Babcock. (R) M/J 83: 43-44
Initial Impact of Motor Carrier Deregulation in Arizona, R. Beilock and J. Freeman. (R) S/O 83: 47-48
Instead of Regulation: Alternatives to Federal Regulatory Agencies, R. W. Poole, Jr., ed. (R) M/A 82: 53-54
 "Is Regulatory Relief Enough?" M. Kusters, and J. Eisenach. M/A 82: 20-27
 "Lifting Burdens at the Margin." (P) J/A 81: 6-9
 "Price Competition on the NYSE," J. A. Eisenach and J. C. Miller III. J/F 81: 16-19
 "Radio Deregulation: Stay Tuned." (P) M/A 81: 9-12
 "Rail and Truck Reform—The Record So Far," T. G. Moore. N/D 83: 33-41
 "Reagan Record, The: A Strategy for Regulatory Reform," C. C. DeMuth. M/A 84: 25-30
 "Reagan Record, The: Where's the Reform?" W. Olson. M/A 84: 30-32, 40
 "Regulation and Deregulation of Natural Gas in the U.S., The, 1938-1985," P. R. Merrill. (R) M/J 81: 51-52
 "Report on Harbridge House Survey of the Impact of Transportation Deregulation on Major U.S. Manufacturing Firms." (R) M/A 82: 52
 "Re-Regulating at the ICC: 'The Congress Made Me Do It!'" (P) N/D 81: 5-9
 "Revitalizing Urban Transit—More Money or Less Regulation?" R. Cervero. M/J 84: 36-42
 "Rise and Fall of Bus Regulation, The," E. A. Pinkston. S/D 84: 45-52
 "Seattle Taxis: Deregulation Hits a Pothole," R. O. Zerbe, Jr. N/D 83: 43-48
SEC and the Public Interest, The, S. M. Phillips and J. R. Zecher. (R) S/O 82: 52-53
Transition to a Free Market: Deregulation of the Air Cargo Industry, A. S. Carron. (R) M/A 82: 51-52
 "Uncertain Course of Bank Deregulation, The," K. E. Scott. M/J 81: 40-45
 "Why Not Abolish Antitrust?" F. L. Smith, Jr. J/F 83: 23-28, 33
 See also Regulatory management
- Discrimination:** see *Bakke* case; Civil rights
- Doron, Gideon**
 "How Smoking Increased When TV Advertising of Cigarettes Was Banned." M/A 79: 49-52
- Drugs and drug industry**
 "Advice for the President-Elect: Food and Drug Administration," R. B. Helms. N/D 80: 28-29
 "Biting the Hand That Cures Them," K. L. Adelman. J/A 82: 16-18, 35
 "Consumer Protection Regulation in Ethical Drugs," H. Grabowski and J. Vernon. (R) N/D 77: 46
Controlling the Use of Therapeutic Drugs: An International Comparison, W. Wardell, ed. (R) S/O 78: 63-65
 "Cost of Getting Nowhere at the FTC, The," B. Yandle. J/A 81: 43-47
 "Drug on the Export Market, A." (P) N/D 79: 10-11
 "'Excess Gastric Acidity?'" (P) S/O 77: 4-5
FDA Drug Approval—A Lengthy Process That Delays the Availability of Important New Drugs, General Accounting Office. (R) S/O 80: 53-54
 "Generic Drug Equivalents: Opening Pandora's Rx." (P) M/J 79: 4-5
 "How to Turn Grandfather Drugs into Orphans." (P) J/A 83: 5-8
 "Laetrile: A 'Forbidden Fruit.'" (P) J/F 78: 9-11
 "Less Paperwork for Generic Drugs?" (P) M/J 81: 5-7
 "Perils of Risk Avoidance, The," P. Johnson. M/J 80: 15-19
 "Politics of Policy Analysis, The: Protection or Overprotection in Drug Regulation?" D. Seidman. J/A 77: 22-37
 "Public Policy and Drug Innovation," J. H. Young. (R) M/A 84: 48-50
 "Regulating Pharmaceutical Innovation: An Economist's View," J. E. S. Parker. (R) M/A 78: 48
 "Revising the Drug Law—A Case of Give and Take?" (P) M/J 78: 12-13
 "Rx: More Regulation or Better Therapies?" W. Wardell. S/O 79: 25-33
 "Technology, Regulation, and Market Structure in the Modern Pharmaceutical Industry," P. Temin. (R) N/D 80: 62-63
 "Tylenol: Regulate in Haste..." (P) M/A 83: 12-14
- "UN System's War on the Drug Industry, The," H. Schwartz. J/A 82: 19-24
 "Valproic Acid Controversy, The." (P) J/A 78: 9-10
 "When Patients Know What's Good for Them." (P) S/O 81: 6-10
 "Who Will Adopt the Orphan Drugs?" L. Lasagna. N/D 79: 27-32
 "Will All New Drugs Become Orphans?" L. Lasagna. (R) N/D 82: 46-47
- Dunlop, John T.**
 "New Approaches to Economic Policy." J/F 79: 13-16
- Eads, George**
 "Harnessing Regulation: The Evolving Role of White House Oversight." M/J 81: 19-26
- Easterbrook, Frank H.**
 "Breaking Up Is Hard to Do." N/D 81: 25-31
 "On Not Enforcing the Law." J/F 83: 14-16
 "Round and 'Round on RPM: Restricted Dealing Is a Way to Compete." J/F 84: 23-27
- Easterbrook, Gregg**
 "Synthetic Progress: The Fifth Annual Report of the Energy Security Corporation, July 15, 1984." N/D 79: 40-41
- Economic impact statements**
 "After Economic Impact Statements—What?" (P) J/F 78: 12-13
 "Lessons of the Economic Impact Statement Program." J. C. Miller III. J/A 77: 14-21
- Economic policy**
 "Economists and Public Policy," G. J. Stigler. M/J 82: 13-17
Environmental Regulation and the U.S. Economy, H. M. Peskin, P. R. Portney, and A. V. Kneese, eds. (R) J/F 82: 50-51
 "Federal Government Initiatives to Reduce the Price Level," R. W. Crandall. (R) M/A 79: 57-58
 "George J. Stigler: An Appreciation," R. H. Coase. N/D 82: 21-24
Impact of Tax and Financial Regulatory Policies on Industrial Innovation, The, J. J. Cordes. (R) S/O 80: 49-50
 "Laissez Partir: The Borders of Freedom," C. Fried. S/O 83: 43-45
 "Myth of De-industrialization, The," W. H. Branson. S/O 83: 24-29, 53-54
 "New Approaches to Economic Policy," J. T. Dunlop. J/F 79: 13-16
 "1981 Budget and Regulatory Reform, The." (P) M/A 80: 7-8
 "On Carter's Anti-Inflation Policy," A. Greenspan, A. E. Kahn, M. H. Kusters, and R. Oswald. J/F 79: 17-30
 "On Constitutional Economics," R. H. Bork. S/O 83: 14-18
 "On the Neoliberal Frontier," W. Kristol. M/J 83: 38-40
Regulated Industries and the Economy, The, P. W. MacAvoy. (R) J/A 80: 43, 46-48
 "Regulation and the 1982 Budget." (P) J/A 81: 9-11
 "Regulation and the 1983 Budget." (P) M/A 82: 9-11
 "Regulation and the 1984 Budget." (P) M/A 83: 8-10
 "Regulation and the 1985 Budget." (P) M/A 84: 9-11
 "Repairing Capitalism," R. Vaubel. J/A 80: 12-16
 "Theory of Expropriation and Deviations from Perfect Capital Mobility, A," J. Eaton and M. Gersovitz. (R) S/D 84: 71-72
Wage-Price Standards and Economic Policy, J. A. Meyer. (R) J/F 83: 44-45
- Education**
 "Academic Freedom Misapplied." (P) S/O 80: 6-7
 "Bilingual Education: The New Accent in Civil Rights Regulation." (P) N/D 80: 5-8
Bureaucrats and Brainpower: Government Regulation of Universities, P. Seabury, ed. (R) M/A 80: 53-54
 "... But Not Everywhere: HEW-ing at Hillsdale." (P) J/F 79: 11-12
Compelling Belief: The Culture of American Schooling, S. Arons. (R) N/D 83: 53-55
 "Competition in the Legal Education Industry," H. First. (R) M/A 81: 57-58
Costs of Implementing Federally Mandated Social Programs at Colleges and Universities, The, S. Coldren and C. Van Alstyne. (R) N/D 77: 43-44
 "Democracy and Due Process: The Case of Handicapped Education," J. E. Haynes. N/D 82: 29-34
 "Dress Codes and Sports: HEW Applies Some 'Common Sense'..." (P) J/F 79: 10-11
 "Dress Codes Decontrolled." (P) S/O 82: 12-13, 26

"Education Reform and Its Costs." (P) S/D 84: 13-14, 44
 "Government in the Classroom, The." J. M. Atkin. (R) M/J 81: 55-56
 "Guadalajara! A Case Study in Regulation by Munificence." A. Scalia. M/A 78: 23-29
 "Health Manpower and Government Planning." W. S. Comanor. M/J 81: 47-49
 "Higher Education and Government: Government Regulations Are Strangling Business and Education." E. Bartell. (R) N/D 77: 44-45
How Much Freedom for Universities? Towards Independent Universities. H. S. Ferns. (R) S/O 83: 52-53
 "Poor Man's Voucher, The?" (P) S/O 81: 5-6
 "Private Schools, Tax Exemption, and the IRS." (P) J/F 82: 5-8
 "UNCTAD Takes on the Brain Drain." (P) N/D 82: 8-11
 "Vouchers and Family Choice." P. Skerry (Review of J. E. Coons and S. D. Sugarman's *Education by Choice: The Case for Family Control*). J/A 79: 50-51
 See also Bakke case

Eisenach, Jeffrey A.

"Is Regulatory Relief Enough?" (with M. H. Kusters). M/A 82: 20-27
 "Price Competition on the NYSE" (with J. C. Miller III). J/F 81: 16-19

Elzenstat, Stuart

"Democrat Looks at the Republican Platform, A." S/O 80: 14, 19-21

Elderly persons: see Age

Ely, Northcutt

"One OPEC Is Enough!" N/D 81: 19-24

Employee Retirement Income Security Act (ERISA): see Pensions and annuities

Employment practices

"Academic Freedom Misapplied." (P) S/O 80: 6-7
 "Advice for the President-Elect: Labor Regulation." M. H. Kusters. N/D 80: 30-32
 "Affirmative Action after *Teal*: A New Twist or a Turn of the Screw?" M. W. McConnell. M/A 83: 38-44
 "Apples and Aliens." E. Cowan. N/D 78: 40-45
Bureaucrats and Brainpower: Government Regulation of Universities. P. Seabury, ed. (R) M/A 80: 53-54
 "Does Father Know Best? The Case of State Employment Agencies." W. Papier. M/A 82: 43-46
Employment Hazards: An Investigation of Market Performance. W. K. Viscusi. (R) M/A 80: 55-56
 "Exploitation in the Jim Crow South: The Market or the Law?" J. Ro-back. S/D 84: 37-43
 "From Bad to Comparable Worth." C. Krauthammer. J/A 84: 31-34
 "Frustrating Business Mobility." R. B. McKenzie. M/J 80: 32-38
 "High Cost of 'Local Content.' The." (P) N/D 82: 14-15, 38
 "How Not to Create a Job." P. R. Portney. N/D 82: 35-38
 "Inflation and the NLRB: A Case of Fortuitous Regulatory Expansion." B. D. Meltzer with R. J. LaLonde. S/O 80: 43-45
 "Locking the Rascals In." (P) M/J 81: 4-5
Low Pay, Occupational Mobility, and Minimum-Wage Policy in Britain. D. Metcalf. (R) M/A 82: 58-59
Minimum Wages, Fringe Benefits, and Working Conditions. W. J. Wessels, and *Minimum Wages and On-the-Job Training.* M. Hashimoto. (R) N/D 81: 52-53
Minimum Wages: Measures and Industry Effects. J. M. Peterson. (R) N/D 82: 48-49
 "On the Corporate Democracy Act," articles by M. Green and R. K. Winter. M/J 80: 20-29
Poverty and the Minimum Wage. D. O. Parsons. (R) M/A 82: 55, 58
 "Public Employee Strikes, Executive Discretion, and the Air Traffic Controllers." B. D. Meltzer and C. R. Sunstein. (R) N/D 83: 50-52
 "Racial Reasoning in Unfree Markets: Preference, Prejudice, and Discrimination." W. E. Williams. M/A 79: 39-48
Reasoning about Discrimination: The Analysis of Professional and Executive Work in Federal Antibias Programs. R. A. Lester. (R) M/J 81: 53-54
Regulatory Process and Labor Earnings, The. R. G. Ehrenberg. (R) M/J 80: 58
 "Rising Impact of Minimum Wages, The." F. Welch. N/D 78: 28-37
 "Stroke of a Pen, The." J. Rabkin. M/J 81: 15-18
 "Weber Case, The: Double Talk and Double Standards." B. D. Meltzer. S/O 79: 34-43
 "What Happened to Bakke?" (P) M/J 79: 8-11
 See also Occupational licensure; Pensions and annuities

Endangered species

"Snail Darters: Illustrating a Lawmakers' Dilemma." (P) J/F 79: 5-7

Energy

"Advice for the President-Elect: Energy Regulation." M. L. Weidenbaum. N/D 80: 24-27
 "Choice between Adjudicating and Rulemaking for Formulating and Implementing Energy Policy, The." R. J. Pierce. (R) M/A 80: 54-55
 "Common Law Doctrines and Solar Energy." D. Zillman, and "Oil Companies and Solar Energy: Two Views." R. Fellmeth and M. B. Johnson, in *Legal Aspects of Solar Energy*, J. Minan and W. Lawrence, eds. (R) S/O 82: 49-51
 "Conflicting Goals of National Energy Policy, The." R. E. Hall and R. S. Pindyck. (R) N/D 77: 40
 "DOE Walks into a Better Mousetrap." (P) S/O 83: 7-8
 "Economics Appraisal of President Carter's Energy Program, An." W. J. Mead. (R) J/F 78: 48-49
 "Energy Crisis, The—Moral Equivalent of Civil War." J. P. Kalt and P. Navarro. J/F 80: 41-43
 "Energy-Efficiency Standards for Appliances." (P) N/D 80: 12-13
Energy in America's Future. S. H. Schurr, J. Darmstadter, H. Perry, W. Ramsay, and M. Russell. (R) N/D 79: 55-56
 "Gasohol Hangover, The." (P) N/D 81: 12-14
 "Making Appliances More 'Energy-Efficient.'" (P) N/D 77: 5-6
 "Mobilizing the Energy Regulators." (P) S/O 79: 6-8
 "Regulation and Deregulation of Natural Gas in the U.S., The, 1938-1985." P. R. Merrill. (R) M/J 81: 51-52
 "Risk with Energy from Conventional and Nonconventional Sources." H. Inhaber. (R) M/J 79: 60-61
 "Synthetic Fuels: Should the Government Subsidize Nonconventional Energy Supplies?" P. L. Joskow and R. S. Pindyck. S/O 79: 18-24, 43
 "Synthetic Progress: The Fifth Annual Report of the Energy Security Corporation, July 15, 1984." G. Easterbrook. N/D 79: 40-41
 See also Coal; Mining; Nuclear power; Petroleum; Utilities

Environment

"Advice for the President-Elect: Environmental Protection Agency." R. W. Crandall. N/D 80: 20-22
Alternatives to Regulation: Managing Risks to Health, Safety and the Environment. M. S. Baram. (R) M/A 82: 53
 "Beyond the New Deal: Coal and the Clean Air Act." B. A. Ackerman and W. T. Hassler. (R) M/A 81: 51-53
 "Bubbles and Efficiency: Cleaner Air at Lower Cost." M. T. Maloney and B. Yandle. M/J 80: 49-52
 "Bureaucracy, Entrepreneurship and Natural Resources: Witless Policy and the Barrier Islands." W. J. Siffin. (R) J/A 81: 54-55
 "Clean Clothes Act, The: A Fable." S. Berg. N/D 81: 43
Compensation for Pollution Damage. (R) M/A 82: 54-55
 "Contribution of the Environment to Cancer Incidence: An Epidemiologic Exercise." E. L. Wynder and G. B. Gori. (R) S/O 77: 45-46
Current Issues in U.S. Environmental Policy. P. R. Portney, ed. (R) S/O 78: 59-60
 "DNA Regulation: Can the Genie Be Rebottled?" (P) N/D 77: 3-4
Dow vs. California: A Turning Point in the Envirobusiness Struggle. C. J. Duerksen. (R) J/A 83: 56-58
Environment, Technology, and Health, The: Human Ecology in Historical Perspective. M. Eisenbud. (R) M/A 79: 54-55
Environmental Regulation and the U.S. Economy. H. M. Peskin, P. R. Portney, and A. V. Kneese, eds. (R) J/F 82: 50-51
Environmental Use and the Market. H. H. Macaulay and B. Yandle. (R) J/F 78: 49-50
 "Exporting Environmental Havoc." R. Starr. (R) N/D 78: 58-59
 "Has Reagan Dropped the Ball?" R. W. Crandall. S/O 81: 15-18
 "How Large and Small Plants Fare under Environmental Regulation." B. P. Pashigian. S/O 83: 19-23
Incentives for Environmental Protection. T. C. Schelling, ed. (R) S/O 83: 49-50
 "Making Pollution Prevention Pay." M. G. Royston. (R) M/J 81: 57-58
 "Politics and Economics of Senate Voting on Coal Strip Mining Policy, The." J. P. Kalt and M. A. Zupan. (R) N/D 83: 49-50
Progress and Privilege: America in the Age of Environmentalism. W. Tucker. (R) M/A 83: 48-50
 "Protecting the Environments of Other Nations." (P) M/J 78: 7-9
 "Reagulation—The First Year: The Environment." R. W. Crandall. J/F 82: 29-32
 "Should Polluters Pay?" (P) J/A 78: 14
Social Regulation: Strategies for Reform. E. Bardach and R. A. Kagan, eds. (R) M/J 82: 54-55
Targeting Economic Incentives for Environmental Protection. A. L. Nichols. (R) M/J 84: 43-44

"Venic Reform: Sue West, Young Man?" (P) J/F 82: 10-14
Yale Journal on Regulation, B. Judson, ed. (R) N/D 83: 55-56
 See also Air pollution; Endangered species; Fishing industry; Forest Service; Noise; Nuclear power; Toxic substances; Water pollution

Environmental Protection Agency: see Environment

Epstein, Edwin M.

"Irony of Electoral Reform, An: The Business PAC Phenomenon." M/J 79: 35-41

Epstein, Richard A.

"Is Pinto a Criminal?" M/A 80: 15-21

"Manville: The Bankruptcy of Product Liability Law." S/O 82: 14-19, 43-46

Equal employment opportunity: see Civil rights

Equal Employment Opportunity Commission

"Sears Catalog of Litigation, The." (P) M/A 79: 6-9

"Weber Case, The: Double Talk and Double Standards," B. D. Meltzer. S/O 79: 34-43

"What Happened to *Bakke*?" (P) M/J 79: 8-11

Europe

Compensation for Pollution Damage (R) M/A 82: 54-55

How Much Freedom for Universities? Towards Independent Universities, H. S. Ferns. (R) S/O 83: 52-53

"How Prometheus Came to Be Bound," M. Golay. (R) J/F 81: 48-49

Incentives in Water Quality Management: France and the Ruhr Area, B. R. Bower, R. Barre, J. Kühner, and C. S. Russell. (R) J/A 81: 51-53

Inspectorates in British Government, G. Rhodes. (R) M/J 81: 54-55

Low Pay, Occupational Mobility, and Minimum-Wage Policy in Britain, D. Metcalf. (R) M/A 82: 58-59

"On Rent Control: A Review of J. F. Brenner and H. M. Franklin's *Rent Control in North America and Four European Countries*," N. R. Peirce. M/J 78: 45-46

Painful Prescription, The: Rationing Health Care, H. J. Aaron and W. B. Schwartz. (R) J/A 84: 44-45

Regulating America, Regulating Sweden: A Comparative Study of Occupational Safety and Health Policy, S. Kelman. (R) N/D 81: 49-50

Trucking Regulation: Lessons from Europe, T. G. Moore. (R) S/O 77: 42-43

Federal Aviation Administration: see Airlines; Air traffic control

Federal Communications Commission: see Telecommunications

Federal Election Commission: see Campaigns and elections

Federal Energy Regulatory Commission: see Energy

Federalism: see Local and state government

Federal Maritime Commission: see Transportation

Federal Reserve Board: see Banking and finance

Federal Trade Commission

"Advice for the President-Elect: Auto Regulation," W. A. Niskanen. N/D 80: 24-27

"Advice for the President-Elect: Federal Trade Commission," A. Scalia. N/D 80: 18-20

"Antitrust Enforcement in the Medical Services Industry: What Does It All Mean?" C. C. Havighurst. (R) N/D 80: 59-60

"Antitrust Rulemaking at the FTC." (P) N/D 79: 5-7

"Can Regulation Sweeten the Automotive Lemon?" (P) S/D 84: 7-10

"Congressional Meddling at the FTC." (P) J/F 80: 6-8

"Cost of Getting Nowhere at the FTC, The," B. Yandle. J/A 81: 43-47

Economic Regulation and the Public Interest: The Federal Trade Commission in Theory and Practice, A. Stone. (R) J/A 78: 58-59

"Effects of FTC Advertising Regulation, The," S. Peltzman. (R) M/J 82: 52-54

"Excess Gastric Acidity?" (P) S/O 77: 4-5

"Federal Trade Commission and Congressional Oversight of Antitrust Enforcement, The," W. E. Kovacic. (R) M/J 83: 41-42

"Ford Motor Co. v. FTC: No Rule without a Rulemaking?" (P) S/O 81: 13-14, 59

"FTC and Children's Advertising, The." (P) M/J 78: 5-6

"FTC's Eveglass Rule, The." (P) S/O 78: 9-11

"FTC Tantrum against Children's Television, The," C. C. DeMuth. (R) J/A 79: 54-56

"Funding Public Participation in Regulatory Proceedings." (P) M/A 78: 10

"Generic Drug Equivalents: Opening Pandora's Rx." (P) M/J 79: 4-5

"Myth of Runaway Bureaucracy, The: The Case of the FTC," B. R. Wein-gast and M. J. Moran. M/J 82: 33-38

"Needs and Licenses," M. Pertschuk. M/A 79: 14-16

"New Era in Antitrust, The," J. Sims and W. Blumenthal. J/A 82: 25-28

"New Gibberish at the FTC, The," E. Gellhorn. M/J 78: 37-42

"New Tack for Antitrust." (P) M/J 79: 7-8

"Premerger Notification: A Case of Runaway Regulation," H. Latimer. M/J 79: 46-52

"Reagulation—The First Year: Antitrust and Trade Regulation," E. Gellhorn. J/F 82: 22-24

"Regulating Funerals." (P) S/O 78: 11-12

Regulatory Bureaucracy: The Federal Trade Commission and Antitrust Policy, R. A. Katzmann. (R) M/A 80: 57-58

Report on Trade Regulation Rulemaking Procedures of the Federal Trade Commission, Part I, B. B. Boyer, M. W. Bowers, H. Toiv, D. J. Edelman, B. C. Cartwright, C. J. DeVita, and J. M. Bennett. (R) J/A 79: 53

"Restrictive State Laws and the Federal Trade Commission," R. G. Badal. (R) M/J 78: 51-52

"Rulemaking, Bias, and the Dues of Due Process at the FTC," J. Rabkin. J/F 79: 43-45

"Rules without Reason—The Case of the FTC," T. J. Muris. S/O 82: 20-26

Shared Monopoly and the Cereal Industry, B. F. Harris. (R) S/O 80: 48-49

"Soap Opera, A—To Be Continued." (P) N/D 77: 4-5

"Sour Lemons at the FTC." (P) M/A 79: 9-12

"Taxi Reform—The FTC Can Hack It," E. W. Kitch. M/J 84: 13-15

"Truth vs. Provability at the FTC." (P) J/F 83: 4-6

"Two's a Crowd: The FTC's Redundant Antitrust Powers," E. Gellhorn. N/D 81: 32-42

"Wages of Zealotry, The: The FTC under Siege," E. Gellhorn. J/F 80: 33-40

First Amendment

"Advertising and Free Speech," R. H. Coase. (R) J/F 78: 53

"Assault on the First Amendment: The SEC's War on Newsletters," M. McMenamin and W. Gorenc, Jr. (R) M/A 83: 51-52

"Obscenity, Indecency, and the FCC." (P) N/D 78: 4-5

"OMB's 'Wall of Separation' against Tax-Funded Advocacy." (P) J/F 83: 8-11

"Regulated Libretto, The," R. Homan. M/A 84: 45

"Talk vs. Action at the FCC," H. Geller. M/A 83: 15-18

"UNESCO of the North: The Coming of Press Regulation in Canada," M. Laws. S/O 83: 37-42

When Government Speaks: Politics, Law, and Government Expression in America, M. G. Yudof. (R) S/D 84: 66-67

Fishing Industry

"Sea of Troubles: Managing New England's Fisheries," C. H. Foreman. J/A 82: 43-47

Fix, Michael

"Federal Solicitude, Local Costs: The Impact of Federal Regulation on Municipal Finances" (with T. Muller). J/A 80: 29-36

Food: see Agriculture; Food and Drug Administration

Food and Drug Administration

Food Safety Policy: Scientific and Social Considerations, Committee for a Study on Saccharin and Food Safety Policy. (R) M/J 79: 61-62

"Food Safety: Revising the Statute," D. A. Kessler. (R) M/J 84: 45-46

"Hair Dyes, Cancer, and the FDA." (P) M/A 78: 5-6

"If You Believe in Peanut Butter, Read This." (P) N/D 78: 5-7

"Regulation, Logic, and Ideology," J. L. Mashaw. N/D 79: 44-51

"Ruminations on a Rat: Saccharin and Human Risk," W. R. Havender. M/A 79: 17-24

"Saccharin and the Public Interest." (P) J/A 77: 10-11

"Trade Secret Status of Health and Safety Testing Information, The: Reforming Agency Disclosure Policies," T. O. McGarity and S. A. Shapiro. (R) N/D 80: 56-57

See also Drugs and drug industry; Toxic substances

Ford, Gerald R.

"Seizing the Opportunity." J/F 78: 15-17

Foreign Corrupt Practices Act

"Overseas Ethics, Four Years Later." (P) J/A 81: 11-12, 59

Foreman, Christopher H.

"Sea of Troubles: Managing New England's Fisheries." J/A 82: 43-47

Forest Service

"Wasting Our National Forests—How to Get Less Timber and Less Wilderness at the Same Time." T. M. Lenard. J/A 81: 29-36

Freedom of Information Act

"Freedom of Information Act Has No Clothes, The." A. Scalia. M/A 82: 14-19

Free speech: see First Amendment

Fried, Charles

"Fast and Loose in the Welfare State." M/J 79: 13-16

"Laissez Partir: The Borders of Freedom." S/O 83: 43-45

Gallatin, Albert

"Free Trade: Four American Voices" (from *State Papers and Speeches on the Tariff*, F. W. Taussig, ed.). J/F 83: 42

Garbage collection industry

"Regulating Rackets." P. Reuter. S/D 84: 29-36

Geller, Henry

"Making Cable TV Pay? The Copyright Controversy." M/J 81: 35-39, 58

"Reagulation—The First Year: Telecommunications." J/F 82: 24-26

"Talk vs. Action at the FCC." M/A 83: 15-18

Gellhorn, Ernest

"New Gibberish at the FTC, The." M/J 78: 37-42

"Reagulation—The First Year: Antitrust and Trade Regulation." J/F 82: 22-24

"Reform as Totem—A Skeptical View." M/J 79: 23-26

"Two's a Crowd: The FTC's Redundant Antitrust Powers." N/D 81: 32-42

"Wages of Zealotry, The: The FTC under Siege." J/F 80: 33-40

Gergen, David R.

"Will Carter Put Out the Fire?" S/O 77: 21-26

Goldfarb, Robert S.

"Compensating Victims of Policy Change." S/O 80: 22-30

Gordon, Richard L.

"Hobbling Coal—Or How to Serve Two Masters Poorly." J/A 78: 36-45

Gorecki, Paul K.

"Canada's Chicken-and-Egg Problem: The High Cost of Price and Output Controls." M/A 82: 28-36

Graham, David R.

"Airline Deregulation IS Working" (with D. P. Kaplan). M/J 82: 26-32

Grants and benefits, federal

Bureaucratic Justice: Managing Social Security Disability Claims, J. L. Mashaw. (R) S/O 83: 50-52

"Capital-Biased Subsidies, Bureaucratic Monitoring, and Bus Scraping." M. W. Frankena. (R) J/A 83: 53-54

Democratic Muse: The Visual Arts and the Public Interest, E. C. Banfield. (R) J/A 84: 48-50

Federal Grants-in-Aid to New Hampshire and Revenue Adequacy, C. D. Campbell, J. R. Fries, and R. G. Campbell. (R) M/J 83: 44-45

"Health Benefits for the Jobless: The Middle Class Cashes In." (P) M/J 83: 7-8

"Liberty and Property: The Problem of Government Benefits." S. F. Williams. (R) M/A 83: 47-48

"OMB's 'Wall of Separation' against Tax-Funded Advocacy." (P) J/F 83: 8-11

"Poor Man's Voucher, The?" (P) S/O 81: 5-6

Regulatory Federalism: Policy, Process, Impact and Reform, Advisory Commission on Intergovernmental Relations. (R) S/D 84: 68-70

"Unintended Consequences: Regulating the Quality of Subsidized Day Care." S. Rose-Ackerman. (R) M/J 84: 44-45

"Unsnarling the Federal Grant System." C. E. Barfield, Jr. S/O 81: 37-46

Green, Mark

"On the Corporate Democracy Act: The Case for Corporate Democracy." M/J 80: 20-25

Greenspan, Alan

"On Carter's Anti-Inflation Policy." J/F 79: 17-30

Guenther, Harry

"Deregulation—Is It Happening in Banking?" N/D 80: 42-49

Hackbarth, Glenn M.

"Competition and Health Care: Planning for Deregulation" (with C. C. Havighurst). M/J 80: 39-43, 46-48

Hamilton, Alexander

"Free Trade: Four American Voices" (from *State Papers and Speeches on the Tariff*, F. W. Taussig, ed.). J/F 83: 42

Handicapped persons

"Building Access: Cost No Barrier?" (P) S/O 82: 5-8

"Democracy and Due Process: The Case of Handicapped Education." J. E. Haynes. N/D 82: 29-34

"HEW and DOT Confront Discrimination against the Handicapped." (P) N/D 78: 7-10

"Regulation Gone Amok—How Many Billions for Wheelchair Transit?" T. B. Clark. M/A 80: 47-52

Harrison, David, Jr.

"Making Ready for the Clean Air Act" (with P. R. Portney). M/A 81: 24-31

Harter, Philip J.

"In Search of OSHA." S/O 77: 33-39

Havender, William R.

"About Knowledge and Decisions: A Review of Thomas Sowell's *Knowledge and Decisions*." M/A 82: 47-50

"EDB and the Marigold Option." J/F 84: 13-17

"Politicians Make Bad Scientists: A Review of Richard Doll and Richard Peto's 'Causes of Cancer.'" N/D 81: 46-48

"Ruminations on a Rat: Saccharin and Human Risk." M/A 79: 17-24

Havighurst, Clark C.

"Competition and Health Care: Planning for Deregulation" (with G. M. Hackbarth). M/J 80: 39-43, 46-48

Haynes, John Earl

"Democracy and Due Process: The Case of Handicapped Education." N/D 82: 29-34

Hazardous materials: see Toxic substances

Health and Human Services, Department of

"Cutting Corners on Samplers." (P) J/A 79: 8-10

"Helping Smokers Make 'Better' Decisions?" (P) S/O 78: 5-7

"HEW and DOT Confront Discrimination against the Handicapped." (P) N/D 78: 7-10

See also Drugs and drug industry; Health care

Health and safety

"Active Judges and Passive Restraints." (P) J/A 82: 10-15

Air Pollution and Human Health, L. B. Lave and E. P. Seskin. (R) M/J 79: 63-64

Alternatives to Regulation: Managing Risks to Health, Safety and the Environment, M. S. Baram. (R) M/A 82: 53

Benefits of Health and Safety Regulation, The, A. R. Ferguson and E. P. LeVeen, eds. (R) J/F 82: 48

Environment, Technology, and Health, The: Human Ecology in Historical Perspective, M. Eisenbud. (R) M/A 79: 54-55

"Exorcists vs. Gatekeepers in Risk Regulation." P. Huber. N-D 83: 23-32

"Global Paternalism—The UN and the New International Regulatory Order." J. J. Kirkpatrick. J/F 83: 17-22

"Hazards of Hazard Labeling, The." (P) M/J 82: 9-10

- Health and Air Quality: Evaluating the Effects of Policy*, P. E. Graves and R. J. Krumm. (R) S/O 81: 55
- "Helping Smokers Make 'Better' Decisions?" (P) S/O 78: 5-7
- "How Smoking Increased When TV Advertising of Cigarettes Was Banned," G. Doron. M/A 79: 49-52
- "Industrial Involvement in the Development of NIH Recombinant DNA Research Guidelines and Related Federal Policies," J. G. Perpich. (R) M/J 83: 46-47
- "Legislative Boost for Risk Assessment, A?" (P) M/J 84: 10-12
- "Market for Risk, The," P. Huber. M/A 84: 33-39
- "Motorcycles, Safety, and Freedom," (P) J/A 80: 10-11
- "Reagulation—The First Year: Health and Safety," W. K. Viscusi. J/F 82: 34-36
- Risk/Benefit Analysis*, R. Wilson and E. Crouch. (R) S/O 82: 48-49
- "Safety at Any Price?" W. Oi. N/D 77: 16-23
- "Safety Regulation," N. W. Cornell, R. G. Noll, and B. Weingast. (R) S/O 77: 43-44
- "Sensitive Populations and Environmental Standards," R. D. Friedman. (R) J/A 81: 58-59
- Social Regulation: Strategies for Reform*, E. Bardach and R. A. Kagan, eds. (R) M/J 82: 54-55
- "Trade Secret Status of Health and Safety Testing Information, The: Reforming Agency Disclosure Policies," T. O. McGarity and S. A. Shapiro. (R) N/D 80: 56-57
- See also Cancer; Drugs and drug industry; Occupational safety and health; Product safety and liability
- Health care**
- "Antitrust Enforcement in the Medical Services Industry: What Does It All Mean?" C. C. Havighurst. (R) N/D 80: 59-60
- "Blood and the Visible Hand," (P) M/J 78: 11-12
- Bureaucratic Justice: Managing Social Security Disability Claims*, J. L. Mashaw. (R) S/O 83: 50-52
- "Case of Labor Market Pains, A," (P) J/A 83: 8-9
- "Charity by Decree," (P) J/A 79: 10-12
- "Competition and Health Care: Planning for Deregulation," C. C. Havighurst and G. M. Hackbarth. M/J 80: 39-43, 46-48
- "Competition in Kidney Dialysis," (P) J/F 81: 9-12
- "Containing Hospital Costs," (P) J/A 77: 9-10
- Controlling Hospital Costs: The Role of Government Regulation*, P. L. Joskow. (R) J/F 82: 51, 54
- Cost of Regulation: Report of the Task Force on Regulation*, Hospital Association of New York State. (R) J/A 79: 59-60
- "Curing Hospital Costs by Decree," (P) M/J 79: 5-7
- "Duplicated Hospital Facilities: How Much Can We Save by Consolidating Them?" W. B. Schwartz and P. L. Joskow. (R) M/J 81: 50-51
- "Effects of Regulation on Hospital Costs and Input Use," F. A. Sloan and B. Steinwald. (R) J/A 80: 50
- "Fast and Loose in the Welfare State," C. Fried. M/J 79: 13-16
- "Health Benefits for the Jobless: The Middle Class Cashes In," (P) M/J 83: 7-8
- Health Care Cost Increases*, J. A. Meyer. (R) N/D 79: 56-58
- "Health Care Reform and Market Discipline—Federalism Strikes Back," J. A. Meyer. N/D 82: 16-20
- "Health Manpower and Government Planning," W. S. Comanor. M/J 81: 47-49
- "Hiding the Costs of National Health Insurance," J. A. Meyer. M/A 80: 22-28, 58
- "High Cost of Hospitals—and What to Do about It, The," M. Feldstein. (R) S/O 77: 46-47
- "Hospital Industry's New Vulnerability to Antitrust, The," (P) S/O 80: 12-13
- "How Much Should We Spend to Save a Life?" S. Rhoads. (R) J/A 78: 59-60
- "Is HHS Deadening the Pain of Competition?" (P) J/F 83: 11-13
- "Medical Care System under National Health Insurance, The: Four Models," W. McClure. (R) N/D 77: 46-47
- National Health Insurance in Ontario—The Effects of a Policy of Cost Control*, W. S. Comanor. (R) J/A 80: 42-43
- Painful Prescription, The: Rationing Health Care*, H. J. Aaron and W. B. Schwartz. (R) J/A 84: 44-45
- "Regulatory Control of the Membership of Corporate Boards of Directors: The Blue Shield Case," W. J. Lynk. (R) S/O 81: 58-59
- "Rx: More Regulation or Better Therapies?" W. Wardell. S/O 79: 25-33
- "Special Symposium: Market-Oriented Approaches to Achieving Health Policy Goals," V. Albrecht, ed. (R) N/D 81: 50-51
- "Study of the Regulatory Impact of the Medical Device Amendments, A: A Survey of Medical Device Manufacturers," Louis Harris and Associates. (R) M/A 83: 50-51
- Technology in Hospitals: Medical Advances and Their Diffusion*, L. B. Russell. (R) J/F 80: 49-51
- "Truth-in-Hospitalization," (P) J/A 84: 7-9
- "Wealthier Is Healthier," A. Wildavsky. J/F 80: 10-12, 55
- "When Patients Know What's Good for Them," (P) S/O 81: 6-10
- "Where Have All the Doctors Gone?" J. P. Newhouse, A. P. Williams, B. Bennett, and W. B. Schwartz. (R) N/D 82: 47-48
- Health, Education, and Welfare, Department of:** see Drugs and drug industry; Education; Health and Human Services, Department of; Health care
- Helms, Robert B.**
- "Advice for the President-Elect: Food and Drug Administration," N/D 80: 28-29
- Historic preservation:** see Land tenure and use
- Homan, Richard**
- "Regulated Libretto, The," M/A 84: 45
- Horwich, George**
- "Next Oil Shock, The—Giving the Market a Chance" (with D. L. Weimer). M/A 84: 16-24
- "Regulating Retirement: The Indirect Costs," M/J 78: 27-36
- Housing**
- "Building Access: Cost No Barrier?" (P) S/O 82: 5-8
- "Controlling Rents, Razing Cities," R. Starr. (R) J/F 79: 48-49
- "Habitability Laws and the Welfare of Indigent Tenants," W. Z. Hirsch. (R) N/D 81: 51-52
- "HUD Relaxes Its Property Code," (P) N/D 82: 6-8
- "*Mount Laurel II*: State Courts Rush In . . ." (P) M/A 83: 6-8
- "New Rules against 'Redlining,'" (P) J/A 78: 8-9
- "No Growth—No Vacancies," T. Bethell. J/A 81: 13-16
- "On Rent Control," N. R. Peirce (review of J. F. Brenner and H. M. Franklin's *Rent Control in North America and Four European Countries*). M/J 78: 45-46
- Price Increases Caused by Housing Assistance Programs*, C. P. Rydell, J. E. Mulford, and L. Helbers. (R) N/D 81: 53-54
- "Racial Reasoning in Unfree Markets," W. E. Williams. M/A 79: 39-48
- Rent Control: Myths and Realities*, W. Block and E. Olsen, ed. (R) J/A 81: 55-57
- Revitalizing America's Cities: Neighborhood Reinvestment and Displacement*, M. H. Schill and R. P. Nathan. (R) M/J 84: 47-48
- "'Tenant Protection' at HUD: Due Process of Undue Proceduralism?" (P) N/D 83: 7-9
- Housing and Urban Development, Department of:** see Housing
- Huber, Peter**
- "Exorcists vs. Gatekeepers in Risk Regulation," N/D 83: 23-32
- "*I Ching* of Acid Rain, The," S/D 84: 15-20, 56-65
- "Market for Risk, The," M/A 84: 33-39
- Imports:** see Trade, international
- Industrial policy:** see Nationalization
- Information and Regulatory Affairs, Office of:** see Regulatory management
- Insurance**
- "Advice for the President-Elect: Auto Regulation," W. A. Niskanen. N/D 80: 24-27
- "Auto Insurance: The Irrelevance of Regulation," M. Nadel. M/A 82: 37-42
- "Bureaucracy, Entrepreneurship and Natural Resources: Witless Policy and the Barrier Islands," W. J. Siffin. (R) J/A 81: 54-55
- Compensation for Pollution Damage*. (R) M/A 82: 54-55
- "Department of Anticipated Consequences," (P) J/F 81: 6-8
- "Effects of Price Regulation in the Automobile Insurance Industry," R. A. Ippolito. (R) N/D 79: 53-54
- "Insurance, Liability, and Accidents: A Theoretical and Empirical Investigation of the Effect of No-Fault Accidents," E. M. Landes. (R) J/A 82: 49-50
- Issues and Needed Improvements in State Regulation of the Insurance Business*, General Accounting Office. (R) J/F 80: 44-45

- "Liability by Association." (P) J/A 80: 6-9
No-Risk Society, The, Y. Aharoni. (R) J/F 82: 48-49
 "Regulatory Control of the Membership of Corporate Boards of Directors: The Blue Shield Case," W. J. Lynk. (R) S/O 81: 58-59
 "Sex Discrimination in Employer-Sponsored Insurance Plans: A Legal and Demographic Analysis," L. Brilmayer, R. W. Hekeler, D. Laycock, and T. A. Sullivan. (R) J/F 81: 49-50
- Interagency Regulatory Liaison Group**
 "Regulating Cancer—Fast, Fast, Fast Relief!" (P) M/A 80: 4-7
- Internal Revenue Service:** see Taxation
- International Trade Commission:** see Trade, international
- Interstate Commerce Commission:** see Railroads; Transportation; Trucking
- Ippolito, Pauline**
 "Defending Cost-Benefit Analysis: Replies to Steven Kelman" (with G. Butters and J. E. Calfee). M/A 81: 41-42
- Jackson, Jesse**
 "Reparations Are Justified for Blacks." S/O 78: 24-29
- Japan**
Compensation for Pollution Damage. (R) M/A 82: 54-55
 "Logjam for U.S. Exports, A." (P) M/A 83: 10-12
 "Taxing Approach to Protection, A." (P) J/F 83: 6-8
- Johnson, Leland L.**
 "Toward Competition in Phone Service: Why Local Rates Are Rising." J/A 83: 31-36, 50-51
- Johnson, Paul**
 "Perils of Risk Avoidance, The." M/J 80: 15-19
- Joskow, Paul L.**
 "Synthetic Fuels: Should the Government Subsidize Nonconventional Energy Supplies?" (with R. S. Pindyck). S/O 79: 18-24, 43
- Kadlec, Charles W.**
 "Regulating Chrysler Out of Business?" (with K. W. Clarkson and A. B. Laffer). S/O 79: 44-49
- Kafoglis, Milton**
 "Paradox of Regulated Trucking, A." S/O 77: 27-32
- Kahn, Alfred E.**
 "Applying Economics to an Imperfect World." N/D 78: 17-27
 "On Carter's Anti-Inflation Policy." J/F 79: 17-30
- Kalt, Joseph P.**
 "Energy Crisis, The—Moral Equivalent of Civil War" (with P. Navarro). J/F 80: 41-43
 "Why Oil Prices Should Be Decontrolled" (with K. J. Arrow). S/O 79: 13-17
- Kaplan, Daniel P.**
 "Airline Deregulation IS Working" (with D. R. Graham). M/J 82: 26-32
- Katz, Michael L.**
 "Toward Competition in Phone Service: The Case for Freeing AT&T" (with R. D. Willig). J/A 83: 43-49
- Kauper, Thomas E.**
 "Antitrust: A Form of Regulation" (review of R. Bork's *The Antitrust Paradox*). S/O 78: 54-57
- Kelman, Steven**
 "Competition among the States: The Ethics of Regulatory Competition." M/J 82: 39-44
 "Cost-Benefit Analysis—An Ethical Critique." J/F 81: 33-40
- Kennedy, Edward M.**
 "Competition in the Airlines" (with A. V. Casey, E. I. Colodny, M. L. Muse, and J. E. Robson). N/D 77: 24-35
- Kirkpatrick, Jeane J.**
 "Global Paternalism—The UN and the New Regulatory Order." J/F 83: 17-22
 "Regulation, Liberty, and Equality." N/D 77: 11-15
- Kitch, Edmund W.**
 "Taxi Reform—The FTC Can Hack It." M/J 84: 13-15
- Kosters, Marvin H.**
 "Advice for the President-Elect: Labor Regulation." N/D 80: 30-32
 "Counting the Costs: The Business Roundtable Study." J/A 79: 17-19, 22-25
 "Is Regulatory Relief Enough?" (with J. A. Eisenach). M/A 82: 20-27
- Krattenmaker, Thomas G.**
 "Regulating Network Television" (with S. M. Besen). M/J 81: 27-34
- Krauthammer, Charles**
 "From Bad to Comparable Worth." J/A 84: 31-34
- Kristol, Irving**
 "Regulated Society, A?" J/A 77: 12-13
- Kristol, William**
 "On the Neoliberal Frontier: A Review of Robert Reich's *The Next American Frontier*." M/J 83: 38-40
- Labor:** see Employment practices
- Laffer, Arthur B.**
 "Regulating Chrysler Out of Business?" (with K. W. Clarkson and C. W. Kadlec). S/O 79: 44-49
- LaLonde, Robert J.**
 "Inflation and the NLRB: A Case of Fortuitous Regulatory Expansion" (assisting B. D. Meltzer). S/O 80: 43-45
- Land tenure and use**
 "Bureaucracy, Entrepreneurship and Natural Resources: Witless Policy and the Barrier Islands," W. J. Siffin. (R) J/A 81: 54-55
 "Eminently Domineering." (P) S/D 84: 10-13
Facility Siting and Public Opposition, M. O'Hare, L. Bacow, and D. Sanderson. (R) J/A 84: 45-47
 "Landmarks Preservation in New York," J. B. Rose. (R) J/A 84: 47-48
Locking Up the Range: Federal Land Controls and Grazing, G. D. Libecap. (R) M/J 82: 51-52
 "Saving the Cities . . ." (P) S/O 81: 10-11
 "... and Saving the Country." (P) S/O 81: 11-13
 "Subsidized Sagebrush, The: Why the Privatization Movement Failed," R. H. Nelson. J/A 84: 20-26, 39-43
 "Urbanization of Agricultural Land, The: A Review of the National Agricultural Lands Study," W. A. Fischel. (R) J/A 82: 50-51
 "Why the Sagebrush Revolt Burned Out," R. H. Nelson. M/J 84: 27-35
- Lasagna, Louis**
 "Who Will Adopt the Orphan Drugs?" N/D 79: 27-32
- Latimer, Hugh**
 "Premerger Notification: A Case of Runaway Regulation." M/J 79: 46-52
- Law and legal issues**
 "Academic Freedom Misapplied." (P) S/O 80: 6-7
 "Betamax Goes Free." (P) J/F 84: 10-12
 "Bilingual Education: The New Accent in Civil Rights Regulation." (P) N/D 80: 5-8
 "Bubble Upheld, The." (P) M/J 84: 5-7
 "Captive of the Court: A Federal Agency in Receivership," J. Rabkin. M/J 84: 16-26
 "Common Law Doctrines and Solar Energy," D. Zillman, and "Oil Companies and Solar Energy: Two Views," R. Fellmeth and M. B. Johnson, in *Legal Aspects of Solar Energy*, J. Minan and W. Lawrence, eds. (R) S/O 82: 49-51
 "Consent of the Governors." (P) M. A 81: 7-9
 "Constitutional Litigation for Fun and Profit." (P) J/A 80: 9-10
 "Cotton Dust Case, The." (P) J/F 81: 5-6
 "(Cotton) Dust Settles, The." (P) J. A 81: 4-6

- "Democracy and Due Process: The Case of Handicapped Education," J. E. Haynes. N/D 82: 29-34
- "Eminently Domineering," (P) S/D 84: 10-13
- "Fall of the House of *Usery*, The: Federalism in the Supreme Court," G. Rees III. M/J 83: 31-37
- "*Ford Motor Co. v. FTC*: No Rule without a Rulemaking?" (P) S/O 81: 13-14, 59
- "How to Convince an Agency: A Handbook for Policy Advocates," J. V. DeLong. S/O 82: 27-36
- "Is Pinto a Criminal?" R. A. Epstein. M/A 80: 15-21
- "Judicial Power of the Purse, The," G. E. Frug. (R) M/A 79: 58
- "Karen Silkwood, Federalist," (P) J/F 84: 4-7
- "Legislative History Reconsidered," (P) S/O 80: 10-12
- "Liability by Association," (P) J/A 80: 6-9
- "Liberty and Property: The Problem of Government Benefits," S. F. Williams. (R) M/A 83: 47-48
- "Litigation, Bargaining, and Regulation," P. H. Schuck. J/A 79: 26-34
- "Locking the Rascals In," (P) M/J 81: 4-5
- "Manville: The Bankruptcy of Product Liability Law," R. A. Epstein. S/O 82: 14-19, 43-46
- "*Mount Laurel II*: State Courts Rush In . . ." (P) M/A 83: 6-8
- "Multiple Regression in Legal Proceedings," F. M. Fisher, and "Judicial Reception of Multiple Regression Studies in Race and Sex Discrimination Cases, The," M. O. Finkelstein. (R) J/F 81: 52
- "Note on the Benzene Case, A," A. Scalia. J/A 80: 25-28
- "On Constitutional Economics," R. H. Bork. S/O 83: 14-18
- "On Not Enforcing the Law," F. H. Easterbrook. J/F 83: 14-16
- "On Predicting the Future of Administrative Law," M. Shapiro. M/J 82: 18-25
- "Private Attorney General Industry, The: Doing Well by Doing Good," (P) M/J 82: 5-7
- "Protecting Workers' Hearing: An Economic Test for OSHA Initiatives," J. C. Miller III and T. F. Walton. S/O 80: 31-37
- "Public Programs and Private Rights," R. B. Stewart and C. R. Sunstein. (R) J/A 82: 54-55
- "Race, Ratchets, Redistricting, and the Voting Rights Act," (P) J/A 84: 11-13, 38
- Regulation and the Courts: The Case of the Clean Air Act*, R. S. Melnick. (R) J/F 84: 42-44
- "Regulatory Oversight Wins in Court: *Sierra Club v. Costle*," M. Sohn and R. Litan. J/A 81: 17-24
- "Reversing the D. C. Circuit at the FCC," (P) M/J 81: 11-14
- "Rum, Federalism, and Regulation," (P) N/D 79: 14-15
- "Should Courts Draw the Lines?" (P) N/D 81: 10-12
- "Suing our Servants: The Court, Congress, and the Liability of Public Officials for Damages," P. H. Schuck. (R) J/A 81: 53-54
- "Venue Reform: Sue West, Young Man?" (P) J/F 82: 10-14
- "Weber Case, The: Double Talk and Double Standards," B. D. Meltzer. S/O 79: 34-43
- See also Antitrust; *Bakke* case; Legislative veto; Sunset laws
- Law of the Sea Convention:** see Regulation, international
- Laws, Margaret**
- "UNESCO of the North: The Coming of Press Regulation in Canada," S/O 83: 37-42
- Legal profession**
- "Evolving Concept of Professional Responsibility, The," T. D. Morgan. (R) S/O 77: 48
- "Fast and Loose in the Welfare State," C. Fried. M/J 79: 13-16
- "Private Attorney General Industry, The: Doing Well by Doing Good," (P) M/J 82: 5-7
- "Will Lawyering Strangle Democratic Capitalism?" L. H. Silberman. M/A 78: 15-22, 44
- Legislative veto**
- "After the Legislative Veto: Reflections from the Losing Side," M. Davidson. J/A 83: 23-26
- "After the Legislative Veto: Restoring the Separation of Powers," T. B. Olson. J/A 83: 19-22, 27-30
- "Congressional Control of Administrative Regulation: A Study of Legislative Vetoes," H. H. Bruff and E. Gellhorn. (R) J/F 78: 54-55
- "Congressional Veto and Separation of Powers, The: Executive on a Leash?" R. G. Dixon, Jr. (R) N/D 78: 61-62
- "Legislative Veto, The: A False Remedy for System Overload," A. Scalia. N/D 79: 19-26
- Legislative Veto, The: Unseparating the Powers*, J. R. Bolton. (R) J/F 78: 53-54
- "Legislative Veto and the Constitution, The—A Reexamination," B. Schwartz. (R) N/D 78: 62-63
- Lenard, Thomas M.**
- "Wasting Our National Forests—How to Get Less Timber and Less Wilderness at the Same Time," J/A 81: 29-36
- Levin, Mark M.**
- "Nursing the Railroads Back to Health" (with B. N. Stram). S/O 81: 29-36
- Levin, Michael**
- "Politics and Polarity: The Limits of OSHA Reform," N/D 79: 33-39
- Lichter, S. Robert**
- "How Liberal Are Bureaucrats?" (with S. Rothman). N/D 83: 16-22
- "Nuclear Power—The Decision Makers Speak" (with R. L. Cohen). M/A 83: 32-37
- Litan, Robert**
- "Regulatory Oversight Wins in Court: *Sierra Club v. Costle*" (with M. Sohn). J/A 81: 17-24
- Lobbying**
- "Grass-Roots Lobbying: Propaganda Non Grata," (P) M/J 81: 8-11
- "OMB's 'Wall of Separation' against Tax-Funded Advocacy," (P) J/F 83: 8-11
- "Politics and Economics of Senate Voting on Coal Strip Mining Policy, The," and "Further Evidence on Capture and Ideology in the Economic Theory of Politics," J. P. Kalt and M. A. Zupan. (R) N/D 83: 49-50
- "Should Consumers Pay for Lobbying Expenses?" (P) J/F 78: 7-8
- Local and state government**
- Antitrust and Local Government: Perspectives on the Boulder Decision*, J. V. Siena, ed. (R) M/J 83: 45-46
- "Auto Insurance: The Irrelevance of Regulation," M. Nadel. M/A 82: 37-42
- "Competition among the States: The Ethics of Regulatory Competition," S. Kelman. M/J 82: 39-44. "A Response," W. Olson. M/J 82: 44-47
- Controlling Hospital Costs: The Role of Government Regulation*, P. L. Joskow. (R) J/F 82: 51, 54
- "Democracy and Due Process: The Case of Handicapped Education," J. E. Haynes. N/D 82: 29-34
- "Does Father Know Best? The Case of State Employment Agencies," W. Papier. M/A 82: 43-46
- "Electric Utility Regulation and National Energy Policy," P. Navarro. J/F 81: 20-27
- "Fall of the House of *Usery*, The: Federalism in the Supreme Court," G. Rees III. M/J 83: 31-37
- Federal Grants-in-Aid to New Hampshire and Revenue Adequacy*, C. D. Campbell, J. R. Fries, and R. G. Campbell. (R) M/J 83: 44-45
- "Federal Solicitude, Local Costs: The Impact of Federal Regulation on Municipal Finances," T. Muller and M. Fix. J/A 80: 29-36
- "Health Care Reform and Market Discipline—Federalism Strikes Back," J. A. Meyer. N/D 82: 16-20
- "Karen Silkwood, Federalist," (P) J/F 84: 4-7
- "Licensing, Migration and Earnings: Some Empirical Insights," M. M. Kleiner, R. S. Gay, and K. Greene. (R) N/D 82: 49-50
- "More Governmental Innovation from the Golden State," (P) J/F 81: 8-9
- "*Mount Laurel II*: State Courts Rush In . . ." (P) M/A 83: 6-8
- "Much A-Brew about Nothing," (P) M/J 81: 7-8
- "New York City Looks at Taxi Regulation," (P) M/A 82: 11-13, 36
- "No Growth—No Vacancies," T. Bethell. J/A 81: 13-16
- "Patchwork Quilt, The State and Federal Roles in Bank Regulation," K. E. Scott. (R) J/F 81: 50-51
- Politics of Public Utility Regulation, The*, W. T. Gormley, Jr. (R) J/F 84: 45-46
- "Regulation, Federalism, and Interstate Commerce," A. D. Tarlock, ed. (R) S/O 81: 57
- "Regulation Gone Amok—How Many Billions for Wheelchair Transit?" T. B. Clark. M/A 80: 47-52
- Regulatory Federalism: Policy, Process, Impact and Reform*, Advisory Committee on Intergovernmental Relations. (R) S/D 84: 68-70
- Regulatory Politics and Electric Utilities: A Case Study in Political Economy*, D. D. Anderson. (R) J/A 82: 55-56

- "Regulatory Reform in the States: A View from New York." (P) S/O 82: 11-12
 "Saving the Cities..." (P) S/O 81: 10-11
Self-Regulation in the Professions, H. Shuchman et al. (R) J/F 82: 49-50
 "Skagway v. EPA—Cassandra's Prophecy Revisited." D. M. Shell. N/D 80: 50-53
 "'State' of Regulatory Reform, The," B. E. Babbitt. S/O 80: 38-42
 "State Taxes and Federal Dilemmas." (P) M/J 82: 10-12, 38
 "Taxi Reform—The FTC Can Hack It," E. W. Kitch. M/J 84: 13-15
 "Unsnarling the Federal Grant System," C. E. Barfield, Jr. S/O 81: 37-46
 "Why the Sagebrush Revolt Burned Out," R. H. Nelson. M/J 84: 27-35
- Mabley, Robert E.**
 "Deregulation—A Green Light for Trucking Efficiency" (with W. D. Strack). J/A 82: 36-42, 56
- Macauley, Molly K.**
 "Property Rights in Orbit—Slicing the Geostationary Pie" (with P. R. Portney). J/A 84: 14-18, 51-52
- McConnell, Michael W.**
 "Affirmative Action after *Teal*: A New Twist or a Turn of the Screw?" M/A 83: 38-44
- McKenzie, Richard B.**
 "Frustrating Business Mobility." M/J 80: 32-38
- Malbin, Michael J.**
 "Neither a Mountain Nor a Molehill: The Business PAC Phenomenon." M/J 79: 41-43
 "What Should Be Done about Independent Campaign Expenditures?" J/F 82: 41-46
- Maloney, M. T.**
 "Bubbles and Efficiency: Cleaner Air at Lower Cost" (with B. Yandle). M/J 80: 49-52
- Management and Budget, Office of**
 "OMB's 'Wall of Separation' against Tax-Funded Advocacy." (P) J/F 83: 8-11
 See also Regulatory management
- Marshall, Burke**
 "Conversation with a Dean of Admissions." S/O 78: 39-41
- Mashaw, Jerry L.**
 "Regulation, Logic, and Ideology." N/D 79: 44-51
- Maslove, Allan M.**
 "Wage Controls in Canada" (with G. Swimmer). J/F 79: 31-36
- Mass transit:** see Transportation
- Medical care and equipment:** see Health care
- Meltzer, Bernard D.**
 "Inflation and the NLRB: A Case of Fortuitous Regulatory Expansion" (assisted by R. J. LaLonde). S/O 80: 43-45
 "Weber Case, The: Double Talk and Double Standards." S/O 79: 34-43
- Mendeloff, John**
 "Does Overregulation Cause Underregulation? The Case of Toxic Substances." S/O 81: 47-52
- Meyer, Jack A.**
 "Health Care Reform and Market Discipline—Federalism Strikes Back." N/D 82: 16-20
 "Hiding the Costs of National Health Insurance" M/A 80: 22-28, 58
- Migrant workers**
 "Apples and Aliens." E. Cowan. N/D 78: 40-45
- Milk:** see Agriculture
- Miller, James C. III**
 "Advice for the President-Elect: Aviation Regulatory Policy." N/D 80: 32-33
- "Advice for the President-Elect: Occupational Safety and Health Administration." N/D 80: 22-23
 "Deregulation HQ: An Interview on the New Executive Order with Murray L. Weidenbaum and James C. Miller III." M/A 81: 14-23
 "Lessons of the Economic Impact Statement Program." J/A 77: 14-21
 "Price Competition on the NYSE" (with J. A. Eisenach). J/F 81: 16-19
 "Protecting Workers' Hearing: An Economic Test for OSHA Initiatives" (with T. F. Walton). S/O 80: 31-37
 "Regulators and Experts." N/D 77: 36-37
 "Round and 'Round on RPM: An Analytical Framework." J/F 84: 31-32
- Minimum wage:** see Employment practices
- Mining**
 "Economic Impacts of Environmental Regulations on the U.S. Copper Industry, The." R. S. Hartman, K. Bozdogan, and R. M. Nadkarni. (R) S/O 80: 54
 See also Coal; Energy; Regulation, international
- Mitchell, Edward J.**
 "New Ideas about Oil Mergers." M/A 84: 13-15
 "Oil, Film, and Folklore." J/A 78: 17-20, 55
 "Protection for Petroleum Refiners?" J/A 81: 37-42
- Moore, Thomas Gale**
 "Advice for the President-Elect: Regulation of Surface Transport." N/D 80: 34-35
 "Deregulating Transportation." M/A 78: 37-44
 "Rail and Truck Reform—The Record So Far." N/D 83: 33-41
 "Regulation—The First Year: Transportation." J/F 82: 27-29
- Moran, Mark J.**
 "Myth of Runaway Bureaucracy, The: The Case of the FTC" (with B. R. Weingast). M/J 82: 33-38
- Mueller, Milton**
 "Airwaves for Sale? Spectrum Fees vs. Spectrum Liberation." M/J 83: 21-25, 52
- Muller, Nathan J.**
 "Reflections on the Election Commission: An Interview with Neil O. Staebler." M/A 79: 33-38
- Muller, Thomas**
 "Federal Solicitude, Local Costs: The Impact of Federal Regulation on Municipal Finances" (with M. Fix). J/A 80: 29-36
- Munger, Michael C.**
 "Protection at Any Price?" (with M. L. Weidenbaum). J/A 83: 14-18
- Muris, Timothy J.**
 "Rules without Reason—The Case of the FTC." S/O 82: 20-26
- Murphy, John G., Jr.**
 "Federal Election Commission, The: A Rebuttal." S/O 78: 42-51
- Muse, M. Lamar**
 "Competition in the Airlines" (with A. V. Casey, E. I. Colodny, E. M. Kennedy, and J. E. Robson). N/D 77: 24-35
- Nadel, Mark**
 "Auto Insurance: The Irrelevance of Regulation." M/A 82: 37-42
- Nager, Glen D.**
 "Bureaucrats and the Cost-Benefit Chameleon." S/O 82: 37-42
- National health insurance:** see Health care
- National Highway Traffic Safety Administration**
 "Motorcycles, Safety, and Freedom." (P) J/A 80: 10-11
 See also Autos and auto industry
- Nationalization**
Crown Corporations in Canada: The Calculus of Instrument Choice, J. R. S. Prichard, ed. (R) S/D 84: 72-73
 "Eminently Domineering." (P) S/D 84: 10-13

- "Heavy Landing" for Canada: A Tale of Industrial Policy." (P) S/D 84: 4-7
Nationalized Companies, R. J. Munsen and K. D. Walters. (R) M/A 84: 50-51
 "Theory of Expropriation and Deviations from Perfect Capital Mobility, A," J. Eaton and M. Gersovitz. (R) S/D 84: 71-72

National Labor Relations Board

- "Inflation and the NLRB: A Case of Fortuitous Regulatory Expansion," B. D. Meltzer (assisted by R. J. LaLonde). S/O 80: 43-45

Navarro, Peter

- "Electric Utility Regulation and National Energy Policy." J/F 81: 20-27
 "Energy Crisis, The—Moral Equivalent of Civil War" (with J. P. Kalt). J/F 80: 41-43
 "Save Now, Freeze Later—The Real Price of Cheap Electricity." S/O 83: 31-36

Nelson, Robert H.

- "Subsidized Sagebrush, The: Why the Privatization Movement Failed." J/A 84: 20-26, 39-43
 "Undue Diligence—The Mine-It-or-Lose-It Rule for Federal Coal." J/F 83: 34-38
 "Why the Sagebrush Revolt Burned Out." M/J 84: 27-35

Neustadt, Richard M.

- "Taming the Paperwork Tiger." J/F 81: 28-32

New media: see First Amendment

Nisbet, Robert

- "Cancer and Ideology: A Review of Edith Efron's *The Apocalyptic: Politics, Science, and the Big Cancer Lie*." M/A 84: 41-44
 "Capitalism and the Intellectuals: A Review of P. Johnson's *The Enemies of Society*." N/D 77: 38-39
 "Defending Cost-Benefit Analysis: Replies to Steven Kelman." M/A 81: 42-43

Niskanen, William A.

- "Advice for the President-Elect: Auto Regulation." N/D 80: 24-27

Noise

- "Charges to Control Aircraft Noise," D. C. Cell. (R) J/A 82: 53-54
 "Protecting Workers' Hearing: An Economic Test for OSHA Initiatives," J. C. Miller III and T. F. Walton. S/O 80: 31-37

Noll, Roger G.

- "What Makes Reform Happen?" (with B. M. Owen). M/A 83: 19-24

Novak, Michael

- "Questions for the Court." S/O 78: 34-36

Nuclear power

- "Congress, Regulation, and the Decline of Nuclear Power," B. R. Wein-gast. (R) S/O 80: 51-53
 "How Prometheus Came to Be Bound," M. Golay. (R) J/F 81: 48-49
 "Inhaber and the Limits of Cost-Benefit Analysis," S. Weaver. J/A 79: 14-16
 "Karen Silkwood, Federalist." (P) J/F 84: 4-7
 "Licensing of Nuclear Power Plants," M. A. Rowden. J/F 78: 40-47, 56
 "Nuclear Power—The Decision Makers Speak," R. L. Cohen and S. R. Lichter. M/A 83: 32-37
Seabrook and the Nuclear Regulatory Commission—The Licensing of a Nuclear Power Plant, D. W. Stever, Jr. (R) S/O 80: 50-51
 "Vermont Yankee: The APA, the DC. Circuit, and the Supreme Court," A. Scalia. (R) M/J 79: 63
 "Vermont Yankee Power: Judicial Oversight of Agency Procedures." (P) J/A 78: 10-12
 See also Energy

Occupational licensure

- "Controlling Clip Joints," J. Rose. J/A 80: 37-40
Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry, R. S. Bond, J. E. Kwoka, Jr., J. J. Phelan, and I. T. Whitten. (R) J/A 80: 49-50
 "Licensing, Migration and Earnings: Some Empirical Insights," M. M. Kleiner, R. S. Gay, and K. Greene. (R) N/D 82: 49-50

- "New York City Looks at Taxi Regulation." (P) M/A 82: 11-13, 36
 "Professional Licensure—One Diagnosis, Two Cures." (P) S/O 83: 11-13
 "Regulatory Reform in the States: A View from New York." (P) S/O 82: 11-12
 "Seattle Taxis: Deregulation Hits a Pothole," R. O. Zerbe, Jr. N/D 83: 43-48
Self-Regulation in the Professions, H. Shuchman et al. (R) J/F 82: 49-50

Occupational safety and health

- "Advice for the President-Elect: Occupational Safety and Health Administration," J. C. Miller III. N/D 80: 22-23
 "Battling Carcinogens Systematically: New Strategies at OSHA and CPSC." (P) J/F 79: 7-9
 "Benzene and Worker Health." (P) N/D 77: 7-9
 "Can Government Regulate Safety? The Coal Mine Example," M. S. Lewis-Beck and J. R. Alford. (R) J/A 81: 57-58
 "Constraining Regulatory Costs—Part I: The White House Review Programs," C. C. DeMuth. J/F 80: 13-26
 "Cotton Dust Case, The." (P) J/F 81: 5-6
 "(Cotton) Dust Settles, The." (P) J/A 81: 4-6
 "Does Overregulation Cause Underregulation: The Case of Toxic Substances," J. Mendeloff. S/O 81: 47-52
Employment Hazards: An Investigation of Market Performance, W. K. Viscusi. (R) M/A 80: 55-56
 "Government Comes to the Workplace: An Assessment of OSHA," A. L. Nichols and R. Zeckhauser. (R) J/F 78: 50-51
 "Hazards of Hazard Labeling, The." (P) M/J 82: 9-10
 "Impact of Occupational Safety and Health Regulation, The," W. K. Viscusi. (R) J/F 80: 51
 "Impact of OSHA Inspections on Manufacturing Injury Rates, The," R. S. Smith. (R) M/A 80: 56-57
 "In Search of OSHA," P. J. Harter. S/O 77: 33-39
 "Note on the Benzene Case, A," A. Scalia. J/A 80: 25-28
 "OSHA and the Fourth Amendment." (P) J/A 78: 6-7
 "OSHA and Work-Place Hazards: Cotton Dust." (P) J/A 77: 6-7
 "OSHA: The Urgency of Revival," R. Bargmann. (R) S/O 77: 44-45
 "Perils of Risk Avoidance, The," P. Johnson. M/J 80: 15-19
 "Politics and Polarity: The Limits of OSHA Reform," M. Levin. N/D 79: 33-39
 "Protecting Workers' Hearing: An Economic Test for OSHA Initiatives," J. C. Miller III and T. F. Walton. S/O 80: 31-37
 "Reagulation—The First Year: Health and Safety," W. K. Viscusi. J/F 82: 34-36
Regulating America, Regulating Sweden: A Comparative Study of Occupational Safety and Health Policy, S. Kelman. (R) N/D 81: 49-50
 "Regulating Cancer—Fast, Fast, Fast Relief!" (P) M/A 80: 4-7
Regulating Safety: An Economic and Political Analysis of Occupational Safety and Health Policy, J. Mendeloff. (R) N/D 80: 57-59
Risk by Choice, W. K. Viscusi. (R) M/J 83: 42-43
 "Safety Regulation and Firm Size: Effects of the Coal Mine Health and Safety Act of 1969," G. R. Neumann and J. P. Nelson. (R) J/F 83: 46-48

Occupational Safety and Health Administration: see Occupational safety and health

Oceans and ocean shipping

- "Cargo Preference: A Foot in the Door?" (P) S/O 77: 3-4
Enclosure of Ocean Resources, The, R. Eckert. (R) J/A 80: 41-42
 "Oil Discharges and Oil Spills." (P) S/O 77: 2-3
 See also Fishing industry; Regulation, international

Oi, Walter

- "Safety at Any Price?" N/D 77: 16-23

Oil: see Energy

Olson, Theodore B.

- "After the Legislative Veto: Restoring the Separation of Powers." J/A 83: 19-22, 27-30

Olson, Walter

- "Competition among the States: A Response." M/J 82: 44-47
 "Reagan Record, The: Where's the Reform?" M/A 84: 30-32, 40

Optometry: see Occupational licensure

Oswald, Rudolph

- "On Carter's Anti-Inflation Policy." J/F 79: 17-30

Oversight: see Regulatory management

Owen, Bruce M.

"What Makes Reform Happen?" (with R. G. Noll). M/A 83: 19-24

Paperwork and red tape: see Bureaucracy

Papier, William

"Does Father Know Best? The Case of State Employment Agencies." M/A 82: 43-46

Pashigian, B. Peter

"How Large and Small Plants Fare under Environmental Regulation." S/O 83: 19-23

Patents: see Copyright and patents

Pelrice, Neal R.

"On Rent Control: A Review of J. F. Brenner and H. M. Franklin's *Rent Control in North America and Four European Countries*." M/J 78: 45-46

Pelcovits, Michael D.

"Toward Competition in Phone Service: A Legacy of Regulatory Failure" (with S. R. Brenner and N. W. Cornell). J/A 83: 37-42

Pensions and annuities

"Department of Anticipated Consequences." (P) J/F 81: 6-8

"ERISA, Thidwick, and the 'Gotcha' Problem." (P) S/O 83: 4-7

"Pension Reversions: Who Owns the \$100 Billion?" (P) M/A 84: 11-12, 40

"Pension Vesting and the IRS: The Power of Regulatory Persistence." (P) N/D 83: 9-12

"Sex Discrimination in Employer-Sponsored Insurance Plans: A Legal and Demographic Analysis." L. Brilmayer, R. W. Hekeler, D. Laycock, and T. A. Sullivan. (R) J/F 81: 49-50

Pertschuk, Michael

"Needs and Licenses." M/A 79: 14-16

Petroleum

"Advice for the President-Elect: Auto Regulation." W. A. Niskanen. N/D 80: 24-27

"Advice for the President-Elect: Energy Regulation." M. L. Weidenbaum. N/D 80: 23-24

"Conflicting Goals of National Energy Policy, The." R. E. Hall and R. S. Pindyck. (R) N/D 77: 40

"DOE Walks into a Better Mousetrap." (P) S/O 83: 7-8

"Dubious Bill of Divorcement, A: The Case of Oil Refiners and Gas Stations." J. Barron and J. R. Umbeck. J/F 83: 29-33

Economics and Politics of Oil Price Regulation, The: Federal Policy in the Post-Embargo Era, J. P. Kalt. (R) S/O 81: 54-55

"Effectiveness of Odd-Even Gasoline Rationing, The." M. R. Metzger and R. S. Goldfarb. (R) M/A 84: 48

"Energy Crisis, The—Moral Equivalent of Civil War." J. P. Kalt and P. Navarro. J/F 80: 41-43

"Fuel Efficiency by Government Mandate: A Cost-Benefit Analysis." B. Yandle. (R) N/D 80: 60-61

"Gasohol Hangover, The." (P) N/D 81: 12-14

Limiting Oil Imports: An Economic History and Analysis, D. R. Bohi and M. Russell. (R) S/O 79: 56-57

"Miles per Gallon: Steps to 1985." (P) S/O 77: 7-8

"New Ideas about Oil Mergers." E. J. Mitchell. M/A 84: 13-15

"Next Oil Shock, The—Giving the Market a Chance." G. Horwich and D. L. Weimer. M/A 84: 16-24

"Oil, Film, and Folklore." E. J. Mitchell. J/A 78: 17-20, 55

"Protection for Petroleum Refiners?" E. J. Mitchell. J/A 81: 37-42

"Tariff Alternative, The." (P) S/O 79: 5-6

"Why Oil Prices Should Be Decontrolled." K. J. Arrow and J. P. Kalt. S/O 79: 13-17

"Wreck of the Auto Industry, The." W. C. Tucker. (R) N/D 80: 61-62

Pharmaceuticals: see Drugs and drug industry

Pindyck, Robert S.

"Synthetic Fuels: Should the Government Subsidize Nonconventional Energy Supplies?" (with P. L. Joskow). S/O 79: 18-24, 43

Pinkston, Elizabeth A.

"Rise and Fall of Bus Regulation, The." S/D 84: 45-52

Pitofsky, Robert

"Round and 'Round on RPM: Why *Dr. Miles* Was Right." J/F 84: 27-30

Political action committees

"Reflections on the Election Commission: An Interview with Neil O. Staebler." N. J. Muller. M/A 79: 33-38

See also Campaigns and elections

Pollution: see Environment

Portney, Paul R.

"How Not to Create a Job." N/D 82: 35-38

"Making Ready for the Clean Air Act" (with D. Harrison, Jr.). M/A 81: 24-31

"Property Rights in Orbit—Slicing the Geostationary Pie" (with M. K. Macauley). J/A 84: 14-18, 51-52

Posner, Richard A.

"Economic Theory of Privacy, An." M/J 78: 19-26

Postal Service, U.S.

"Government Regulation of Government: The USPS, the PRC, and the FCC." (P) M/J 80: 5-9

Preemption: see Local and state government

Press regulation: see First Amendment

Price controls and rationing

"Effectiveness of Odd-Even Gasoline Rationing, The." M. R. Metzger and R. S. Goldfarb. (R) M/A 84: 48

"Next Oil Shock, The—Giving the Market a Chance." G. Horwich and D. L. Weimer. M/A 84: 16-24

See also Wage and price controls

Privacy

"Economic Theory of Privacy, An." R. A. Posner. M/J 78: 19-26

"EFT, the Fed, and Your Right to Privacy." (P) J/F 78: 11-12

"Junk Telephone Calls." (P) S/O 78: 4-5

"OSHA and the Fourth Amendment." (P) J/A 78: 6-7

Personal Privacy in an Information Society, Privacy Protection Study Commission. (R) N/D 77: 42-43

Product safety and liability

"Aqua Slide 'N' Dive: The CPSC and the Court." (P) M/J 78: 9-10

"Back-Door Rulemaking: A View from the CPSC." T. M. Scanlon and R. A. Rogowsky. J/A 84: 27-30

"Battling Carcinogens Systematically: New Strategies at OSHA and CPSC." (P) J/F 79: 7-9

"CPSC Redesigns Its Injury Information System." (P) M/A 78: 8-9

"International Nanny—Regulating Hazardous Exports." (P) N/D 80: 8-12

"Is Pinto a Criminal?" R. A. Epstein. M/A 80: 15-21

"Karen Silkwood, Federalist." (P) J/F 84: 4-7

"Lawn Mowers, Matchbooks, and Architectural Glass." (P) N/D 77: 10, 35

"Liability by Association." (P) J/A 80: 6-9

"Manville: The Bankruptcy of Product Liability Law." R. A. Epstein. S/O 82: 14-19, 43-46

"NHTSA and the Firestone 500." (P) J/F 79: 12, 60

"Products Liability Insurance, Moral Hazard, and Contributory Negligence." R. S. Higgins. (R) S/O 81: 57-58

"Products Liability: The Gathering Storm." R. A. Epstein. S/O 77: 15-20

"Re Regulation—The First Year: Health and Safety." W. K. Viscusi. J/F 82: 34-36

"Safety Regulation." N. W. Cornell, R. G. Noll, and B. Weingast. (R) S/O 77: 43-44

"Toward a New Consumer Protection." R. B. Reich. (R) J/F 80: 48-49

"Tris and Children's Sleepwear: A Two-Edged Sword?" (P) S/O 77: 5-6

Property: see Land tenure and use

Protectionism: see Trade, international

Public employees: see Employment practices; Postal Service, U.S.

Public opinion

- "Cutting Corners on Samplers" (P) J. A 79: 8-10
Government Controls and the Public Interest: An International Survey of Business Opinion and Experience, M. Duerr and J. Greene. (R) S/O 77: 43
 "How's Business? What the Public Thinks," S. M. Lipset and W. Schneider. (R) N/D 78: 56-57
 "Public View of Regulation, The," S. M. Lipset and W. Schneider. (R) M/J 79: 59-60
 "Regulators and the Polls." (P) N/D 78: 10-12, 54

Public utilities: see Utilities

Quotas, employment: see Civil Rights

Rabin, Robert L.

- "Ozone Depletion Revisited—EPA Regulation of Chlorofluorocarbons." M/A 81: 32-38

Rabkin, Jeremy

- "Captive of the Court: A Federal Agency in Receivership." M/J 84: 16-26
 "Rulemaking, Bias, and the Dues of Due Process at the FTC." J/F 79: 43-45
 "Stroke of a Pen, The." M/J 81: 15-18

Racketeering

- "Regulating Rackets," P. Reuter. S/D 84: 29-36

Radio: see Telecommunications

Railroads

- "Advice for the President-Elect: Regulation of Surface Transport," T. G. Moore. N/D 80: 34-35
 "Allocation in Surface Freight Transportation: Does Rate Regulation Matter?" R. C. Levin. (R) J/A 78: 61-62
 "Boxcar Decontrol: No Empty Gesture." (P) S/O 83: 8-11
 "Deregulating Transportation," T. G. Moore. M/A 78: 37-44
Federal Subsidies for Rail Passenger Service: An Assessment of Amtrak, Congressional Budget Office. (R) S/O 82: 51-52
 "High Cost of Regulating U.S. Railroads, The," D. W. Caves, L. R. Christensen, and J. A. Swanson. J/F 81: 41-46
 "Impact of Rail Deregulation on the Movement of Fresh Fruits and Vegetables, The," H. W. German and M. W. Babcock. (R) M/J 83: 43-44
 "Letting the Buses Run Free." (P) S/O 79: 8-10
 "Midwest Railroads and Northeast Lessons," J. W. Barnum. J/A 78: 30-35
 "Minimum Rate Regulation, Modal Split Sensitivities, and the Railroad Problem," K. D. Boyer. (R) S/O 77: 43
 "Nursing the Railroads Back to Health," M. M. Levin and B. N. Stram. S/O 81: 29-36
 "Rail and Truck Reform—The Record So Far," T. G. Moore. N/D 83: 33-41
Railroad Revitalization and Regulatory Reform, P. W. MacAvoy and J. W. Snow, eds. (R) M/A 78: 50-51
 "Railroads' 'Yo-Yo' Provision Expires, The." (P) J/A 78: 7-8
Railway Pricing under Commercial Freedom: The Canadian Experience, T. D. Heaven and J. C. Nelson. (R) M/J 78: 50-51
 "Regulation—The First Year: Transportation," T. G. Moore. J/F 82: 28-29
 "Report on Harbridge House Survey of the Impact of Transportation Deregulation on Major U.S. Manufacturing Firms." (R) M/A 82: 52
Transportation Policy: Regulation, Competition, and the Public Interest, K. M. Ruppenthal and W. T. Stanbury, eds. (R) M/J 78: 52-54
Transportation Rates and Economic Development in Northern Ontario, N. C. Bonsor. (R) S/O 77: 41-42
 "U.S.-Canadian Railroads: Bordering on Frustration." (P) J/A 83: 12-13, 52

Rationing: see Price controls and rationing

Reapportionment

- "Race, Ratchets, Redistricting, and the Voting Rights Act." (P) J/A 84: 11-13, 38
 "Should Courts Draw the Lines?" (P) N/D 81: 10-12

Rees, Grover III

- "Fall of the House of Usher, The: Federalism in the Supreme Court." M/J 83: 31-37

Regulation, general

- "About Knowledge and Decisions: A Review of Thomas Sowell's *Knowledge and Decisions*," W. Havender. M/A 82: 47-50
 "Bootleggers and Baptists—The Education of a Regulatory Economist," B. Yandle. M/J 83: 12-16
 "CAB + ICC + FMC = NTC?" (P) M/J 83: 10-11, 50
 "Can Government Regulate Itself?" J. Q. Wilson and P. Rachal. (R) J/A 77: 47-48
 "Capitalism and the Intellectuals: A Review of P. Johnson's *The Enemies of Society*," R. Nisbet. N/D 77: 38-39
 "Compensating Victims of Policy Change," R. S. Goldfarb. S/O 80: 22-30
 "Competition among the States: The Ethics of Regulatory Competition," S. Kelman. M/J 82: 39-44. "A Response," W. Olson. M/J 82: 44-47
 "Congressional Control." (P) M/J 80: 12-13
 "Constraining Regulatory Costs—Part I: The White House Review Programs; Part II: The Regulatory Budget," C. C. DeMuth. J/F 80: 13-26; M/A 80: 29-39, 42-44
 "Controlling Clip Joints," J. Rose. J/A 80: 37-40
 "Crisis in the Fiscal Commons, A: The Impact of Federal Expenditures on State and Local Governments," P. L. Posner and S. M. Sorett. (R) M/J 79: 58-59
 "Decline of Separation of Functions in Regulatory Agencies," W. F. Pederson, Jr. (R) N/D 79: 52-53
 "Democrat Looks at the Republican Platform, A," S. Eizenstat. S/O 80: 14, 19-21
 "Does Overregulation Cause Underregulation? The Case of Toxic Substances," J. Mendeloff. S/O 81: 47-52
 "Executive Reorganization and Presidential Power," B. Karl. (R) J/F 79: 49-50
 "Factory Regulation: A Reinterpretation of Early English Experience," H. P. Marvel. (R) M/A 79: 55-56
 "Federal Solicitude, Local Costs: The Impact of Federal Regulation on Municipal Finances," T. Muller and M. Fix. J/A 80: 29-36
 "Final Senate Report on Regulation," Governmental Affairs Committee. (R) J/A 79: 52-53
 "For Effectiveness and Efficiency: S 262," A. Ribicoff. M/J 79: 17-20
Future of Business Regulation, The, M. L. Weidenbaum. (R) S/O 79: 55
 "George J. Stigler: An Appreciation," R. H. Coase. N/D 82: 21-24
Going by the Book: The Problem of Regulatory Unreasonableness, E. Bardach and R. A. Kagan. (R) N/D 82: 45-46
Governance of Federal Regulatory Agencies, D. M. Welborn. (R) M/A 78: 45-46
 "How to Convince an Agency: A Handbook for Policy Advocates," J. V. DeLong. S/O 82: 27-36
Impact of Regulation on Industrial Innovation, The, H. G. Grabowski and J. M. Vernon. (R) J/F 80: 46-47
Implementation Game, The: What Happens after a Bill Becomes Law, E. Bardach. (R) N/D 78: 60-61
 "Inspectorates in British Government," G. Rhodes. (R) M/J 81: 54-55
 "Laissez Partir: The Borders of Freedom," C. Fried. S/O 83: 43-45
 "Litigation, Bargaining, and Regulation," P. H. Schuck. J/A 79: 26-34
 "Making Crises, Not Energy," Y. Brozen. M/A 80: 11-14
 "Market for Risk, The," P. Huber. M/A 84: 33-39
 "More Demanding Standard, A: The Brown-Bentsen Bills," C. J. Brown. M/J 79: 20-23
 "Needs and Licenses," M. Pertschuk. M/A 79: 14-16
 "New 'Social Regulation,' The," W. Lilley and J. C. Miller III. (R) J/A 77: 43
 "On the Corporate Democracy Act," articles by M. Green, M. L. Weidenbaum, and R. K. Winter. M/J 80: 20-31
 "Perils of Risk Avoidance, The," P. Johnson. M/J 80: 15-19
Political Control of the Economy, E. R. Tufte. (R) N/D 78: 59-60
 "Presidential Power and the Politics of RARG," S. J. Tolchin. J/A 79: 44-49
 "Public Programs and Private Rights," R. B. Stewart and C. R. Sunstein. (R) J/A 82: 54-55
 "Public Use of Private Interest, The," C. L. Schultze. S/O 77: 10-14
 "Public View of Regulation, The," S. M. Lipset and W. Schneider. (R) M/J 79: 59-60
Regulated Industries and the Economy, The, P. W. MacAvoy. (R) J/A 80: 43, 46-48
 "Regulated Society, A?" I. Kristol. J/A 77: 12-13
 "Regulating against the Clock." (P) M/A 81: 5-7
Regulation and the Courts: The Case of the Clean Air Act, R. S. Melnick. (R) J/F 84: 42-44
 "Regulation and the 1982 Budget." (P) J/A 81: 9-11
 "Regulation and the 1983 Budget." (P) M/A 82: 9-11
 "Regulation and the 1984 Budget." (P) M/A 83: 8-10

- "Regulation and the 1985 Budget," (P) M/A 84: 9-11
Regulation, Economics, and the Law, B. H. Siegan, ed. (R) N/D 79: 54-55
Regulation Game, The, B. M. Owen and R. M. Braeutigam. (R) J/F 79: 51-52
 "Regulation, Liberty, and Equality," J. J. Kirkpatrick. N/D 77: 11-15
 "Regulation, Logic, and Ideology," J. L. Mashaw. N/D 79: 44-51
 "Regulatory Calendar, The: A Catalog without Prices," (P) J/F 80: 3-5
 "Regulatory Performance and Presidential Administration," T. M. Moe. (R) J/F 83: 48
 "Repairing Capitalism," R. Vaubel. J/A 80: 12-16
 "Republican Looks at the Democratic Platform, A," C. J. Collier. S/O 80: 15-18
 "Seizing the Opportunity," G. R. Ford. J/F 78: 15-17
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 "Theory of Non-market Failures, A," C. Wolf, Jr. (R) J/A 79: 56-57
 "Toward a More General Theory of Regulation," S. Peltzman. (R) J/A 77: 45-46
Tragic Choices, G. Calabresi and P. Bobbitt. (R) M/A 79: 53-54
 "Truth in Regulatory Budgeting," L. J. White. M/A 80: 44-46
Two Cheers for Capitalism, I. Kristol. (R) S/O 78: 58-59
 "Warring Critiques of Regulation," R. B. Reich. J/F 79: 37-42
 "Welfare State and the Decline of Electoral Politics, The," R. K. Winter, Jr. M/A 78: 11-14
 "Who's in Charge Here?" (P) S/O 79: 10-12
 "Will Carter Put Out the Fire?" D. R. Gergen. S/O 77: 21-26
Yale Journal on Regulation, B. Judson, ed. (R) N/D 83: 55-56

Regulation, International

- "Biting the Hand That Cures Them," K. L. Adelman. J/A 82: 16-18, 35
Enclosure of Ocean Resources, The, R. Eckert. (R) J/A 80: 41-42
 "Global Paternalism—The UN and the New International Regulatory Order," J. J. Kirkpatrick. J/F 83: 17-22
 "Global Straitjacket, A: The New International Regulation," R. Berryman and R. Schifter. S/O 81: 19-28
 "Mining the Seas for a Brave New World," W. Berns. N/D 81: 15-18
 "One OPEC Is Enough!" N. Ely. N/D 81: 19-24
 "Overseas Ethics, Four Years Later," (P) J/A 81: 11-12, 59
 "Property Rights in Orbit—Slicing the Geostationary Pie," M. K. Macauley and P. R. Portney. J/A 84: 14-18, 51-52
Regulating International Business through Codes of Conduct, R. J. Waldmann. (R) J/A 81: 50-51
Regulation of Business by International Agencies, M. A. Fejfar. (R) J/A 84: 51-52
 "UNCTAD Takes on the Brain Drain," (P) N/D 82: 8-11
 "UN System's War on the Drug Industry, The," H. Schwartz. J/A 82: 19-24
 "Vacuuming the Ocean Floor," (P) S/O 78: 8-9

Regulatory Analysis Review Group

- "Constraining Regulatory Costs—Part I: The White House Review Programs; Part II: The Regulatory Budget," C. C. DeMuth. J/F 80: 13-26; M/A 80: 29-39, 42-44
 "Presidential Power and the Politics of RARG," S. J. Tolchin. J/A 79: 44-49
 "Who's in Charge Here?" (P) S/O 79: 10-12

Regulatory costs: see Costs and benefits, general regulatory

Regulatory Council

- "Constraining Regulatory Costs—Part I: The White House Review Programs," C. C. DeMuth. J/F 80: 13-26
 "Regulatory Calendar, The: A Catalog without Prices," (P) J/F 80: 3-5

Regulatory management

- "Advice for the President-Elect: Reforming Government Regulation," M. L. Weidenbaum. N/D 80: 15-18
 "Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform," S. Breyer. (R) J/A 79: 53-54
 "Bootleggers and Baptists—The Education of a Regulatory Economist," B. Yandle. M/J 83: 12-16
 "Bureaucrats and the Cost-Benefit Chameleon," G. D. Nager. S/O 82: 37-42
 "Constraining Regulatory Costs—Part I: The White House Review Programs," C. C. DeMuth. J/F 80: 13-26
 "Deregulation HQ: An Interview on the New Executive Order with Murray L. Weidenbaum and James C. Miller III," M/A 81: 14-23
Federal Regulation: Roads to Reform, ABA Commission on Law and the Economy. (R) N/D 78: 57-58

- "Government Enterprise—A New Frontier for Regulatory Reformers," J. H. Shenefield. N/D 79: 16-18
 "Harnessing Regulation: The Evolving Role of White House Oversight," G. Eads. M/J 81: 19-26
 "Has Reagan Dropped the Ball?" R. W. Crandall. S/O 81: 15-18
 "Historical Note on Regulatory Reform, An," R. D. Tollison. N/D 78: 46-49
 "Is Regulatory Relief Enough?" M. H. Kusters and J. A. Eisenach. M/A 82: 20-27
 "More Governmental Innovation from the Golden State," (P) J/F 81: 8-9
 "1981 Budget and Regulatory Reform, The," (P) M/A 80: 7-8
 "Reagan Record, The: A Strategy for Regulatory Reform," C. C. DeMuth. M/A 84: 25-30
 "Reagan Record, The: Where's the Reform?" W. Olson. M/A 84: 30-32, 40
 "Reagulation—The First Year: Regulatory Review and Management," A. Scalia. J/F 82: 19-21. "General Discussion," J/F 82: 37-40
 "Reform as Totem—A Skeptical View," E. Gellhorn. M/J 79: 23-26
 "Regulatory Calendar, R.I.P.?" (P) M/A 82: 7-9
 "Regulatory Oversight Wins in Court: *Sierra Club v. Costle*," M. Sohn and R. Litan. J/A 81: 17-24
 "Regulatory Reform: Assessing the California Plan," M. N. Cohen. (R) J/F 84: 44-45
 "Regulatory Reform, c. 1525," (P) M/J 84: 11
Regulatory Reform in Canada, W. T. Stanbury and F. Thompson. (R) J/A 83: 58-59
 "Regulatory Reform in the States: A View from New York," (P) S/O 82: 11-12
Regulatory Reform Seminar: Proceedings and Background Papers, U.S. Commerce Department. (R) N/D 79: 56
 "'State' of Regulatory Reform, The," B. E. Babbitt. S/O 80: 38-42
 "Strong Beginning on Reform, A," C. C. DeMuth. J/F 82: 15-18
 "Taming the Paperwork Tiger," R. M. Neustadt. J/F 81: 28-32
 "Unsnarling the Federal Grant System," C. E. Barfield, Jr. S/O 81: 37-46
 "What Makes Reform Happen?" R. G. Noll and B. M. Owen. M/A 83: 19-24
 See also Deregulation

Regulatory procedure

- "Active Judges and Passive Restraints," (P) J/A 82: 10-15
 "Back-Door Rulemaking: A View from the CPSC," T. M. Scanlon and R. A. Rogowsky. J/A 84: 27-30
 "Back to Basics: Making Law without Making Rules," A. Scalia. J/A 81: 25-28
 "Bureaucrats and the Cost-Benefit Chameleon," G. D. Nager. S/O 82: 37-42
 "Choice between Adjudicating and Rulemaking for Formulating and Implementing Energy Policy, The," R. J. Pierce. (R) M/A 80: 54-55
 "Constraining Regulatory Costs—Part II: The Regulatory Budget," C. C. DeMuth. M/A 80: 29-39, 42-44
 "Cost of Getting Nowhere at the FTC, The," B. Yandle. J/A 81: 43-47
 "*Ford Motor Co. v. FTC*: No Rule without a Rulemaking?" (P) S/O 81: 13-14, 59
 "Freedom of Information Act Has No Clothes, The," A. Scalia. M/A 82: 14-19
 "Funding Public Participation in Regulatory Proceedings," (P) M/A 78: 10
 "*Home Box Office Case, The*: A Summer Rerun," (P) S/O 77: 4
 "Legislative Boost for Risk Assessment, A?" (P) M/J 84: 10-12
 "Negotiating Regulations: A Cure for Malaise," P. J. Harter. (R) J/A 83: 59-60
 "On Cable-TV and 'Lobbying' before the Agencies," (P) J/A 77: 4-5
 "On Predicting the Future of Administrative Law," M. Shapiro. M/J 82: 18-25
 "Reformation of American Administrative Law, The," R. Stewart. (R) J/A 77: 48
 "Regulators and Experts," J. C. Miller III. N/D 77: 36-37
 "Regulatory Reform—The Game Has Changed," A. Scalia. J/F 81: 13-15
 "Repealing Rules," J. V. DeLong. M/J 83: 26-30
Report on Trade Regulation Rulemaking Procedures of the Federal Trade Commission, Part I, B. B. Boyer, M. W. Bowers, H. Toiv, D. J. Edelman, B. C. Cartwright, C. J. DeVita, and J. M. Bennett. (R) J/A 79: 53
 "Reversing the D.C. Circuit at the FCC," (P) M/J 81: 11-14
 "Rulemaking, Bias, and the Dues of Due Process at the FTC," J. Rabkin. J/F 79: 43-45
 "Rules without Reason—The Case of the FTC," T. J. Muris. S/O 82: 20-26

- "Trade Secret Status of Health and Safety Testing Information, The: Reforming Agency Disclosure Policies," T. O. McGarity and S. A. Shapiro. (R) N/D 80: 56-57
- "Two Wrongs Make a Right: The Judicialization of Standardless Rulemaking," A. Scalia. J/A 77: 38-41
- "Vermont Yankee: The APA, The D.C. Circuit, and the Supreme Court," A. Scalia. (R) M/J 79: 63
- "Vermont Yankee Power: Judicial Oversight of Agency Procedures," (P) J/A 78: 10-12
- "What Makes Reform Happen?" R. G. Noll and B. M. Owen. M/A 83: 19-24

Regulatory reform: see Deregulation; Regulatory management

Reich, Robert B.

- "Warring Critiques of Regulation." J/F 79: 37-42

Religion

- "Regulators and Religion: Caesar's Revenge," A. C. Carlson. M/J 79: 27-34, 64

Rent control: see Housing

Republican party

- "Democrat Looks at the Republican Platform, A," S. Eizenstat. S/O 80: 14, 19-21

Resale price maintenance (RPM): see Antitrust

Research and development

- "Elusive Carrot, The: Tax Incentives for R&D," K. M. Brown. J/F 84: 33-38

Retirement

- "Regulating Retirement: The Indirect Costs," G. Horwich. M/J 78: 27-36

See also Pensions and annuities

Reuter, Peter

- "Regulating Rockets." S/D 84: 29-36

Ribicoff, Abe

- "For Effectiveness and Efficiency: S. 262." M/J 79: 17-20

Roback, Jennifer

- "Exploitation in the Jim Crow South: The Market or the Law?" S/D 84: 37-43

Robinson, Kenneth

- "Airwaves for Sale? Some Thoughts on Broadcasting Reform." M/J 83: 17-20, 47-50

Robson, John E.

- "Competition in the Airlines" (with A. V. Casey, E. I. Colodny, E. M. Kennedy, and M. L. Muse). N/D 77: 24-35

Rogowsky, Robert A.

- "Back-Door Rulemaking: A View from the CPSC" (with T. M. Scanlon). J/A 84: 27-30

Rose, Jonathan

- "Controlling Clip Joints." J/A 80: 37-40

Rothman, Stanley

- "How Liberal Are Bureaucrats?" (with S. R. Lichter). N/D 83: 16-22

Rowden, Marcus A.

- "Licensing of Nuclear Power Plants." J/F 78: 40-47, 56

Safety: see Cancer; Drugs and drug industry; Health and safety; Occupational safety and health; Product safety and liability

Scalia, Antonin

- "Advice for the President-Elect: Federal Communications Commission." N/D 80: 27-28
- "Advice for the President-Elect: Federal Trade Commission." N/D 80: 18-20
- "Back to Basics: Making Law without Making Rules." J/A 81: 25-28
- "Freedom of Information Act Has No Clothes, The." M/A 82: 14-19

- "Guadalajara! A Case Study in Regulation by Munificence." M/A 78: 23-29

- "Legislative Veto, The: A False Remedy for System Overload." N/D 79: 19-26

- "Note on the Benzene Case, A." J/A 80: 25-28

- "Reagulation—The First Year: Regulatory Review and Management." J/F 82: 19-21

- "Regulatory Reform—The Game Has Changed." J/F 81: 13-15

- "Two Wrongs Make a Right: The Judicialization of Standardless Rulemaking." J/A 77: 38-41

Scanlon, Terrence M.

- "Back-Door Rulemaking: A View from the CPSC" (with R. A. Rogowsky). J/A 84: 27-30

Schifter, Richard

- "Global Straitjacket, A: The New International Regulation" (with R. Berryman). S/O 81: 19-28

Schuck, Peter H.

- "Litigation, Bargaining, and Regulation." J/A 79: 26-34

Schultze, Charles L.

- "Public Use of Private Interest, The." S/O 77: 10-14

Schwartz, Harry

- "UN System's War on the Drug Industry, The." J/A 82: 19-24

Schwartz, Warren F.

- "Antidumping Duties for Japanese TVs." M/J 79: 53-56

Scott, Kenneth E.

- "Reagulation—The First Year: Financial Institutions." J/F 82: 32-34
- "Uncertain Course of Bank Deregulation, The." M/J 81: 40-45

Securities and Exchange Commission: see Securities industry

Securities industry

- "Assault on the First Amendment: The SEC's War on Newsletters," M. McMenamin and W. Gorenc, Jr. (R) M/A 83: 51-52

- "Corporate Control Transactions," F. H. Easterbrook and D. R. Fischel. (R) J/F 83: 45-46

- "Economic Effects of Federal and State Regulations of Cash Tender Offers, The," G. A. Jarrell and M. Bradley. (R) M/A 81: 54-56

- "Economic Effects of Federal Regulation of the Market for New Security Issues, The," G. A. Jarrell. (R) M/J 82: 49-50

- "Issues in the CFTC's Sunset Review." (P) M/J 78: 6-7

- "Large Changes for Small Business." (P) N/D 79: 11-14

- "Lifting Burdens at the Margin." (P) J/A 81: 6-9

- "Price Competition on the NYSE," J. A. Eisenach and J. C. Miller III. J/F 81: 16-19

- "Price Deregulation in the Brokerage Industry: An Empirical Analysis," A. R. Ofer and A. Melnick. (R) J/F 79: 52

- Regulation by Prosecution: The Securities and Exchange Commission vs. Corporate America*, R. Karmel. (R) M/J 82: 50-51

- SEC and Corporate Disclosure, The: Regulation in Search of a Purpose*, H. Kripke. (R) J/F 80: 51, 54

- SEC and the Public Interest, The*, S. M. Phillips and J. R. Zecher. (R) S/O 82: 52-53

- "Two Lies Are Better Than One." (P) M/J 80: 9-10

Seldman, David

- "Politics of Policy Analysis, The: Protection or Overprotection in Drug Regulation?" J/A 77: 22-37

Shapiro, Martin

- "On Predicting the Future of Administrative Law." M/J 82: 18-25

Shell, David M.

- "Skagway v. EPA—Cassandra's Prophecy Revisited." N/D 80: 50-53

Shenefield, John H.

- "Government Enterprise—A New Frontier for Regulatory Reformers." N/D 79: 16-18

Shipping: see Oceans and ocean shipping; Trucking

Silberman, Laurence H.

- "Will Lawyering Strangle Democratic Capitalism?" M/A 78: 15-22

Simon, Michael E.

"What We Did: The Business Roundtable Study." J/A 79: 20-21

Sims, Joe

"Antitrust Comes to City Hall." J/A 79: 35-41, 60

"New Era in Antitrust, The" (with W. Blumenthal). J/A 82: 25-28

"Report of the President's Commission on Antitrust." M/A 79: 25-32

Sindler, Allan P.

"Court's Three Decisions, The." S/O 78: 15-23

Skerry, Peter

"Vouchers and Family Choice: A Review of J. E. Coons and S. D. Sugarman's *Education by Choice: The Case for Family Control*." J/A 79: 50-51

Small business: see Business and industry

Smith, Fred L., Jr.

"Why Not Abolish Antitrust?" J/F 83: 23-28, 33

Social Security

Bureaucratic Justice: Managing Social Security Disability Claims, J. L. Mashaw. (R) S/O 83: 50-52

Sohn, Michael

"Regulatory Oversight Wins in Court: *Sierra Club v. Costle*" (with R. Litan). J/A 81: 17-24

Solow, Robert M.

"Defending Cost-Benefit Analysis: Replies to Steven Kelman." M/A 81: 40-41

Sowell, Thomas

"Landmark or Curiosity?" S/O 78: 30-34

State government: see Local and state government

Staten, Michael E.

"Close Encounters in the Skies: A Paradox of Regulatory Incentives" (with J. R. Umbeck). M/A 83: 25-31

Steel Industry

"Steel Imports: Dumping or Competition?" R. W. Crandall. J/A 80: 17-24

"Steel Imports—Reference Prices and a Precedent." (P) J/F 78: 13-14, 56

Stelzer, Irwin M.

"Electric Utilities—Next Stop for Deregulators?" J/A 82: 29-35

Stigler, George J.

"Economists and Public Policy." M/J 82: 13-17

See also Coase, Ronald H.

Strack, Walter D.

"Deregulation—A Green Light for Trucking Efficiency" (with R. E. Mabley). J/A 82: 36-42, 56

Stram, Bruce N.

"Nursing the Railroads Back to Health" (with M. M. Levin). S/O 81: 29-36

Suburbs

"Saving the Cities..." (P) S/O 81: 10-11

"...and Saving the Country." (P) S/O 81: 11-13

Sunset laws

"False Dawn of Sunset Laws, The." R. D. Behn. (R) J/F 78: 55-56

"Issues in the CFTC's Sunset Review." (P) M/J 78: 6-7

Swanson, Joseph A.

"High Cost of Regulating U.S. Railroads, The" (with D. W. Caves and L. R. Christensen). J/F 81: 41-46

Swimmer, Gene

"Wage Controls in Canada" (with A. M. Maslove). J/F 79: 31-36

Taxation

"Bob Jones University v. United States: Public Policy in Search of Tax Policy." P. B. Stephan III. (R) J/A 84: 50-51

"Elusive Carrot, The: Tax Incentives for R&D." K. M. Brown. J/F 84: 33-38

Federal Grants-in-Aid to New Hampshire and Revenue Adequacy, C. D. Campbell, J. R. Fries, and R. G. Campbell. (R) M/J 83: 44-45

"Grass-Roots Lobbying: Propaganda Non Grata." (P) M/J 81: 8-11

"OMB's 'Wall of Separation' Against Tax-Funded Advocacy." (P) J/F 83: 8-11

"Pension Vesting and the IRS: The Power of Regulatory Persistence." (P) N/D 83: 9-12

"Private Schools, Tax Exemption, and the IRS." (P) J/F 82: 5-8

"Regulators and Religion: Caesar's Revenge." A. C. Carlson. M/J 79: 27-34, 64

"State Taxes and Federal Dilemmas." (P) M/J 82: 10-12, 38

"Taxing Approach to Protection, A." (P) J/F 83: 6-8

Technology transfer: see Regulation, international

Telecommunications

"Advice for the President-Elect: Federal Communications Commission." A. Scalia. N/D 80: 27-28

"And Now, a Spectrum Bubble." (P) M/J 83: 8-10

"Citizens' Band—Citizens' Language." (P) N/D 77: 6-7

"Communications Act of 1978, The." (P) S/O 78: 13-14

"Deregulating Telecommunications." S. M. Besen. M/A 78: 30-36

"FCC v. National Citizens' Committee for Broadcasting and the Judicial Uses of Administrative Discretion." D. D. Polsby. (R) M/J 79: 62-63

"Government Regulation of Government: The USPS, the PRC, and the FCC." (P) M/J 80: 5-9

"Millions of CBs That Can't Be Sold." (P) M/A 78: 6

"Property Rights in Orbit—Slicing the Geostationary Pie." M. K. Macauley and P. R. Portney. J/A 84: 14-18, 51-52

"Talk vs. Action at the FCC." H. Geller. M/A 83: 15-18

See also: Broadcasting; Telephone industry

Telephone Industry

"Advice for the President-Elect: Federal Communications Commission." A. Scalia. N/D 80: 27-28

"Communications Act of 1978, The." (P) S/O 78: 13-14

"Deregulating Telecommunications." S. M. Besen. M/A 78: 30-36

"Government Regulation of Government: The USPS, the PRC, and the FCC." (P) M/J 80: 5-9

"Junk Telephone Calls." (P) S/O 78: 4-5

"Rate-of-Return Regulation: Protecting Whom from What?" N. W. Cornell. N/D 80: 36-41, 49

"Reagulation—The First Year: Antitrust and Trade Regulation." E. Gellhorn. J/F 82: 22-24

"Reagulation—The First Year: Telecommunications." H. Geller. J/F 82: 24-26

"Sorry, Wrong Company? Competition in Pay Phones." (P) J/A 84: 9-11

"Toward Competition in Phone Service: The Case for Freeing AT&T." M. L. Katz and R. D. Willig. J/A 83: 43-49

"Toward Competition in Phone Service: A Legacy of Regulatory Failure." N. W. Cornell, M. D. Pelcovits, and S. R. Brenner. J/A 83: 37-42

"Toward Competition in Phone Service: Why Local Rates Are Rising." L. L. Johnson. J/A 83: 31-36, 50-51

See also: Broadcasting; Telecommunications

Tennessee Valley Authority: see Endangered species

Timber Industry

"Logjam for U.S. Exports, A." (P) M/A 83: 10-12

"Lumber Transport and the Jones Act: A Multicommodity Spatial Equilibrium Analysis." R. Boyd. (R) S/O 83: 48-49

"Wasting Our National Forests—How to Get Less Timber and Less Wilderness at the Same Time." T. M. Lenard. J/A 81: 29-36

Tolchin, Susan J.

"Presidential Power and the Politics of RARG." J/A 79: 44-49

Tollison, Robert D.

"Historical Note on Regulatory Reform, An." N/D 78: 46-49

Toxic Substances

"Does Overregulation Cause Underregulation? The Case of Toxic Substances." J. Mendeloff. S/O 81: 47-52

"EDB and the Marigold Option." W. R. Havender. J/F 84: 13-17

- "International Nanny—Regulating Hazardous Exports." (P) N/D 80: 8-12
 "Managing Wastes Wastefully?" (P) M/A 80: 8-10
 "Of Mites and Men," W. Tucker. (R) N/D 78: 55-56
Regulatory Toxicology and Pharmacology, vol. 1 no. 1, F. Coulston and A. C. Kolbye, Jr., eds. (R) N/D 81: 54
 "Sensitive Populations and Environmental Standards," R. D. Friedman. (R) J/A 81: 58-59
Strategy of Social Regulation, The: Decision Frameworks for Policy, L. B. Lave. (R) S/O 81: 55-57
 "Toxic Substances Control Act: EPA's Initial Effort." (P) J/F 78: 8-9
 "Trade Secret Status of Health and Safety Testing Information, The: Reforming Agency Disclosure Policies," T. O. McGarity and S. A. Shapiro. (R) N/D 80: 56-57
 See also: Cancer; Occupational safety and health

Trade, International

- "Advice for the President-Elect: Auto Regulation," W. A. Niskanen. N/D 80: 24-27
 "Antidumping Duties for Japanese TVs," W. F. Schwartz. M/J 79: 53-56
 "Cargo Preference: A Foot in the Door?" (P) S/O 77: 3-4
 "Compensating Victims of Policy Change," R. S. Goldfarb. S/O 80: 22-30
 "Dispatch from the Nut Wars." (P) J/F 82: 8-10
 "Drug on the Export Market, A." (P) N/D 79: 10-11
Effects of Restrictions on United States Imports: Five Case Studies and Theory, M. Morkre and D. G. Tarr. (R) J/F 81: 51-52
 "Foreign Investors under Fire." (P) M/A 82: 5-7
 "Free Trade: Four American Voices" (from *State Papers and Speeches on the Tariff*, F. W. Taussig, ed.). J/F 83: 39-42
 "High Cost of 'Local Content,' The." (P) N/D 82: 14-15, 38
 "Import Restrictions on Sugar, Shoes, and TV Sets." (P) J/A 77: 8-9
 "International Nanny—Regulating Hazardous Exports." (P) N/D 80: 8-12
Limiting Oil Imports: An Economic History and Analysis, D. R. Bohi and M. Russell. (R) S/O 79: 56-57
 "Logjam for U.S. Exports, A." (P) M/A 83: 10-12
 "Missing the Boat on Export Trading Companies," A. Abbott. N/D 82: 39-44
 "Myth of De-industrialization, The." W. H. Branson. S/O 83: 24-29, 53-54
 "Protection at Any Price?" M. L. Weidenbaum and M. C. Munger. J/A 83: 14-18
 "Soviet Ammonia and Afghanistan." (P) J/F 80: 8-9, 55
 "Steel Imports: Dumping or Competition?" R. W. Crandall. J/A 80: 17-24
 "Steel Imports—'Reference Prices' and a Precedent." (P) J/F 78: 13-14, 56
 "Sugar Quotas: A Guide for the Economically Perplexed." (P) J/A 82: 4-6
 "Tariff Alternative, The." (P) S/O 79: 5-6
 "Taxing Approach to Protection, A." (P) J/F 83: 6-8
 "TVs, Border Taxes, and Executive Discretion." (P) S/O 77: 8-9
Zenith Radio Corp. v. U.S.: Countervailing Duties and the Regulation of International Trade, W. F. Schwartz. (R) M/J 79: 62

Transportation

- "Advice for the President-Elect: Regulation of Surface Transport," T. G. Moore. N/D 80: 34-35
 "CAB + ICC + FMC = NTC?" (P) M/J 83: 10-11, 50
 "Capital-Biased Subsidies, Bureaucratic Monitoring, and Bus Scrapping," M. W. Frankena. (R) J/A 83: 53-54
 "Charter for Bus Reform, A." (P) J/A 82: 6-8
 "Deregulation and the Theory of Contestable Markets," E. E. Bailey and W. J. Baumol. (R) S/D 84: 70-71
Free Enterprise Urban Transportation, G. Roth and G. G. Wynne. (R) J/F 83: 43-44
 "Getting Downtown—Relief of Highway Congestion through Pricing," S. F. Williams. M/A 81: 45-50
 "HEW and DOT Confront Discrimination against the Handicapped." (P) N/D 78: 7-10
 "Lumber Transport and the Jones Act: A Multicommodity Spatial Equilibrium Analysis," R. Boyd. (R) S/O 83: 48-49
 "Motorcycles, Safety, and Freedom." (P) J/A 80: 10-11
 "New York City Looks at Taxi Regulation." (P) M/A 82: 11-13, 36
Private Road Ahead: Ways of Providing Better Roads Sooner, G. Roth and E. Butler. (R) J/A 83: 55-56
 "Reagulation—The First Year: Transportation," T. G. Moore. J/F 82: 27-29

- "Revitalizing Urban Transit—More Money or Less Regulation?" R. Cervero. M/J 84: 36-42
 "Rise and Fall of Bus Regulation, The," E. A. Pinkston. S/D 84: 45-52
Roads and the Private Sector, E. Butler, ed. (R) J/A 83: 55-56
 "Seattle Taxis: Deregulation Hits a Pothole," R. O. Zerbe, Jr. N/D 83: 43-48
 "Taxi Reform—The FTC Can Hack It," E. W. Kitch. M/J 84: 13-15
 "Taxis, Jitneys, and Mass Transit." (P) J/F 78: 6-7
 See also Airlines; Autos and auto industry; Oceans and ocean shipping; Railroads; Trucking; Waterways, inland

Tretheway, Michael W.

- "Airline Productivity under Deregulation" (with D. W. Caves and L. R. Christensen). N/D 82: 25-28

Trucking

- "Advice for the President-Elect: Regulation of Surface Transport," T. G. Moore. N/D 80: 34-35
 "Allocation in Surface Freight Transportation: Does Rate Regulation Matter?" R. C. Levin. (R) J/A 78: 61-62
 "Deregulating Transportation," T. G. Moore. M/A 78: 37-44
 "Deregulation—A Green Light for Trucking Efficiency," R. E. Mabley and W. D. Strack. J/A 82: 36-42, 56
 "Has Reagan Dropped the Ball?" R. W. Crandall. S/O 81: 15-18
Improving Motor-Carrier Entry Regulation: Report and Recommendations of a Staff Task Force, ICC. (R) S/O 77: 41
Initial Impact of Motor Carrier Deregulation in Arizona, R. Beilock and J. Freeman. (R) S/O 83: 47-48
 "Letting the Buses Run Free." (P) S/O 79: 8-10
 "Minimum Rate Regulation, Modal Split Sensitivities, and the Railroad Problem," K. D. Boyer. (R) S/O 77: 43
 "Monopoly Value of Household-Goods Carrier Operating Certificates, The," D. A. Breen. (R) J/A 78: 62-63
 "Paradox of Regulated Trucking, A," M. Kafoglis. S/O 77: 27-32
 "Rail and Truck Reform—The Record So Far," T. G. Moore. N/D 83: 33-41
 "Reagulation—The First Year: Transportation," T. G. Moore. J/F 82: 27-29
 "Reforming Trucking Regulation." (P) M/J 80: 10-12
 "Regulation and Household Moving Costs," D. A. Breen. S/O 78: 51-54
Regulation of Entry and Pricing in Truck Transportation, P. W. MacAvoy and J. W. Snow, eds. (R) S/O 77: 40-41
 "Report on Harbridge House Survey of the Impact of Transportation Deregulation on Major U.S. Manufacturing Firms." (R) M/A 82: 52
 "Re-Regulating at the ICC: 'The Congress Made Me Do It!'" (P) N/D 81: 5-9
Transportation Policy: Regulation, Competition, and the Public Interest, K. M. Ruppenthal and W. T. Stanbury, eds. (R) M/J 78: 52-54
Transportation Rates and Economic Development in Northern Ontario, N. C. Bonsor. (R) S/O 77: 41-42
 "Trucking Deregulation—A Long Haul." (P) J/A 79: 3-4
Trucking Regulation: Lessons from Europe, T. G. Moore. (R) S/O 77: 42-43

Tullock, Gordon

- "Achieving Deregulation—A Public Choice Perspective." N/D 78: 50-54

Umbeck, John R.

- "Close Encounters in the Skies: A Paradox of Regulatory Incentives" (with M. E. Staten). M/A 83: 25-31
 "Dubious Bill of Divorcement, A: The Case of Oil Refiners and Gas Stations" (with J. Barron). J/F 83: 29-33

Unemployment

- "Health Benefits for the Jobless: The Middle Class Cashes In." (P) M/J 83: 7-8
 See also Employment practices

United Nations: see Regulation, international

Urban Issues

- "Enterprise Zones: The New Fluoride for Urban Decay." (P) S/O 80: 4-6
 "Getting Downtown—Relief of Highway Congestion through Pricing," S. F. Williams. M/A 81: 45-50
Revitalizing America's Cities: Neighborhood Reinvestment and Displacement, M. H. Schill and R. P. Nathan. (R) M/J 84: 47-48
 See also Housing; Land tenant and use; Suburbs; Transportation

Urban transit: see Transportation

Utilities

- "Applying Economics to an Imperfect World," A. E. Kahn. N/D 78: 17-27
- "Demand for State Regulation of the Electric Utility Industry, The," G. A. Jarrell. (R) M/A 79: 56-57
- "Economist at Work in Public Utility Regulation, An," A. E. Kahn. (R) M/J 78: 49-50
- "Electric Utilities—Next Stop for Deregulators?" I. M. Stelzer. J/A 82: 29-35
- "Electric Utility Regulation and National Energy Policy," P. Navarro. J/F 81: 20-27
- "Inflation, Regulation, and Utility Stock Prices," M. W. Keran. (R) J/A 77: 44-45
- "Making Crises, Not Energy," Y. Brozen. M/A 80: 11-14
- "New Deal for Utilities, A?" (P) M/J 82: 7-9
- Politics of Public Utility Regulation, The*, W. T. Gormley, Jr. (R) J/F 84: 45-46
- Problems in Public Utility Economics and Regulation*, M. A. Crew, ed. (R) N/D 79: 58
- "Rate-of-Return Regulation: Protecting Whom from What?" N. W. Cornell. N/D 80: 36-41; 49
- Regulatory Politics and Electric Utilities: A Case Study in Political Economy*, D. D. Anderson. (R) J/A 82: 55-56
- "Save Now, Freeze Later—The Real Price of Cheap Electricity," P. Navarro. S/O 83: 31-36
- "Two Utilities Are Better Than One," J. Bellamy. (R) J/F 82: 47-48
- See also Telecommunications

Vaubel, Roland

- "Repairing Capitalism." J/A 80: 12-16

Viscusi, W. Kip

- "Phosphates and the Environmental Free Lunch." S/D 84: 53-55
- "Reagulation—The First Year: Health and Safety." J/F 82: 34-36

Wage and price controls

- "Ballad of the 'Right Price,'" B. Knight. (P) N/D 78: 12-13
- "Facts of *Munn v. Illinois*, The," E. Kitch and C. A. Bowler. (R) M/J 79: 62

Regulatory Justice, R. A. Kagan. (R) S/O 78: 60-61

"Wage Controls in Canada," A. M. Maslove and G. Swimmer. J/F 79: 31-36

Wage-Price Standards and Economic Policy, J. A. Meyer. (R) J/F 83: 44-45

See also Price controls and rationing

Wage and Price Stability, Council on

"Benefit-Cost Analyses of Social Regulation," J. C. Miller III and B. Yandle. (R) S/O 79: 55-56

"Constraining Regulatory Costs—Part I: The White House Review Programs; Part II: The Regulatory Budget," C. C. DeMuth. J/F 80: 13-26; M/A 80: 29-39, 42-44

"Presidential Power and the Politics of RARG," S. J. Tolchin. J/A 79: 44-49

Wages: see Employment practices

Walker, Robert J.

"Free Trade: Four American Voices" (from *State Papers and Speeches on the Tariff*, F. W. Taussig, ed.). J/F 83: 41

Walton, Thomas F.

"Protecting Workers' Hearing: An Economic Test for OSHA Initiatives" (with J. C. Miller III). S/O 80: 31-37

Wardell, William

"Rx: More Regulation or Better Therapies?" S/O 79: 25-33

Water pollution

"Acid Test for Congress, An," R. W. Crandall. S/D 84: 21-28

"Clean Water: Apocalypse Later." (P) J/A 83: 9-12

"Economic Impacts of Environmental Regulations on the U.S. Copper Industry, The," R. S. Hartman, K. Bozdogan, and R. M. Nadkarni. (R) S/O 80: 54

Enclosure of Ocean Resources, The, R. Eckert. (R) J/A 80: 41-42

"EPA Requires Pretreatment of Industrial Effluents." (P) S/O 78: 12-13

(Continued on next page)

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"I Ching of Acid Rain, The," P. Huber. S/D 84: 15-20, 56-65

Incentives in Water Quality Management: France and the Ruhr Area, B. R. Bower, R. Barre, J. Kühner, and C. S. Russell. (R) J/A 81: 51-53

"Oil Discharges and Oil Spills." (P) S/O 77: 2-3

"Phosphates and the Environmental Free Lunch," W. K. Viscusi. S/D 84: 53-55

"Skagway v. EPA—Cassandra's Prophecy Revisited," D. M. Shell. N/D 80: 50-53

"Tighter Standards for Drinking Water." (P) M/A 78: 9-10

Water Crisis: Ending the Policy Drought, T. L. Anderson. (R) S/O 83: 46-47

Waterways, Inland

"Trouble for White-Water Rafting?" (P) J/A 77: 7-8

"Waterway User Charges and Balanced Transportation." (P) S/O 77: 9, 39

Weaver, Suzanne

"Inhaber and the Limits of Cost-Benefit Analysis." J/A 79: 14-16

Webster, Daniel

"Free Trade: Four American Voices" (from *State Papers and Speeches on the Tariff*, F. W. Taussig, ed.). J/F 83: 39-41

Weidenbaum, Murray L.

"Advice for the President-Elect: Energy Regulation." N/D 80: 23-24

"Advice for the President-Elect: Reforming Government Regulation." N/D 80: 15-18

"Deregulation HQ: An Interview on the New Executive Order with Murray L. Weidenbaum and James C. Miller III." M/A 81: 14-23

"On Estimating Regulatory Costs." M/J 78: 14-17

"On the Corporate Democracy Act: What Is True Corporate Responsibility?" M/J 80: 30-31

"Protection at Any Price?" (with M. C. Munger). J/A 83: 14-18

Weimer, David Leo

"Next Oil Shock, The—Giving the Market a Chance" (with G. Horwich). M/A 84: 16-24

Weingast, Barry R.

"Myth of Runaway Bureaucracy, The: The Case of the FTC" (with M. J. Moran). M/J 82: 33-38

Welch, Finis

"Rising Impact of Minimum Wages, The." N/D 78: 28-37

White, Lawrence J.

"Truth in Regulatory Budgeting." M/A 80: 44-46

Wildavsky, Aaron

"Wealthier Is Healthier." J/F 80: 10-12, 55

Williams, Stephen F.

"Getting Downtown—Relief of Highway Congestion through Pricing." M/A 81: 45-50

Williams, Walter E.

"Racial Reasoning in Unfree Markets." M/A 79: 39-48

Willig, Robert D.

"Toward Competition in Phone Service: The Case for Freeing AT&T" (with M. L. Katz). J/A 83: 43-49

Winter, Ralph K., Jr.

"On the Corporate Democracy Act: What's *Not* in a Name." M/J 80: 26-29

"Welfare State and the Decline of Electoral Politics, The." M/A 78: 11-14

Yandle, Bruce

"Bootleggers and Baptists—The Education of a Regulatory Economist." M/J 83: 12-16

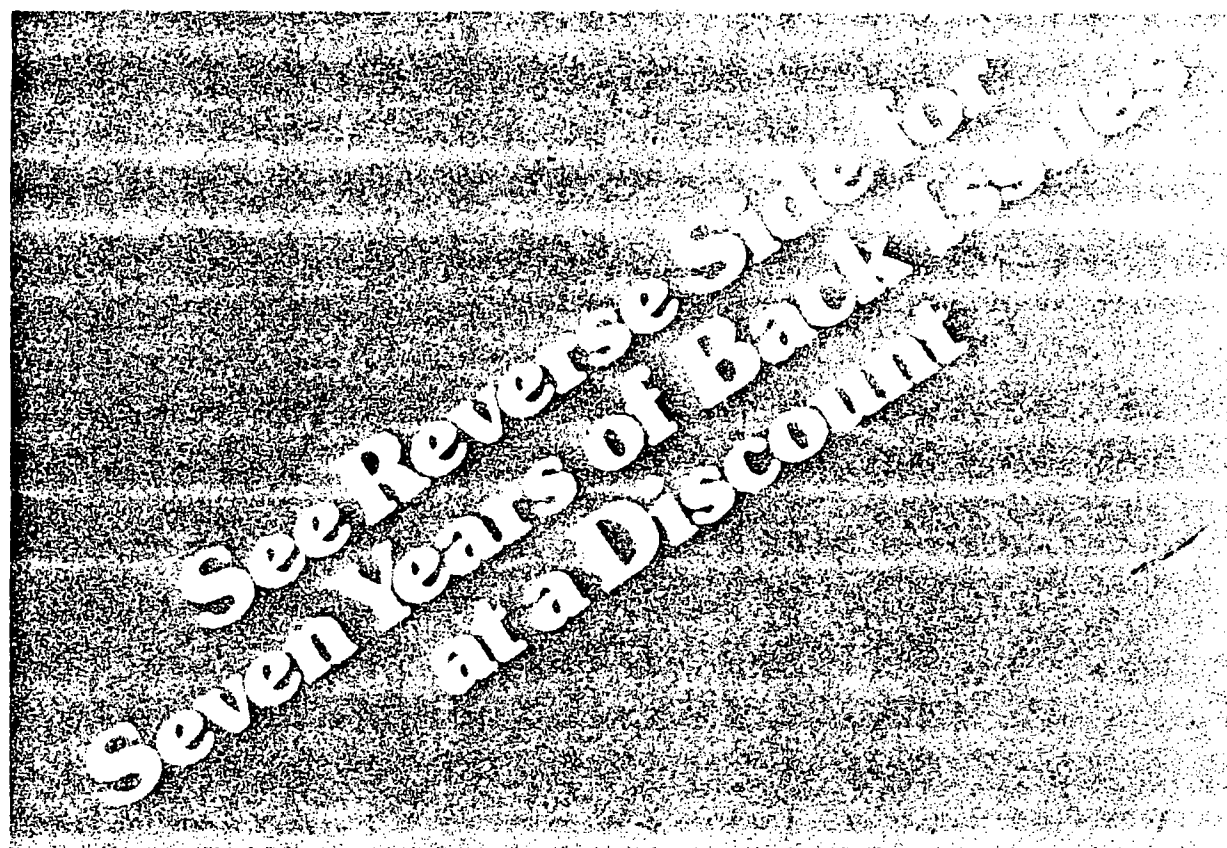
"Bubbles and Efficiency: Cleaner Air at Lower Cost" (with M. T. Maloney). M/J 80: 49-52

"Cost of Getting Nowhere at the FTC, The." J/A 81: 43-47

"Emerging Market in Air Pollution Rights, The." J/A 78: 21-29

Zerbe, Richard O., Jr.

"Seattle Taxis: Deregulation Hits a Pothole." N/D 83: 43-48

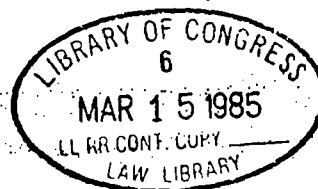


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LETTERS

2

PERSPECTIVES on Current Developments

4

Is Conrail Finally on the Right Track?

Goober Madness at the USDA

Airline Reservation Systems: Curse of
the Mummy's Tomb

Economic Liberties and the Judiciary

ON THE MERITS OF THE FRYING PAN

10

Antonin Scalia

THE ACTIVE VIRTUES

14

Richard A. Epstein

FOUL PLAY IN "PUBLIC INTEREST" LITIGATION:

19

THE JOY OF ATTORNEYS' FEES

Grover Rees III

SPECIAL FEATURE: CUMULATIVE INDEX

21

Volumes 1 through 8

THE ECONOMICS OF FUEL ECONOMY STANDARDS

45

David R. Henderson

READINGS of Particular Interest

57

Regulation

Mar/Apr 1985

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LETTERS

2

PERSPECTIVES on Current Developments

4

A Truce in the Takeover Wars?
Regulation and the 1986 Budget
Bumpers to Bumpers in Court
In Brief—

MICROSECONDS AND MACROPOLICY

13

Walter B. Wriston

HELIUM—HOW MUCH IS ENOUGH?

17

Richard L. Stroup and Jane S. Shaw

TELEPHONES AND COMPUTERS: The Costs of Artificial Separation

23

William J. Baumol and Robert D. Willig

STATUTES AND STOPPING POINTS: BUILDING A BETTER BUBBLE AT EPA

33

Michael H. Levin

REGULATING DEMON RUM

43

David R. Spiegel

READINGS of Particular Interest

49

REGULATION, March/April 1985, Vol. 9, No. 2.
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LETTERS

2

PERSPECTIVES on Current Developments

4

Down the Hatch with
School Independence
No More Early Projections?
Insider Trading as Victimless Crime
In Brief—

VACCINES AND PRODUCT LIABILITY—A CASE OF CONTAGIOUS LITIGATION

11

Edmund W. Kitch

HARVEST OF WASTE: THE MARKETING ORDER PROGRAM

19

Thomas M. Lenard and Michael P. Mazur

THE GREAT SATELLITE SHOOTOUT

27

Peter F. Cowhey and Jonathan D. Aronson

REDISTRIBUTING RISK

37

Chris Whipple

READINGS of Particular Interest

45

REGULATION, May/June 1985, Vol. 9, No. 3.
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LETTERS

2

PERSPECTIVES on Current Developments

5

AIDS, Hepatitis, and the National Blood Policy

The Long Arm of Antiquity Law

Nuclear Decommissioning: Revenge of the Tortoise

In Brief—

IS AFFIRMATIVE ACTION CONSTITUTIONAL?

12

William B. Allen, Drew S. Days III,

Benjamin L. Hooks, and William

Bradford Reynolds

ANTITRUST AND THE BANKING REVOLUTION

19

Lee Loevinger

DRILLING FOR DOLLARS: THE FEDERAL OIL-LEASE LOTTERY PROGRAM

25

Abraham E. Haspel

FARE IS FAIR IN AIRLINE DEREGULATION— THE DECLINE OF PRICE DISCRIMINATION

32

Joseph P. Schwieterman

READINGS of Particular Interest

46

REGULATION, July/August 1985, Vol. 9, No. 4.
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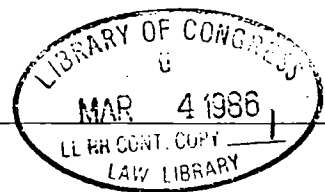
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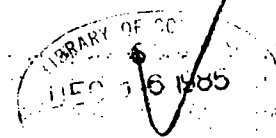
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LETTERS	2
PERSPECTIVES on Current Developments	5
One Share, One Vote, Forever?	
Urban Decay, Regulatory Sprawl	
Labor's War on "Double-Breasting"	
PUBLIC OWNERSHIP VS. ENERGY CONSERVATION: 13	
A PARADOX OF UTILITY REGULATION	
<i>James Q. Wilson and Louise Richardson</i>	
COURTS OF CONVENIENCE—	18
or Have Lawsuit, Will Travel	
<i>Peter Huber</i>	
TAKING CALIFORNIANS TO THE CLEANERS	24
<i>David L. Kirp and Eileen M. Soffer</i>	
SYSTEM ERROR: HOW THE IBM ANTITRUST SUIT	27
RAISED COMPUTER PRICES	
<i>David Levy and Steve Welzer</i>	
THOU SHALT NOT CUT PRICES! Sales-Below-	31
Cost Laws for Gas Stations	
<i>Robert N. Fenili and William C. Lane</i>	
A NOTE ON BUREAUCRACY	44
<i>Ludwig von Mises</i>	
READINGS of Particular Interest	46

REGULATION, September/October 1985, Vol. 9, No. 5. Published bimonthly by the American Enterprise Institute for Public Policy Research. Copyright 1985 American Enterprise Institute. Subscription rates: \$24 for one year, \$44 for two years (overseas prices available on request). Single copy price, \$5.00. Information on bulk orders or multiple subscriptions available on request. Editorial and business offices: c/o AEI, 1150 17th Street, N.W., Washington, D.C. 20036. Send changes of address and all subscription correspondence to Circulation Department, c/o AEI, same address.

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LETTERS 2

PERSPECTIVES on Current Developments 5

 Antitrust: Fear of Fairness
 The Glacial Water Project
 Nature's Own Subsidies?
 In Brief—

STRETCHING DELANEY TILL IT BREAKS 11

Richard M. Cooper

THE PIRATES OF PENNZOIL 18

Richard A. Epstein

**AN OVERDOSE OF CONCERN: CHILD ABUSE
 AND THE OVERREPORTING PROBLEM** 25

Douglas J. Besharov

DOES PROTECTION REALLY PROTECT? 29

David G. Tarr

**OVERSTEER: TWENTY YEARS OF FEDERAL
 AUTO POLICY** 35

Frank Gregorsky

READINGS of Particular Interest 45

INDEX to Volume IX 53

REGULATION, November/December 1985, Vol. 9,
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INDEX

to Volume IX

January/February through
November/December 1985

This index includes all articles, book reviews, perspectives (P), and readings (R) published in 1985. Articles and reviews are indexed by their authors and subjects. Perspectives and readings are indexed by subject only, with readings being listed by the title of the book or article summarized.

Agriculture

- "Contracting Problems and the Adoption of Regulatory Cartels," W. S. Hallagan. (R) N/D: 50-51
- "Glacial Water Project, The." (P) N/D: 7-10
- "Goobar Madness at the USDA." (P) J/F: 6-8
- "Harvest of Waste: The Marketing Order Program," T. M. Lenard and M. P. Mazur. M/J: 19-26
- Impacts of Rail Deregulation on Marketing of Kansas Wheat*, K. Klindworth, O. Sorenson, M. Babcock, and M. Chow. (R) N/D: 49-50

Airlines

- "Airline Reservation Systems: Curse of the Mummy's Tomb." (P) J/F: 8-9, 55-56
- Deregulation and the New Airline Entrepreneurs*, J. R. Meyer and C. V. Oster, Jr., with M. Clippinger et al. (R) M/A: 54-55
- "Fare Is Fair in Airline Deregulation—The Decline of Price Discrimination," J. Schwieterman. J/A: 32-38

Alcoholic beverages

- "Regulating Demon Rum," D. R. Spiegel. M/A: 43-48

Allen, William B.

- "Is Affirmative Action Constitutional? A Discussion" (with D. S. Days III, B. L. Hooks, and W. B. Reynolds). J/A: 12-18, 39-45

Antitrust

- "Antitrust and the Banking Revolution," L. Loevinger. J/A: 19-24
- "Antitrust: Fear of Fairness." (P) N/D: 5-7
- "Is Conrail Finally on the Right Track?" (P) J/F: 4-6
- "System Error: How the IBM Antitrust Suit Raised Computer Prices," D. Levy and S. Welzer. S/O: 27-30
- "Winners and Losers under the Robinson-Patman Act," T. W. Ross. (R) M/A: 51-53

Aronson, Jonathan D.

- "Great Satellite Shootout, The" (with P. F. Cowhey). M/J: 27-35

AT&T: see Telecommunications

Autos and auto industry

- Aggregate Costs to the United States of Tariffs and Quotas on Imports; General Tariff Cuts and Removal of Quotas on Automobiles, Steel, Sugar and Textiles*, D. G. Tarr and M. E. Morkre. (R) S/O: 51-52

- "Bumpers to Bumpers in Court." (P) M/A: 11-12, 56
- "Economics of Fuel Economy Standards, The," D. R. Henderson. J/F: 45-48
- "Oversteer: Twenty Years of Federal Auto Policy," F. Gregorsky. N/D: 35-41
- Reagan Regulatory Strategy, The: An Assessment*, G. C. Eads and M. Fix. (R) M/A: 53-54

Banking and finance: see Antitrust

Baumol, William J.

- "Telephones and Computers: The Costs of Artificial Separation" (with R. D. Willig). M/A: 23-32

Besharov, Douglas J.

- "Overdose of Concern, An: Child Abuse and the Over-reporting Problem." N/D: 25-28

Bureaucracy

- "Note on Bureaucracy, A," L. von Mises. S/O: 44-45

Business and industry

- "Achilles Heel of the Takeover, The: Nature and Scope of Successor Corporation Products Liability in Asset Acquisitions," R. J. Yamin. (R) M/A: 50-51
- Firm Size and Regulatory Compliance Costs: The Case of LIFO Regulations*, J. Hilke. (R) S/O: 46-47
- Modern Corporation, The: Free Markets vs. Regulation*, N. Wolfson. (R) J/F: 58-59
- "Note on Bureaucracy, A," L. von Mises. S/O: 44-45
- "Pirates of Pennzoil, The," R. Epstein. N/D: 18-24, 42
- "Truce in the Takeover Wars, A?" (P) M/A: 4-8
- See also Antitrust

Child abuse: see Health and safety

Civil Aeronautics Board: see Airlines

Civil rights

- "Is Affirmative Action Constitutional? A Discussion," W. B. Allen, D. S. Days III, B. L. Hooks, and W. B. Reynolds. J/A: 12-18, 39-45
- "Racial Remarks in the Workplace: Humor or Harassment?" T. Leap and L. Smeltzer. (R) J/A: 50-51
- "Terminating School Desegregation Lawsuits," M. Greve. (R) M/J: 48-49

Clean Air Act: see Environment

Computers: see Information technology

Conservation

- "Economics of Fuel Economy Standards, The," D. R. Henderson. J/F: 45-48
- "Helium—How Much Is Enough?" R. L. Stroup and J. S. Shaw. M/A: 17-22
- "Public Ownership vs. Energy Conservation: A Paradox of Utility Regulation," J. Q. Wilson and L. Richardson. S/O: 13-17, 36-38

Construction industry

- "Labor's War on 'Double-Breasting.'" (P) S/O: 11-12

Cooper, Richard M.

- "Stretching Delaney Till It Breaks." N/D: 11-17, 41

Copyright and patents

- "Microseconds and Macropolicy," W. B. Wriston. M/A: 13-16
- "New York Authorship Rights Act, The: A Comparative Critique," E. J. Damich. (R) J/A: 48-50

Costs and benefits, general regulatory

- "Safety and the Second Best: The Hazards of Public Risk Management in the Courts," P. Huber. (R) S/O: 50-51

"Stretching Delaney Till It Breaks," R. M. Cooper. N/D: 11-17, 41

Courts: *see* Law and legal issues

Cowhey, Peter F.

"Great Satellite Shootout, The" (with J. D. Aronson). M/J: 27-35

Days, Drew S. III

"Is Affirmative Action Constitutional?" A Discussion" (with W. B. Allen, B. L. Hooks, and W. B. Reynolds). J/A: 12-18, 39-45

Deregulation

Deregulation and the New Airline Entrepreneurs, J. R. Meyer and C. V. Oster, Jr., with M. Clippinger et al. (R) M/A: 54-55

"Fare Is Fair in Airline Deregulation—The Decline of Price Discrimination," J. Schwieterman. J/A: 32-38

Impacts of Rail Deregulation on Marketing of Kansas Wheat, K. Klindworth, O. Sorenson, M. Babcock, and M. Chow. (R) N/D: 49-50

"Is Conrail Finally on the Right Track?" (P) J/F: 4-6

See also Regulatory management

Discrimination: *see* Civil rights

Drugs and drug industry

"Stretching Delaney Till It Breaks," R. M. Cooper. N/D: 11-17, 41

Economic policy

"Economic Liberties and the Judiciary: The Active Virtues," R. A. Epstein. J/F: 14-18

"Economic Liberties and the Judiciary: On the Merits of the Frying Pan," A. Scalia. J/F: 10-14

Economist's View of the World, The: Government, Markets, and Public Policy, S. E. Rhoads. (R) N/D: 46-48

Poverty of "Development Economics," The, D. Lal. (R) M/J: 45-46

"Prices and Sanctions," R. Cooter. (R) M/J: 50-51

"Regulation and the 1986 Budget." (P) M/A: 9-11

"Supreme Court, 1983 Term, The—Foreword: The Court and the Economic System," F. H. Easterbrook. (R) M/A: 49-50

Education

"Down the Hatch with School Independence." (P) M/J: 4-6

"Terminating School Desegregation Lawsuits," M. Greve. (R) M/J: 48-49

Employment practices

"Labor's War on 'Double-Breasting.'" (P) S/O: 11-12

See also Civil Rights

Energy

Ban on Intra-Major Joint Bids in Federal Petroleum Offshore Lease Sales, The: An Evaluation, J. P. Mulholland. (R) J/A: 51

"Benefits of Eliminating the Alaskan Crude Oil Export Ban, The: An Economic Policy Analysis," C. T. Roush, Jr. (R) M/J: 49-50

"Drilling for Dollars: The Federal Oil-Lease Lottery Program," A. E. Haspel. J/A: 25-31

"Economics of Fuel Economy Standards, The," D. R. Henderson. J/F: 45-48

"Energy, Taxes and Growth," B. L. Weinstein. (R) S/O: 47-48

"Helium—How Much Is Enough?" R. L. Stroup and J. S. Shaw. M/A: 17-22

"Nuclear Decommissioning: Revenge of the Tor-
toise." (P) J/A: 10-11, 52

"Pirates of Pennzoil, The," R. Epstein. N/D: 18-24, 42

"Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations," R. N. Fenili and W. C. Lane. S/O: 31-35

"When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy through an Exceptions Process," P. H. Schuck. (R) J/A: 46-47

See also Utilities

Environment

"Cost-Minimizing Regulation of Sulfur Emissions: Regional Gains in Electric Power," F. M. Gollop and M. J. Roberts. (R) N/D: 51-52

"Statutes and Stopping Points: Building a Better Bubble at EPA," M. H. Levin. M/A: 33-42

Environmental Protection Agency: *see* Environment

Epstein, Richard A.

"Economic Liberties and the Judiciary: The Active Virtues." J/F: 14-18

"Pirates of Pennzoil, The." N/D: 18-24, 42

Federal Communications Commission: *see* Telecommunications

Fenili, Robert N.

"Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations" (with W. C. Lane). S/O: 31-35

First Amendment

"No More Early Projections?" (P) M/J: 6-8

Food and Drug Administration

"Stretching Delaney Till It Breaks," R. M. Cooper. N/D: 11-17, 41

Food industry

"Winners and Losers under the Robinson-Patman Act," T. W. Ross. (R) M/A: 51-53

See also Agriculture

Gregorsky, Frank

"Oversteer: Twenty Years of Federal Auto Policy." N/D: 35-41

Haspel, Abraham E.

"Drilling for Dollars: The Federal Oil-Lease Lottery Program." J/A: 25-31

Health and safety

"AIDS, Hepatitis, and the National Blood Policy." (P) J/A: 5-7

"Liability for Harm versus Regulation of Safety," S. Shavell. (R) J/A: 47-48

"Overdose of Concern, An: Child Abuse and the Over-reporting Problem," D. J. Besharov. N/D: 25-28

"Redistributing Risk," C. Whipple. M/J: 37-44

See also Drugs and drug industry; Product safety and liability

Health care

"Hospital Readmissions in the Medicare Population," G. F. Anderson and E. P. Steinberg. (R) J/F: 59-60

Helium

"Helium—How Much Is Enough?" R. L. Stroup and J. S. Shaw. M/A: 17-22

Henderson, David R.

"Economics of Fuel Economy Standards, The." J/F: 45-48

Hooks, Benjamin L.

"Is Affirmative Action Constitutional? A Discussion" (with W. B. Allen, D. S. Days III, and W. B. Reynolds). J/A: 12-18, 39-45

Housing

"Urban Decay, Regulatory Sprawl." (P) S/O: 7-11

Huber, Peter

"After Bhopal: Courts of Convenience—or Have Law-suit, Will Travel." S/O: 18-23, 39-42

Information technology

"Microseconds and Macropolicy," W. B. Wriston. M/A: 13-16

"System Error: How the IBM Antitrust Suit Raised Computer Prices," D. Levy and S. Welzer. S/O: 27-30

"Telephones and Computers: The Costs of Artificial Separation," W. Baumol and R. Willig. M/A: 23-32

Kirp, David L.

"Taking Californians to the Cleaners" (with E. M. Soffer). S/O: 24-26

Kitch, Edmund W.

"Vaccines and Product Liability—A Case of Con-tagious Litigation." M/J: 11-18

Labor: see Employment practices

Lane, William C.

"Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations" (with R. N. Fenili). S/O: 31-35

Law and legal issues

"Achilles Heel of the Takeover, The: Nature and Scope of Successor Corporation Products Liability in Asset Acquisitions," R. J. Yamin. (R) M/A: 50-51

"After Bhopal: Courts of Convenience—or Have Law-suit, Will Travel," P. Huber. S/O: 18-23, 39-42

"Bumpers to Bumpers in Court." (P) M/A: 11-12, 56

"Economic Liberties and the Judiciary: The Active Virtues," R. A. Epstein. J/F: 14-18

"Economic Liberties and the Judiciary: On the Merits of the Frying Pan," A. Scalia. J/F: 10-14

"Foul Play in 'Public Interest' Litigation: The Joy of Attorneys' Fees," G. Rees III. J/F: 19-20, 49-55

"Information, Uncertainty, and the Transfer of Prop-erty," D. Baird and T. Jackson. (R) M/J: 46-48

"Is Affirmative Action Constitutional? A Discussion," W. B. Allen, D. S. Days III, B. L. Hooks, and W. B. Reynolds. J/A: 12-18, 39-45

"Long Arm of Antiquity Law, The." (P) J/A: 7-10

"New York Authorship Rights Act, The: A Comparative Critique," E. J. Damich. (R) J/A: 48-50

"Pirates of Pennzoil, The," R. Epstein. N/D: 18-24, 42

"Safety and the Second Best: The Hazards of Public Risk Management in the Courts," P. Huber. (R) S/O: 50-51

"Supreme Court, 1984 Term, The—Foreword: The Court and the Economic System," F. H. Easterbrook. (R) M/A: 49-50

Takings: Private Property and the Power of Eminent Domain, R. A. Epstein. (R) N/D: 45-46

Lenard, Thomas M.

"Harvest of Waste: The Marketing Order Program" (with M. P. Mazur). M/J: 19-26

Levin, Michael H.

"Statutes and Stopping Points: Building a Better Bubble at EPA." M/A: 33-42

Levy, David

"System Error: How the IBM Antitrust Suit Raised Computer Prices" (with S. Welzer). S/O: 27-30

Local and state government

"After Bhopal: Courts of Convenience—or Have Law-suit, Will Travel," P. Huber. S/O: 18-23, 39-42

"Energy, Taxes and Growth," B. L. Weinstein. (R) S/O: 47-48

"Overdose of Concern, An: Child Abuse and the Over-reporting Problem," D. J. Besharov. N/D: 25-28

Reagan Regulatory Strategy, The: An Assessment, G. C. Eads and M. Fix. (R) M/A: 53-54

"Regulating Demon Rum," D. R. Spiegel. M/A: 43-48

"Taking Californians to the Cleaners," D. L. Kirp and E. M. Soffer. S/O: 24-26

"Urban Decay, Regulatory Sprawl." (P) S/O: 7-11

Loevinger, Lee

"Antitrust and the Banking Revolution." J/A: 19-24

Marketing orders: see Agriculture

Mazur, Michael P.

"Harvest of Waste: The Marketing Order Program" (with T. M. Lenard). M/J: 19-26

Mises, Ludwig von

"Note on Bureaucracy, A." S/O: 44-45

National Highway Traffic Safety Administration: see Autos and auto industry

News media

Chemical Risks: Fears, Facts and the Media, Media Institute. (R) S/O: 48-50

"No More Early Projections?" (P) M/J: 6-8

Nuclear power: see Energy

Occupational licensure

"Taking Californians to the Cleaners," D. L. Kirp and E. M. Soffer. S/O: 24-26

Oil: see Energy

Pollution: see Environment

Price controls

"Thou Shalt Not Cut Prices! Sales-Below-Cost Laws for Gas Stations," R. N. Fenili and W. C. Lane. S/O: 31-35

Product safety and liability

"Achilles Heel of the Takeover, The: Nature and Scope of Successor Corporation Products Liability in Asset Acquisitions," R. J. Yamin. (R) M/A: 50-51

"Vaccines and Product Liability—A Case of Con-tagious Litigation," E. W. Kitch. M/J: 11-18

Property: see Law and legal issues

Railroads

Impacts of Rail Deregulation on Marketing of Kansas Wheat, K. Klindworth, O. Sorenson, M. Babcock, and M. Chow. (R) N/D: 49-50

"Is Conrail Finally on the Right Track?" (P) J/F: 4-6

Rees, Grover III

"Foul Play in 'Public Interest' Litigation: The Joy of Attorneys' Fees." J/F: 19-20, 49-55

Regulation, general

Economist's View of the World, The: Government, Markets, and Public Policy, S. E. Rhoads. (R) N/D: 46-48

"Liability for Harm versus Regulation of Safety," S. Shavell. (R) J/A: 47-48

"Prices and Sanctions," R. Cooter. (R) M/J: 50-51

"Redistributing Risk," C. Whipple. M/J: 37-44
 "Regulation and the 1986 Budget." (P) M/A: 9-11

Regulation, international

"After Bhopal: Courts of Convenience—or Have Law-suit, Will Travel," P. Huber. S/O: 18-23, 39-42
 "Long Arm of Antiquity Law, The." (P) J/A: 7-10

Regulatory costs: *see* Costs and benefits, general regulatory

Regulatory management

"Antitrust: Fear of Fairness." (P) N/D: 5-7
 "Bumpers to Bumpers in Court." (P) M/A: 11-12, 56
Reagan Regulatory Strategy, The: An Assessment, G. C. Eads and M. Fix. (R) M/A: 53-54
 "Statutes and Stopping Points: Building a Better Bubble at EPA," M. H. Levin. M/A: 33-42
See also Deregulation

Regulatory reform: *see* Deregulation; Regulatory management

Rent control: *see* Housing

Reynolds, William Bradford

"Is Affirmative Action Constitutional? A Discussion" (with W. B. Allen, D. S. Days III, and B. L. Hooks). J/A: 12-18, 39-45

Richardson, Louise

"Public Ownership vs. Energy Conservation: A Paradox of Utility Regulation" (with J. Q. Wilson). S/O: 13-17, 36-38

Safety: *see* Drugs and drug industry; Health and safety; Product safety and liability

Scalia, Antonin

"Economic Liberties and the Judiciary: On the Merits of the Frying Pan." J/F: 10-14

Schwietzman, Joseph P.

"Fare Is Fair in Airline Deregulation—The Decline of Price Discrimination." J/A: 32-38

Securities and Exchange Commission

Modern Corporation, The: Free Markets vs. Regulation, N. Wolfson. (R) J/F: 58-59

Securities industry

"Insider Trading as Victimless Crime." (P) M/J: 8-10
 "One Share, One Vote, Forever?" (P) S/O: 5-7

Shaw, Jane S.

"Helium—How Much Is Enough?" (with R. L. Stroup). M/A: 17-22

Soffer, Eileen M.

"Taking Californians to the Cleaners" (with D. L. Kirp). S/O: 24-26

Spiegel, David R.

"Regulating Demon Rum." M/A: 43-48

State government: *see* Local and state government

Steel industry: *see* Trade, international

Stroup, Richard L.

"Helium—How Much Is Enough?" (with J. S. Shaw). M/A: 17-22

Taxation

"Energy, Taxes and Growth," B. L. Weinstein. (R) S/O: 47-48
Firm Size and Regulatory Compliance Costs: The

Case of LIFO Regulations, J. C. Hilke. (R) S/O: 46-47
Takings: Private Property and the Power of Eminent Domain, R. A. Epstein. (R) N/D: 45-46

Tarr, David G.

"Does Protection Really Protect? The Case of Steel." N/D: 29-34

Telecommunications

"Great Satellite Shootout, The," P. F. Cowhey and J. D. Aronson. M/J: 27-35
 "Microseconds and Macropolicy," W. B. Wriston. M/A: 13-16
Misregulating Television: Network Dominance and the FCC, S. M. Besen, T. G. Krattenmaker, A. R. Metzger, Jr., and J. R. Woodbury. (R) J/F: 60-62
 Telephones and Computers: The Costs of Artificial Separation," W. Baumol and R. Willig. M/A: 23-32

Textile industry: *see* Trade, international

Toxic substances

Chemical Risks: Fears, Facts, and the Media, Media Institute. (R) S/O: 48-50

Trade, international

Aggregate Costs to the United States of Tariffs and Quotas on Imports: General Tariff Cuts and Removal of Quotas on Automobiles, Steel, Sugar and Textiles, D. Tarr and M. Morkre. (R) S/O: 51-52
 "Benefits of Eliminating the Alaskan Crude Oil Export Ban, The: An Economic Policy Analysis," C. T. Roush, Jr. (R) M/J: 49-50
 "Does Protection Really Protect? The Case of Steel," D. G. Tarr. N/D: 29-34
Import Quotas on Textiles: The Welfare Effects of United States Restrictions on Hong Kong, M. E. Morkre. (R) J/F: 57-58
 "Nature's Own Subsidies?" (P) N/D: 10, 43
Poverty of "Development Economics," The, D. Lal. (R) M/J: 45-46

Transportation

Urban Transit: The Private Challenge to Public Transportation, C. A. Lave, ed. (R) N/D: 48-49

Utilities

"Cost-Minimizing Regulation of Sulfur Emissions: Regional Gains in Electric Power," F. M. Gollop and M. J. Roberts. (R) N/D: 51-52
 "Public Ownership vs. Energy Conservation: A Paradox of Utility Regulation," J. Q. Wilson and L. Richardson. S/O: 13-17, 36-38

Vaccines: *see* Product safety and liability

Welzer, Steve

"System Error: How the IBM Antitrust Suit Raised Computer Prices" (with D. Levy). S/O: 27-30

Whipple, Chris

"Redistributing Risk." M/J: 37-44

Willig, Robert D.

"Telephones and Computers: The Costs of Artificial Separation" (with W. J. Baumol). M/A: 23-32

Willson, James Q.

"Public Ownership vs. Energy Conservation: A Paradox of Utility Regulation" (with L. Richardson). S/O: 13-17, 36-38

Wriston, Walter B.

"Microseconds and Macropolicy." M/A: 13-16

INDEX to Volume X

September/October and
November/December 1986

This index includes all articles, Currents (C), and Readings (R) published in 1986. Articles and Readings are indexed by their authors and subjects. Currents are indexed by subject only.

Advertising

- "Do Campaign Finance Laws Protect Voters or Incumbents?" (C) N/D: 12
- "Ghost of Cigarette Advertising Past, The," J. E. Calfee. N/D: 35-45
- "Plugs for Drugs," A. Masson and P. H. Rubin. S/O: 37-44

Airlines

- Economic Effects of Airline Deregulation, The*, S. Morrison and C. Winston. (R) S/O: 44-46

Alcoholic beverages

- "Tanking Up." (C) N/D: 7-8

Antitrust

- "Jittery Play Spoils Legal Super Bowl." (C) N/D: 8-10
- "Reagan FTC Fights Price Cutting on Pencils, Paper Clips." (C) S/O: 13-14

Autos and auto industry

- Regulating the Automobile*, R. W. Crandall, H. K. Gruenspecht, T. E. Keeler, and L. B. Lave. (R) S/O: 50-51

Banking and finance

- "Nonbanks and Nonproblems." (C) S/O: 8-11

Bardach, Eugene

- Environmental Law and American Business: Dilemmas of Compliance*, J. F. DiMento. (R) N/D: 55-57

Bernheim, B. Douglas

- Pensions, Economics, and Public Policy*, R. A. Ippolito. (R) N/D: 53-55

Bureaucracy

- Trouble with America; The: Why the System is Breaking Down*, M. Crozier (trans. P. Heinegg). (R) S/O: 47-48

Business and industry

- "Are Takeovers Hostile to Economic Performance?" J. Pound, K. Lehn, and G. Jarrell. S/O: 25-30

Calfee, John E.

- "Ghost of Cigarette Advertising Past, The." N/D: 35-45

Campaigns and elections

- "Do Campaign Finance Laws Protect Voters or Incumbents?" (C) N/D: 12

Cancer

- "Perils of Prudence, The: How Conservative Risk Assessments Distort Regulation," A. L. Nichols and R. J. Zeckhauser. N/D: 13-24

Cigarettes

- "Ghost of Cigarette Advertising Past, The," J. E. Calfee. N/D: 35-45

Civil rights

- "Incomparable Worth." (C) S/O: 11-12

Consumer Product Safety Commission: *see* Product safety and liability

Costs and benefits, general regulatory

- "Perils of Prudence, The: How Conservative Risk Assessments Distort Regulation," A. L. Nichols and R. J. Zeckhauser. N/D: 13-24
- "Review of the Record, A," J. F. Morrall III. N/D: 25-34

Courts: *see* Law and legal issues

Denzau, Arthur T.

- Regulatory Policy and the Social Sciences*, ed. R. Noll. (R) N/D: 51-53

Deregulation

- Economic Effects of Airline Deregulation, The*, S. Morrison and C. Winston. (R) S/O: 44-46

Discrimination: *see* Civil rights

Drugs and drug industry

- "Plugs for Drugs," A. Masson and P. H. Rubin. S/O: 37-44

Eckert, Ross D.

- "AIDS and the Blood Bankers." S/O: 15-24

Energy

- "Natural Gas Price Controls: An Alternative View," W. A. Niskanen. N/D: 46-50

Environment

- Environmental Law and American Business: Dilemmas of Compliance*, J. F. DiMento. (R) N/D: 55-57
- "Perils of Prudence, The: How Conservative Risk Assessments Distort Regulation," A. L. Nichols and R. J. Zeckhauser. N/D: 13-24

Federal Trade Commission

- "Reagan FTC Fights Price Cutting on Pencils, Paper Clips." (C) S/O: 13-14

Flint, Jerry

- Regulating the Automobile*, R. W. Crandall, H. K. Gruenspecht, T. E. Keeler, and L. B. Lave. (R) S/O: 50-51

Food and Drug Administration: *see* Drugs and drug industry

Graham, David R.

- Economic Effects of Airline Deregulation, The*, S. Morrison and C. Winston. (R) S/O: 44-46

Health and safety

- "AIDS and the Blood Bankers," R. D. Eckert. S/O: 15-24
- "Ghost of Cigarette Advertising Past, The," J. E. Calfee. N/D: 35-45
- "Review of the Record, A," J. F. Morrall III. N/D: 25-34
- See also* Cancer; Drugs and drug industry; Product safety and liability

Health care

- Health Economy, The*, V. R. Fuchs. (R) S/O: 48-50

Industrial policy

- Trouble with America, The: Why the System is Breaking Down*, M. Crozier (trans. P. Heinegg). (R) S/O: 47-48

Jarrell, Gregg

- "Are Takeovers Hostile to Economic Performance?" (with J. Pound and K. Lehn). S/O: 25-30

Landes, William M.

- "New Light on Punitive Damages" (with R. A. Posner). S/O: 33-36

Law and legal issues

- "New Light on Punitive Damages," W. M. Landes and R. A. Posner. S/O: 33-36
- "Quiche Brief, The," R. K. Winter. S/O: 31-32
- Trouble with America, The: Why the System is Breaking Down*, M. Crozier (trans. P. Heinegg). (R) S/O: 47-48

Lehn, Kenneth

- "Are Takeovers Hostile to Economic Performance?" (with J. Pound and G. Jarrell). S/O: 25-30

Masson, Alison

- "Plugs for Drugs" (with P. H. Rubin). S/O: 37-44

Morrall, John F. III

- "Review of the Record, A," N/D: 25-34

Natural gas: *see* Energy

Nichols, Albert L.

- "Perils of Prudence, The: How Conservative Risk Assessments Distort Regulation" (with R. J. Zeckhauser). N/D: 13-24

Niskanen, William A.

- "Natural Gas Price Controls: An Alternative View." N/D: 46-50

Pensions and annuities

- Pensions, Economics, and Public Policy*, R. A. Ippolito. (R) N/D: 53-55

Phelps, Charles E.

- Health Economy, The*, V. R. Fuchs. (R) S/O: 48-50

Posner, Richard A.

- "New Light on Punitive Damages" (with W. M. Landes). S/O: 33-36

Pound, John

- "Are Takeovers Hostile to Economic Performance?" (with K. Lehn and G. Jarrell. S/O: 25-30

Price controls

- "Natural Gas Price Controls: An Alternative View," W. A. Niskanen. N/D: 46-50

Product safety and liability

- "Consumer Behavior and the Safety Effects of Product Safety Regulation," W. K. Viscusi. (R) S/O: 51-53
- "New Light on Punitive Damages," W. M. Landes and R. A. Posner. S/O: 33-36

Professional sports

- "Jittery Play Spoils Legal Super Bowl." (C) N/D: 8-10

Rabkin, Jeremy

- Trouble with America, The: Why the System is Breaking Down*, M. Crozier (trans. P. Heinegg). (R) S/O: 47-48

Regulation, general

- "Regulating Regulation." (C) N/D: 11

Regulatory costs: *see* Costs and benefits, general regulatory

Regulatory procedure

- Environmental Law and American Business: Dilemmas of Compliance*, J. F. DiMento. (R) N/D: 55-57
- "Quiche Brief, The," R. K. Winter. S/O: 31-32
- Regulatory Policy and the Social Sciences*, ed. R. Noll. (R) N/D: 51-53

Regulatory reform: *see* Deregulation

Rubin, Paul H.

- "Plugs for Drugs" (with A. Masson). S/O: 37-44

Safety: *see* Health and safety

Securities industry

- "Are Takeovers Hostile to Economic Performance," J. Pound, K. Lehn, and G. Jarrell. S/O: 25-30
- "Thank God It's ... the SEC." (C) S/O: 5-8

Taxation

- Pensions, Economics, and Public Policy*, R. A. Ippolito. (R) N/D: 53-55

Toxic substances

- Environmental Law and American Business: Dilemmas of Compliance*, J. F. DiMento. (R) N/D: 55-57

Viscusi, W. Kip

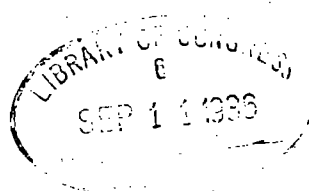
- "Consumer Behavior and the Safety Effects of Product Safety Regulation," W. K. Viscusi. (R) S/O: 51-53

Winter, Ralph K.

- "Quiche Brief, The." S/O: 31-32

Zeckhauser, Richard J.

- "Perils of Prudence, The: How Conservative Risk Assessments Distort Regulation" (with A. L. Nichols). N/D: 13-24



Regulation

Sept/Oct 1986

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LETTERS

2

CURRENTS

5

Thank God It's . . . the SEC
Nonbanks and Nonproblems
Incomparable Worth
Reagan FTC Fights Price Cutting
on Pencils and Paper Clips

AIDS AND THE BLOOD BANKERS

15

Ross D. Eckert

ARE TAKEOVERS HOSTILE TO ECONOMIC PERFORMANCE?

25

*John Pound, Kenneth Lehn, and
Gregg Jarrell*

THE QUICHE BRIEF

31

Ralph K. Winter

NEW LIGHT ON PUNITIVE DAMAGES

33

*William M. Landes and
Richard A. Posner*

PLUGS FOR DRUGS

37

Alison Masson and Paul H. Rubin

READINGS

44

Regulation, (ISSN 0147-0590) Sept./Oct. 1986, Vol. 10, No. 1. Published bimonthly by The Regulation Foundation. Copyright 1986 The Regulation Foundation. Subscription rates: Individuals—\$28 for one year, \$52 for two years. Libraries and institutions—\$49 and \$92. Outside the United States, add \$4.00 per year. Single copy price \$5.00. Information on bulk orders or multiple subscriptions available on request. Editorial and business offices: 1667 K Street, N.W., Suite 575, Washington, D.C. 20006. Telephone: (202) 659-9797. Send all changes of address and all subscription correspondence to Circulation Department, P.O. Box 65295, Washington, D.C. 20036.

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Regulation

Nov/Dec 1986

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LETTERS

4

CURRENTS

7

Tanking Up
Jittery Play Spoils Legal Superbowl
Regulating Regulation
Do Campaign Finance Laws Protect Voters
or Incumbents?

REGULATING RISK

THE PERILS OF PRUDENCE

13

How Conservative Risk Assessments Distort Regulation
*Albert L. Nichols and
Richard J. Zeckhauser*

A REVIEW OF THE RECORD

25

John F. Morrall III

THE GHOST OF CIGARETTE ADVERTISING PAST

35

John E. Calfee

NATURAL GAS PRICE CONTROLS

46

An Alternative View

William A. Niskanen

READINGS

51

INDEX

58

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INDEX

to Volume XI

1987 Numbers 1 thru 4

This index includes all articles, Currents (C), and Readings (R) published in 1987. Articles and Readings are indexed by their authors and subjects. Currents are indexed by subject only.

Advertising

"Food by Any Other Name, A." (C) 1: 7-10

Agriculture

"Milking of New York City, The." (C) 1: 5-7

Airlines

"Deregulation and Air Travel Safety," R. B. McKenzie and W. F. Shughart II. 3/4: 42-47

"Flight from Equity, The." (C) 3/4: 4-6

Air pollution: *see* Environment

Alcohol fuels: *see* Energy and fuels

Alcoholic beverages

"Drinking Age and Traffic Safety, The," P. Asch and D. Levy. 2: 48-52

"Drunken Driving, Hit-and-Runs, and Bribery," R. Theroux and J. Umbeck. 2: 44-47

Antitrust

"Exclusion and Antitrust," T. G. Krattenmaker and S. C. Salop. 3/4: 29-33

"Exclusion and Efficiency," W. J. Liebler. 3/4: 34-40

Asch, Peter

"Drinking Age and Traffic Safety, The" (with D. Levy). 2: 48-52

Bandow, Doug

Art of Judging, The, J. Bond. (R) 3/4: 54-57

Burger Years, The: Rights and Wrongs in the Supreme Court 1969-1986, ed. H. Schwartz. (R) 3/4: 54-57

Court and Constitution, The, A. Cox. (R) 3/4: 54-57

Supreme Court, The: How It Was, How It Is, W. Rehnquist. (R) 3/4: 54-57

Supreme Court's Constitution, The: An Inquiry into Judicial Review and Its Impact on Society, B. Siegan. (R) 3/4: 54-57

Banking and finance

"Fluffing the Capital Cushion." (C) 3/4: 12-14

Barnekov, Christopher C.

"Railroad Deregulation: The Track Record." 1: 19-27

Baumol, William J.

"Railroad Deregulation: Using Competition as a Guide" (with R. D. Willig). 1: 28-35

Bishop, William D.

Economic Analysis of Law, R.A. Posner. (R) 1: 54-56

Boskin, Michael J.

Checks Unbalanced: The Quiet Side of Public Spending, H. B. Leonard. (R) 3/4: 60-62

Buchanan, James M.

"James M. Buchanan: Constitutional Political Economist," R. E. Wagner. 1: 13-17

Budgets and expenditures

Checks Unbalanced: The Quiet Side of Public Spending, H. B. Leonard. (R) 3/4: 60-62

Business and industry

"Pink Slips and Politics." (C) 1: 10-12

Cancer

"Environment of Risk and Uncertainty, An." (C) 2: 9-14

Constitutional issues: *see* Law and legal issues

Costs and benefits, general regulatory

"Environment of Risk and Uncertainty, An." (C) 2: 9-14

"Franchising FIFRA." (C) 3/4: 11-12

"Market for Bads, The: EPA's Experience with Emissions Trading," R. H. Hahn and G. L. Hester. 3/4: 48-53

Courts: *see* Law and legal issues

Crain, W. Mark

Who Profits: Winners, Losers, and Government Regulation, R. A. Leone. (R) 1: 57-59

Deregulation

"Deregulation and Air Travel Safety," R. B. McKenzie and W. F. Shughart II. 3/4: 42-47

"Flight from Equity, The." (C) 3/4: 4-6

"Milking of New York City, The." (C) 1: 5-7

"Railroad Deregulation: The Track Record," C. E. Barnekov. 1: 19-27

"Railroad Deregulation: Using Competition as a Guide," R. D. Willig and W. J. Baumol. 1: 28-35

"Twisted Pair, The: Regulation and Competition in Telecommunications," R. G. Noll. 3/4: 15-22

Drugs and drug industry

"By Prescription Only . . . Or Occasionally?" S. Peltzman. 3/4: 23-28

Economic policy

Economic Analysis of Law, R.A. Posner. (R) 1: 54-56

"James M. Buchanan: Constitutional Political Economist," R. E. Wagner. 1: 13-17

Employee Retirement Income Security Act: *see* Pensions and annuities

Employment practices

- "Minimal Case for the Minimum Wage, The." (C) 3/4: 6-8
 "Pink Slips and Politics." (C) 1: 10-12

Energy and fuels

- "Octane, Ozone, and Obstinacy," C. B. Gray. 2: 37-43
See also Nuclear power; Utilities

Environment

- Distributing Risk*, K. S. Abraham. (R) 2: 56-59
 "Doubtful Indemnity." (C) 3/4: 8-10
 "Environment of Risk and Uncertainty, An." (C) 2: 9-14
 "Franchising FIFRA." (C) 3/4: 11-12
 "Market for Bads, The: EPA's Experience with Emissions Trading," R. H. Hahn and G. L. Hester. 3/4: 48-53
 "Octane, Ozone, and Obstinacy," C. B. Gray. 2: 37-43

Environmental Protection Agency: *see* Environment

Federal Aviation Administration: *see* Airlines

Federal Communications Commission: *see* Telecommunications

Federal Insecticide, Fungicide, and Rodenticide Act

- "Doubtful Indemnity." (C) 3/4: 8-10
 "Franchising FIFRA." (C) 3/4: 11-12

Food: *see* Agriculture; Food and Drug Administration

Food and Drug Administration

- "Food by Any Other Name, A." (C) 1: 7-10
See also Drugs and drug industry

Fuels: *see* Energy and fuels

Gasoline: *see* Energy and fuels

Government spending: *see* Budgets and expenditures

Gray, C. Boyden

- "Octane, Ozone, and Obstinacy." 2: 37-43

Hahn, Robert W.

- "Market for Bads, The: EPA's Experience with Emissions Trading"
 (with G. L. Hester). 3/4: 48-53

Handicapped persons

- Institutional Disability: The Saga of Transportation Policy for the Disabled*, R. A. Katzmman. (R) 1: 56-57

Hazardous materials: *see* Toxic substances

Health and safety

- Consuming Fears: The Politics of Product Risks*, ed. H. M. Sapolsky. (R) 3/4: 57-59
 "Deregulation and Air Travel Safety," R. B. McKenzie and W. F. Shughart II. 3/4: 42-47
 "Drinking Age and Traffic Safety, The," P. Asch and D. Levy. 2: 48-52

- "Drunken Driving, Hit-and-Runs, and Bribery," R. Theroux and J. Umbeck. 2: 44-47

- "Environment of Risk and Uncertainty, An." (C) 2: 9-14
 "Flight from Equity, The." (C) 3/4: 4-6
See also Cancer; Drugs and drug industry; Toxic substances

Health care

- Charting the Future of Health Care: Policy, Politics, and Public Health*, eds. J. A. Meyer and M. E. Lewin. (R) 3/4: 62-64

Hester, Gordon L.

- "Market for Bads, The: EPA's Experience with Emissions Trading" (with R. W. Hahn). 3/4: 48-53

Insurance

- Distributing Risk*, K. S. Abraham. (R) 2: 56-59

Ippolito, Richard A.

- "Pension Security: Has ERISA Had Any Effect?" 2: 15-22.

Kleit, Andrew N.

- "Blackout at Bonneville Power" (with R. L. Stroup). 2: 30-36

Krattenmaker, Thomas G.

- "Exclusion and Antitrust" (with S. C. Salop). 3/4: 29-33

Kunreuther, Howard

- Distributing Risk*, K. S. Abraham. (R) 2: 56-59

Labor: *see* Employment practices

Law and legal issues

- Agent Orange on Trial: Mass Toxic Disasters in the Courts*, P. H. Schuck. (R) 2: 54-56
Art of Judging, The, J. Bond. (R) 3/4: 54-57
Burger Years, The: Rights and Wrongs in the Supreme Court 1969-1986, ed. H. Schwartz. (R) 3/4: 54-57
Court and Constitution, The, A. Cox. (R) 3/4: 54-57
Economic Analysis of Law, R. A. Posner. (R) 1: 54-56
 "Giving Back the Takings Clause." (C) 2: 8-9
 "James M. Buchanan: Constitutional Political Economist," R. E. Wagner. 1: 13-17
Supreme Court, The: How It Was, How It Is, W. Rehnquist. (R) 3/4: 54-57
Supreme Court's Constitution, The: An Inquiry into Judicial Review and Its Impact on Society, B. Siegan. (R) 3/4: 54-57
See also Antitrust

Legislation

- "Quality of Life Action Act" (H.R. 1398, excerpt) 1: 18

Levy, David

- "Drinking Age and Traffic Safety, The" (with P. Asch). 2: 48-52

Licensing: *see* Occupational licensing

Liebeler, Wesley J.

- "Exclusion and Efficiency." 3/4: 34-40

- Litan, Robert E.**
 "Regulatory Reform in Peru" (with P. H. Schuck). 1: 36-43
- McKenzie, Richard B.**
 "Deregulation and Air Travel Safety" (with W. F. Shughart II). 3/4: 42-47
- Milk:** *see* Agriculture
- Minimum wage:** *see* Employment practices
- New York City**
 "Milking of New York City, The." (C) 1: 5-7
- Nichols, Elizabeth**
 "Nuclear Power Regulation: Seeking Safety, Doing Harm?" (with A. Wildavsky). 1: 45-53
- Noll, Roger G.**
 "Twisted Pair, The: Regulation and Competition in Telecommunications." 3/4: 15-22
- Nuclear power**
 "Blackout at Bonneville Power," A. N. Kleit and R. L. Stroup. 2: 30-36
 "Nuclear Power Regulation: Seeking Safety, Doing Harm?" E. Nichols and A. Wildavsky. 1: 45-53
- Occupational licensing**
Rule of Experts, The: Occupational Licensing in America, S. D. Young. (R) 2: 59-60
- Peltzman, Sam**
 "By Prescription Only... Or Occasionally?" 3/4: 23-28
- Pensions and annuities**
 "Pension Security: Has ERISA Had Any Effect?" R. A. Ippolito. 2: 15-22
- Peru**
 "Regulatory Reform in Peru," P. H. Schuck and R. E. Litan. 1: 36-43
- Pharmaceuticals:** *see* Drugs and drug industry
- Plant closings**
 "Pink Slips and Politics." (C) 1: 10-12
- Pollution:** *see* Environment
- Public utilities:** *see* Utilities
- Railroads**
 "Railroad Deregulation: The Track Record," C. E. Barnekov. 1: 19-27
 "Railroad Deregulation: Using Competition as a Guide," R. D. Willig and W. J. Baumol. 1: 28-35
- Regulation, general**
 "Giving Back the Takings Clause." (C) 2: 8-9
Who Profits: Winners, Losers, and Government Regulation, R. A. Leone. (R) 1: 57-59
- Regulatory costs:** *see* Costs and benefits, general regulatory
- Regulatory management**
 "Market for Bads, The: EPA's Experience with Emissions Trading," R. H. Hahn and G. L. Hester. 3/4: 48-53
 "Regulatory Reform in Peru," P. H. Schuck and R. E. Litan. 1: 36-43
- Regulatory reform:** *see* Deregulation; Regulatory management
- Retirement:** *see* Pensions and annuities
- Ricardo-Campbell, Rita**
Charting the Future of Health Care: Policy, Politics, and Public Health, eds. J. A. Meyer and M. E. Lewin. (R) 3/4: 62-64
- Rottenberg, Simon**
Rule of Experts, The: Occupational Licensing in America, S. D. Young. (R) 2: 59-60
- Safety:** *see* Cancer; Drugs and drug industry; Health and safety; Toxic substances
- Salop, Steven C.**
 "Exclusion and Antitrust" (with T. G. Krattenmaker). 3/4: 29-33
- Schuck, Peter H.**
 "Regulatory Reform in Peru" (with R. E. Litan). 1: 36-43
- Securities industry**
 "Portfolio Insurance and Stock Market Risk." (C) 2: 5-7
- Shughart, William F. II**
 "Deregulation and Air Travel Safety" (with R. B. McKenzie). 3/4: 42-47
- Smith, Vernon L.**
 "Currents of Competition in Electricity Markets." 2: 23-29
- Stone, Deborah A.**
Institutional Disability: The Saga of Transportation Policy for the Disabled, R. A. Katzmman. (R) 1: 56-57
- Stroup, Richard L.**
 "Blackout at Bonneville Power" (with A. N. Kleit). 2: 30-36
- Telecommunications**
 "Twisted Pair, The: Regulation and Competition in Telecommunications," R. G. Noll. 3/4: 15-22
- Theroux, Richard**
 "Drunken Driving, Hit-and-Runs, and Bribery" (with J. Umbeck). 2: 44-47
- Toxic substances**
Agent Orange on Trial: Mass Toxic Disasters in the Courts, P. H. Schuck. (R) 2: 54-56

INDEX

"Doubtful Indemnity." (C) 3/4: 8-10
 "Environment of Risk and Uncertainty, An." (C) 2: 9-14
 "Franchising FIFRA." (C) 3/4: 11-12

Trade Issues

"Quality of Life Action Act" (H.R. 1398, excerpt) 1: 18

Transportation

Institutional Disability: The Saga of Transportation Policy for the Disabled, R. A. Katzmann. (R) 1: 56-57

Umbeck, John

"Drunken Driving, Hit-and-Runs, and Bribery" (with R. Theroux). 2: 44-47

Utilities

"Blackout at Bonneville Power," A. N. Kleit and R. L. Stroup. 2: 30-36

"Currents of Competition in Electricity Markets," V. L. Smith. 2: 23-29

Vinyl chloride

"Environment of Risk and Uncertainty, An." (C) 2: 9-14

Viscusi, W. Kip

Agent Orange on Trial: Mass Toxic Disasters in the Courts, P. H. Schuck. (R) 2: 54-56

Wages: see Employment practices

Wagner, Richard E.

"James M. Buchanan: Constitutional Political Economist." 1: 13-17

Whelan, Elizabeth M.

Consuming Fears: The Politics of Product Risks, ed. H. M. Sapolsky. (R) 3/4: 57-59

Wildavsky, Aaron

"Nuclear Power Regulation: Seeking Safety, Doing Harm?" (with E. Nichols). 1: 45-53

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LETTERS

2

CURRENTS

4

Environmental User Fees
Censored Satellites
For Want of a Wheel

THE JAPANESE AUTOMOBILE CARTEL Made in the USA

11

Arthur T. Denzau

LEGAL ALIENS

17

Toward a Positive Immigration Policy

Barry R. Chiswick

CORPORATE TAKEOVERS

23

Who Wins; Who Loses; Who Should Regulate?

*John C. Coffee, Jr., Joseph A. Grundfest,
Roberta Romano, and Murray L. Weidenbaum*

WIRING THE CONSTITUTION FOR CABLE

30

Thomas W. Hazlett

RISKY PRODUCTS, RISKY STOCKS

35

*Paul H. Rubin, R. Dennis Murphy,
and Gregg Jarrell*

READINGS

40

RECEIVED

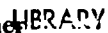
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LETTERS

2

CURRENTS

4

Market InSECurities

RPM Revisited

Miles to Go Before I Die

WHAT DAY CARE CRISIS?

13

Ron Haskins

I WOULD DO IT AGAIN

22

Alfred E. Kahn

AFTER THE CRASH

29

Linkages Between Stocks and Futures

Joel J. Cohen, Merton H. Miller,

Robert R. Davis, Roger M. Kubarych, and Others

PUBLIC UTILITIES' PRIVATE RIGHTS

35

Paying for Failed Nuclear Power Projects

Michael W. McConnell

WHAT'S WRONG WITH PRICE FIXING

44

Responding to the New Critics of Antitrust

Michael E. DeBow

READINGS

51

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LETTERS

2

CURRENTS

5

Let the Punishment Fit the Crime

Dying for Drugs

The Iceberg's Tip

REGULATION AFTER REAGAN

13

Roger G. Noll

MANDATED BENEFITS—ON THE AGENDA

21

Marvin H. Kusters

**TELECOMMUNICATIONS POLICY
IN THE REAGAN ERA**

28

Robert W. Crandall

U.S. TRADE POLICY

34

William A. Niskanen

ENVIRONMENTAL POLICY

43

Richard L. Stroup

BANK AND THRIFT REGULATION

50

William S. Haraf

TRANSPORTATION POLICY

57

Thomas Gale Moore

READINGS

63

Regulation

Winter 1990 The Cato Review of Business & Government

Editor
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LETTERS 2

CURRENTS 8

Under New Management
Tree Huggers and Bean Counters
Gramm-Rudman and Crème de Cassis
The S&L Debacle: How It Happened
and Why Further Reforms Are Needed
The Deposit Insurance Reform Bandwagon
Getting Tough on White-Collar Criminals

THE POLITICS AND RELIGION OF CLEAN AIR 21

Robert W. Hahn

A PRIMER ON SMOG CONTROL 31

Kenneth Chilton and Anne Sholtz

ACID RAIN 41

Causes, Effects, and Control
J. Laurence Kulp

AIR TOXICS AND PUBLIC HEALTH 51

Exaggerating Risk and Misdirecting Policy
Frederick H. Rueter and Wilbur A. Steger

POLITICAL LIMITS OF THE MARKET 61

FOR "BAT MEDALLIONS"
*Gordon L. Brady, Michael T. Maloney,
and Alden F. Abbott*

ENVIRONMENTAL STRATEGIES WITH 65

UNCERTAIN SCIENCE
S. Fred Singer

SHOULD TELEPHONE COMPANIES PROVIDE 72

CABLE TV?
Thomas W. Hazlett

READINGS 82

Regulation

Summer 1990 The Cato Review of Business & Government

Editor
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LETTERS 2

CURRENTS 7

Straws in the Wind
Europeanizing the American Economy
An Elegy to the Barbarians
Good Enough for Government Work: Why
Moving America Is Unsatisfactory
Snake Oil in the SPR

UNINTENDED CONSEQUENCES 21

The Probable Effects of Mandated Medical
Insurance
Simon Rottenberg

**THE PROLIFERATION OF PENSION
REGULATIONS** 29

Kathleen P. Utgoff

WHY WARN? 39

Plant Closing Legislation
*Ronald G. Ehrenberg and
George H. Jakubson*

MORALITY ON THE CHEAP 47

The Americans with Disability Act
Richard V. Burkhauser

LOST IN SPACE 57

U.S. International Satellite
Communications Policy
Robert W. Hahn and Randall S. Kroszner

**AUTOMOBILE INSURANCE REGULATION,
DIRECT DEMOCRACY, AND THE INTERESTS
OF CONSUMERS** 67

Benjamin Zycher

THE GOVERNMENT SECURITIES ACT OF 1986 78

A Case Study of the Demand for Regulation
James B. Burnham

READINGS 85

Regulation

Winter 1990

The Cato Review of Business & Government

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LETTERS 2

CURRENTS 9

Déjà Vu
The Changing Rationale for Motor Vehicle
Fuel-Economy Regulations
A Century of Antitrust: The Lessons, The
Challenges
Do Not Use U.S. Antitrust Enforcement to
Promote U.S. Exports
Resale Price Maintenance Revisited
Stop Giving Away Airline Routes
Higher Budgets for Federal Regulators

THE ORIGINS OF ANTITRUST 26
Rhetoric vs. Reality
Thomas J. DiLorenzo

**INNOVATION, DYNAMIC COMPETITION,
AND ANTITRUST POLICY** 35
Thomas M. Jorde and David J. Teece

TURNING BACK THE ANTITRUST CLOCK 45
Nonprice Predation in Theory and Practice
Donald J. Boudreaux

PRIVATE ANTITRUST ENFORCEMENT 53
Compensation, Deterrence, or Extortion?
William F. Shughart II

DRILLING FOR DOLLARS 62
The New and Improved Federal Oil Lease
Program
Abraham E. Haspel

**DISSIPATING THE AIRLINE
DEREGULATION DIVIDEND** 69
The Decline of Competition at Hub Airports
Severin Borenstein

READINGS 78

Regulation

Winter 1991 The Cato Review of Business & Government

Editor
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LETTERS 2

CURRENTS 9

Up from the Ashes of the Uruguay Round
What Do We Know about Energy Security?
Price-Cap Reform of Telecommunications
Regulation: "A Penny Saved..."
Seidman's Imperialism?
Deposit Insurance: How Much Can We Afford?
The Collapse of Drexel Burnham Lambert:
Lessons for the Bank Regulators
Self-Flagellation among the Capitalists
The Ivory Import Ban
Competing Perspectives on Taxes and the Environment

THE URUGUAY ROUND 30

High Hopes, Hard Realities, and Unfinished Business
Philip H. Trezise

EUROPE 1992 42

Status and Prospects
Claude E. Barfield

VELVET FIST IN AN IRON GLOVE 50

The Omnibus Trade and Competitiveness Act of 1988
Ronald A. Cass

LESSONS FROM THE CANADA-U.S. FREE-TRADE AGREEMENT 57

Mexico, Other Regional Agreements, and the GATT System
Peter Morici

DEREGULATING BOOK IMPORTS 64

J. Hayden Boyd

JOINT VENTURES, STRATEGIC ALLIANCES, AND COLLABORATION IN TELECOMMUNICATIONS 69

Jerry A. Hausman

READINGS 77

Regulation

Spring 1991 The Cato Review of Business & Government

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LETTERS 2

CURRENTS 6

The Silly Season for Energy Policy
Treasury Report on Financial Reform Deserves Prompt Consideration
Capital Standards Alchemy
Insured Deposits and Exotic Financial Instruments: Where to Draw the Regulatory Line
A Recipe for Sustained Environmental Growth
Geographic Restrictions on Banks: A Prescription for Disaster
The Dockside of Regulation
The Case against Cartels among Governments

ARE BANKS SPECIAL? 25

Catherine England

DEPOSIT INSURANCE 35

The Case for the Narrow Bank
James B. Burnham

THE NARROW BANK 44

A Flawed Response to the Failings of Federal Deposit Insurance
Bert Ely

SHOULD THE FEDS REGULATE INSURANCE COMPANY SOLVENCY? 53

Scott E. Harrington

REGULATION OF INTERNATIONAL SECURITIES ISSUES 62

Paul G. Mahoney

PROGRAM TRADING IN CONTEXT 71

The Changing Structure of World Equity Markets
Dean Furbush

THE THEFT OF TIME, INC.? 78

Efficient Law and Efficient Markets
Fred S. McChesney and William J. Carney

KEEP MANDATORY RETIREMENT FOR TENURED FACULTY 85

Richard A. Epstein and Saunders MacLane

READINGS 97

Regulation

Summer 1991

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Editor
William A. Niskanen

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Catherine England

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Leigh E. Tripoli

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LETTERS 2

CURRENTS 9

Uncivil Rights
RCRA Lives, Alas!
Revising RESPA: Can Homebuyers Be Rescued?
Global Warming: The New National Academy of Sciences Report
The Total Cost of Regulation?
Level Playing Fields: International Standards, Product Certification, and the Global Marketplace
Fare Is Fare in Airline Deregulation: Restrictions and the Pursuit of Allocative Efficiency
Workplace Fairness: Reinstatement Rights Cannot Guarantee Jobs

SHOULD THE FEDERAL GOVERNMENT ALLOW THE STATES TO INCREASE TRUCK-SIZE LIMITS? 38

Yes: Allow All States to Set Truck Standards
Robert E. Farris
No: Allow Larger Trucks Only If Fees Are Increased
L. Lee Lane

UNFINISHED BUSINESS IN MOTOR CARRIER DEREGULATION 49

Thomas Gale Moore

AMERICA'S WELFARE QUEEN FLEET 58

The Need for Maritime Policy Reform
Rob Quartel

COMPETITION WITHOUT APOLOGY 68

Market Power and Entry in the Deregulated Airline Industry
Andrew N. Kleit

MAKING SENSE OF THE AIRLINE SAFETY DEBATE 76

Richard B. McKenzie

AT AGE 65, RETIRE THE RAILWAY LABOR ACT 85

Morgan O. Reynolds and D. Eric Schansberg

ANTITRUST AS ANTIMONOPOLY 91

Douglas H. Ginsburg

READINGS 101

Regulation

Fall 1991 The Cato Review of Business & Government

Editor
William A. Niskanen

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Catherine England

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Leigh E. Tripoli

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LETTERS	2
CURRENTS	12
Making Sense of Safety	
Improving Chemical Risk Assessment	
Death by Regulation	
NIMBY and LULU	
A Market without Rights: Sulfur Dioxide	
Emissions Trading	
Timely Accounting and Budgeting for	
Deposit-Insurance Losses	
The Search for Affordable Housing	
The Greening of the First Amendment	
THE PERIL AND PROMISE OF RISK ASSESSMENT	40
<i>Richard B. Belzer</i>	
RISK PERCEPTIONS IN REGULATION, TORT LIABILITY, AND THE MARKET	50
<i>W. Kip Viscusi</i>	
WHY REGULATE CONSUMER PRODUCT SAFETY?	58
<i>Paul H. Rubin</i>	
IMPROVING WORKPLACE SAFETY	64
Standards or Insurance?	
<i>Thomas J. Kniesner and John D. Leeth</i>	
REFORMING FDA POLICY	71
Lessons from the AIDS Experience	
<i>Joanna E. Siegel and Marc J. Roberts</i>	
REFORMING MEDICAL MALPRACTICE AND INSURANCE	78
<i>Joseph P. Newhouse and Paul C. Weiler</i>	
COMPARING RISK STANDARDS	85
The Superiority of a Benefit-Cost Approach	
<i>Albert L. Nichols</i>	
RADON TODAY	95
The Role of Flimflam in Public Policy	
<i>Philip H. Abelson</i>	
READINGS	101

Regulation

Winter 1992 The Cato Review of Business & Government

Editor
William A. Niskanen

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LETTERS	2
CURRENTS	10
Small Change	
Power to the People	
Market Deregulation of the Electric Utility Sector	
The Politics of Electric Power Deregulation	
One Export Eastern Europe Does Not Need	
Are the Greens Planning Fridge-Bombs?	
EXPANDING COMPETITIVE OPPORTUNITIES IN ELECTRICITY GENERATION	25
<i>Paul L. Joskow</i>	
DEREGULATING ELECTRICITY	38
What Stands in the Way	
<i>Robert J. Michaels</i>	
USER-OWNERSHIP OF ELECTRIC TRANSMISSION GRIDS	48
Toward Resolving the Access Issue	
<i>Douglas A. Houston</i>	
THE PUBLIC UTILITY HOLDING COMPANY ACT	58
The Easy Step in Electric Utility Regulatory Reform	
<i>Richard L. Gordon</i>	
CAN NUCLEAR POWER COMPETE?	66
<i>Geoffrey Rothwell</i>	
A HISTORICAL PERSPECTIVE ON ELECTRIC UTILITY REGULATION	75
<i>R. Richard Geddes</i>	
THE ENDANGERED SPECIES ACT	83
Saving Species or Stopping Growth?	
<i>Robert J. Smith</i>	
READINGS	88

Regulation

Spring 1992

The Cato Review of Business & Government

Editor
William A. Niskanen

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LETTERS 2

CURRENTS 7

Straws in the Wind
Reviving Life Insurance Sales Policy
Advancing the Cable-Telephone Company Debate
Politically Correcting Pesticide Exports
EPA Steps up "Inforegulatory" Radon Campaign
The Costs of Regulation (continued)

POLICYHOLDER RUNS, LIFE INSURANCE COMPANY FAILURES, AND INSURANCE SOLVENCY REGULATION 27

Scott E. Harrington

THE McCARRAN-FERGUSON ACT 38

Anticompetitive or Procompetitive?
Patricia M. Danzon

REGULATION AND THE AUTOMOBILE INSURANCE CRISIS 48

J. David Cummins and Mary A. Weiss

SHOULD SOCIETY DEAL WITH THE EARTHQUAKE PROBLEM? 60

Howard Kunreuther, Neil Doherty, and Anne Kleffner

INSURANCE PRICE CONTROLS, "AFFORDABILITY," AND TAXATION BY REGULATION 69

Benjamin Zycher

THE DUTCH DISEASE 75

Lessons for U.S. Disability Policy
Leo Arts, Richard V. Burkhauser, and Philip de Jong

GLOBAL WARMING 87

The Origin and Nature of the Alleged Scientific Consensus
Richard S. Lindzen

READINGS 99

Regulation

Fall 1992 The Cato Review of Business & Government

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LETTERS	2
CURRENTS	7
An Open Letter to the President-Elect Insurance and the Regulation of Medical Care Chipping away at Industrial Policy Is Lead a Heavy Threat?	
LUNCH INSURANCE	16
Gerald L. Musgrave, Leigh Tripoli, and Fu Ling You	
"BODY SHOP" ECONOMICS	25
What's Good for Our Cars May Be Good for Our Health Susan Feigenbaum	
PHYSICIAN LICENSURE AND THE QUALITY OF CARE	32
The Role of New Information Technologies Paul B. Ginsburg and Ernest Moy	
THE REGULATION OF HEALTH CARE PROFESSIONALS OTHER THAN PHYSICIANS	40
Deborah Haas-Wilson	
DRUG APPROVAL OVERREGULATION	47
Michael R. Ward	
BACK TO THE FUTURE	54
Medicare's Resurrection of the Labor Theory of Value Robert Emmet Moffit	
STATE MANDATES ON PRIVATE INSURANCE	64
Gail A. Jensen	
THE LAST PRIESTHOOD	70
The Coming Revolution in Medical Care Delivery Stephen S. Hyde	
READINGS	75

Regulation

1993 Number 3 The Cato Review of Business & Government

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LETTERS

2

CURRENTS

7

The New Regulatory Order
Antitrust in the Bingaman Era
Outlawing Cooperation: Chapter Two
Federal Flood Insurance: Managing Risk
or Creating It?
Financial Derivatives and the Insurance Industry

REFLECTIONS ON THE BUSH
REGULATORY RECORD

22

Michael J. Boskin, David McIntosh, C. Boyden Gray, and John Robson

CLINTON REGULATION WILL BE "RATIONAL"
Interview with Sally Katzen, the New OIRA
Administrator

36

William A. Niskanen

SMOKE AND MIRRORS

44

The EPA's Flawed Study of Environmental
Tobacco Smoke and Lung Cancer
Gary L. Huber, Robert E. Brockie, and
Vijay K. Mahajan

CHANGE, CHALLENGE AND COMPETITION

55

A Review of the Airline Commission Report
Alfred E. Kahn

WOULD DECENTRALIZED COMPARABLE
WORTH WORK?

65

The Case of the United Kingdom
Steven E. Rhoads

EPA'S NEW SUPERFUND RULE

71

Making the Problem Worse
Richard L. Stroup and Bradley Townsend

REGULATORY TAKINGS AFTER LUCAS

76

Henry N. Butler

READINGS

82

Regulation

Vol. 16 Number 4 The Cato Review of Business & Government
1993

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William A. Niskanen

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Brian Doherty

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LETTERS 2

CURRENTS 7

The Abuse of Power (Continued)
Dual-Class Stock, Telecommunications,
and the SEC
The Disappointments of Affirmative Action:
Reputational and Other Effects
Fire, Rats, and the Endangered Species Act

A NEW TECHNOLOGY POLICY
FOR THE UNITED STATES? 18
Murray Weidenbaum

LESSONS FROM THE CUTTING EDGE 29
The HDTV Experience
Cynthia A. Beltz

WHAT'S ALL THIS ABOUT JAPANESE
TECHNOLOGY POLICY? 38
Gary R. Saxonhouse

U.S. TRADE LAWS HARM U.S. INDUSTRIES 47
James Bovard

HOW U.S. FINANCIAL REGULATIONS REDUCE
THE TIME HORIZONS FOR U.S. INVESTMENT 59
Michael T. Jacobs

USING THE MARKET TO FIND
COMMON GROUND 68
Rights in the Workplace
Richard Edwards

DENYING ACCESS TO
LIFE-SAVING TECHNOLOGIES 74
Budgetary Implications of a
Moral Dilemma
Susan Feigenbaum

READINGS 80

Regulation

1994 Number 1 The Cato Review of Business & Government

Editor
William A. Niskanen

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SPECIAL LETTERS SECTION

**A Second Look at
Environmental Tobacco Smoke**

2

CURRENTS

9

Environmental Policy: A Time for Reflection
Adventures of Smogocop III
Leave that Car in San Francisco
**Advancing Science vs. Stagnant Policy: The Case
of Assessing Ozone Depletion Risk**
Malignant Cancer Scares
An Economic End to Below-Cost Timber Sales

AFTER ENVIRONMENTALISM

25

**Three Approaches to Managing
Environmental Regulation**
Michael Kellogg

**THE CHALLENGE OF
SUSTAINABLE DEVELOPMENT**

35

Jerry Taylor

USING THE WRONG MEASURES FOR SMOG

51

James Lis and Kenneth Chilton

MISLEADING QUANTIFICATION

60

**The Contingent Valuation of
Environmental Quality**

Robert K. Niewijk

AMENDING SUPERFUND

72

Reform or Revanche?

Kent Jeffreys

READINGS

80

Regulation

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LETTERS

2

CURRENTS

7

Changing of the Guard
Labor Pains
Senior Editor's Vision
The New GATT Agreement
The Basle Accord and Bank Lending
to Small Businesses
Creeping Privatization: The Present and
Potential of Alternative Dispute
Resolution
Bicycle Safety: A Case Study in Regulatory
Review
Yahoo Justice

REFORM OF MARITIME POLICY

28

Building Blocks of an Integrated Program
Allen R. Ferguson

**REGULATION OF TRUCKING BY
THE STATES**

37

John C. Taylor

**ORIGINS OF THE AIRLINE OVERSALES
AUCTION SYSTEM**

48

Julian L. Simon

**COMPELLING ACCESS TO NETWORK
JOINT VENTURES**

53

Progress and Populism at Odds
Donald I. Baker

**MORTGAGE LENDING, DISCRIMINATION, AND
TAXATION BY REGULATION**

61

*Benjamin Zycher and
Timothy A. Wolfe*

**"CIVILIZED" PHARMACEUTICAL PRICE
REGULATION**

72

Can The U.S. Have It Too?
*Richard T. Rapp and
Adam Lloyd*

READINGS

83

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LETTERS

2

CURRENTS

10

This Issue
Takings, Mandates and Markets
The Worst California Regulation:
Stress as a Workers' Disability
Rumblings Over Regulations
Property Rights and "Rough Proportionality"
Air-Conditioning and Refrigeration
Costs Heat Up

STRANGLED IN THE CRIB

21

Jobs and Regulations
in California
Joseph Farah and Mike Antonucci

GOLDEN LAWSUITS
IN THE GOLDEN STATE

28

Steven Hayward

SINKING OR SWIMMING
IN WATER POLICY?

35

Rodney Smith

POLLUTION TRADING
IN LA LA LAND

44

James L. Johnston

THE FUTURE OF ELECTRICITY
PROVISION

55

Matthew C. Hoffman

READINGS

63

J

**PHOTOCOPY
PRESERVATION**



Harvard Business Review

July-August 1981

Reprint number

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Volume 59, Number 4

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- | | | |
|-----|---|-------|
| 56 | Why Japanese factories work
<i>Robert H. Hayes</i> | 81408 |
| 67 | Japan—where operations really are strategic
<i>Steven C. Wheelwright</i> | 81412 |
| 75 | Nonstore marketing: Fast track or slow?
<i>John A. Quelch and Hirotaka Takeuchi</i> | 81409 |
| 85 | In Minnesota, business is part of the solution
<i>Judson Bemis and John A. Cairns</i> | 81401 |
| 94 | Step by step through a union campaign
<i>William E. Fulmer</i> | 81406 |
| 103 | New ways to reach your customers
<i>Benson P. Shapiro and John Wyman</i> | 81410 |
| 111 | Penny-wise approach to data processing
<i>Martin D.J. Buss</i> | 81402 |
| 118 | Three vice presidents in mid-life
<i>Stanley M. Davis and Roger L. Gould</i> | 81403 |
| 131 | Cash flow analysis: more important than ever
<i>Bradley T. Gale and Ben Branch</i> | 81407 |
| | Special report | 81404 |
| 8 | Facing facts with inflation accounting
<i>John Dearden</i> | |
| | Growing concerns | 81411 |
| 18 | A small business is not a little big business
<i>John A. Welsh and Jerry F. White</i> | |
| | For the manager's bookshelf | N.A. |
| 34 | Books on the management of human resources
<i>Mary V. Chatfield</i> | |
| 38 | Thinking ahead
Getting smarter about regulation
<i>William Drayton</i> | 81405 |
| 54 | Letters to the editor | N.A. |
| | Ideas for action | 81419 |
| 138 | Ads that irritate may erode trust in advertised brands
<i>Rena Bartos</i> | |
| 140 | New interest of U.S. industry in the Caribbean
<i>Arthur J. Lumsden</i> | |
| 155 | Bankruptcies: assets often can be picked up at bargain prices
<i>Lawrence Mittman and Rees W. Morrison</i> | |

Thinking Ahead

Getting smarter about regulation

William Drayton

Reprinted from



Harvard
Business Review

July-August 1981

No. 81405



Thinking Ahead

*If you don't like an EPA regulation,
make a counterproposal;
if it meets the same standards,
the EPA will probably accept it*

Any manager who has had to deal with regulations—whether from the EPA, the FCC, or the FDA—knows that any one regulation will not exactly fit his or her situation. Inevitably, the rule is too inflexible to allow managers to meet the requirements in ways that make sense for their operations.

Recognizing that managers and engineers probably know better than rules writers how to meet emission requirements in specific situations, the EPA has proposed three “controlled trading” reforms to the Clean Air Act that allow managers to batch sources and mix controls. In this article, the author describes how controlled trading works and enjoins managers to take the initiative in proposing new ways to meet pollution standards. He also suggests that this counterproposal process could be adapted to many other kinds of regulation as well, not only saving industry billions of dollars but also providing the same benefits intended by the regulations.

William Drayton was assistant administrator for planning and management of the U.S. Environmental Protection Agency. He has taught regulatory and management reform at both Stanford Law School and Harvard's Kennedy School of Government. Before that he worked for six years as a consultant with McKinsey & Co.

Getting smarter about regulation

William Drayton

Over the last four years, the Environmental Protection Agency has been putting in place a new, smarter approach to regulating air pollution. If a company can find a more efficient, less costly way of getting the regulatory job done than the EPA's rules require—which in almost every case it can—the government will let the company do the job its way.

Companies that have tried this new approach have achieved substantial savings, chiefly by “trading” expensive controls for cheaper, often innovative alternatives. For example, the 3M Company plans to save \$5 million at its Bristol, Pennsylvania plant next year by using water-based coatings and a new solventless “hot melt” process to reduce emissions more than required on three production lines in return for reduced controls on seven other lines.

Managers should be looking to see how they can benefit from this proven new approach. They can do so confident that it has the new administra-

tion's strong support. One of President Reagan's first environmental acts was to make it easier for certain large urban plants to make these kinds of trades.

The idea behind controlled trading is very simple. Rules, even the best possible rules, can't do what the manager on the spot can: find the most efficient way of getting the job done. Rules writers can only produce a series of generalizations that apply regardless of each situation's particular facts (and that usually also ignore other regulations affecting that case). The more a rules writer tries to adapt a rule to particular circumstances, the more detailed and inflexible it becomes.

Controlled trading gives the manager back the flexibility to find the best way of getting the job done that traditional regulation took away. Instead of simply writing rules and then enforcing them (“command and control” regulation), controlled trading encourages business to propose smarter alternatives before government moves on to enforcement (“command, counterproposal, and control”). This simple change promises to be the most significant innovation since the 1930s in how this country regulates.

Managers can either counterpropose changes within one plant, as 3M has

Author's note: A great many people worked very hard to make these reforms a reality. However, Henry Beal, Barbara Blum, Michele Corash, Doug Costle, Roy Gamse, Dave Hawkins, John Hoffman, Jim Kamibachi, Bob Kerr, Frans Kok, Mike Levin, John Palmisano, Steve Seidel, Deborah Taylor, and, most particularly, Jodie Bernstein were all key colleagues.

done at Bristol, or they can negotiate trades with other plants in the same area—e.g., by paying another company to reduce pollution more than it is required to do as a means of avoiding a more expensive equal reduction at their own facilities. They can also “bank” any such excess reductions for future use or sale. Government, as trustee for the public’s interest, makes sure that such counterproposals are both environmentally equivalent to and as enforceable as the rules they replace.

Business can save a great deal by using these new tools. A Du Pont study of roughly 50 of its plants, for instance, suggested that the company could cut its costs for controlling hydrocarbon pollution by more than 60%, or \$80 million annually, if it were allowed to make a simple switch in the mix of its controls. Because its calculations assume no innovation and no trading across plant lines, Du Pont’s eventual savings will probably be much greater.

For example, at its Deepwater, New Jersey chemical complex, Du Pont will save \$12 million by reducing emissions from five large hydrocarbon stacks more than 97% in exchange for not having to meet 85% reduction requirements at 200 small, difficult-to-control process sources. The air will be cleaner after this switch than before. Further, since Du Pont will now have to control and the state environmental agency monitor only five point sources, the trade will result in faster compliance and better enforcement.

It is easy to understand how Du Pont could achieve such results in view of the extraordinary range of control costs that industry after industry now experiences. Companies commonly incur vastly different costs for removing a pound of the same pollutant from different parts of a plant. In 1977 the EPA looked at a number of plants to get a quick sense of the range of costs. At the first plant it found that the cost of removing one pound of dust from the emissions of different processes, each subject to its own regulation, ranged from less than 25 cents to \$100.

Even a rule setting a performance standard for one process (e.g., paint spray booths) is likely to prove crude and wasteful. A plant engineer who

is responsible for 20 such booths knows that some are big and new while others are old and small; that they have different engineering qualities; that some are used all the time and others only for special jobs or at peak load capacity; that several will be scrapped soon. If only the rule that all paint spray booths must meet a fixed standard were not in the way, the plant engineer could accomplish the same result much more efficiently by controlling big, new, easily controlled, heavily used machines more and small, old, peak-load booths less. Or he or she could ignore some of these small booths by controlling more tightly another process emitting the same pollutant elsewhere in the plant.

Swaps across plant lines and industries make even more sense than those within a regulated process or among different processes within a plant. The average cost of removing a pound of a pollutant in industries with high abatement costs is a hundred times greater than the average cost in industries with less expensive options. Taking such huge variations in cost both within and among industries into account, managers can achieve truly dramatic savings by trading increased controls on low-cost processes in a low-cost industry such as chemicals for less stringent requirements for high-cost processes in a high-cost industry such as nonferrous metals.

This reform will eventually save billions of dollars a year. With air and water pollution clean-up costs alone running at roughly \$40 billion per year, even a 10% savings would be worth \$4 billion annually. Actual savings are likely to prove much greater than 10%, especially once trading across plant boundaries becomes common. The EPA is working to create new market institutions to facilitate this trading. Applying the counterproposal idea to other areas of regulation will, of course, further multiply the savings.

This reform has passed the initiative back to business. These very substantial savings, which go to the businesses innovating better controls and trading in this new market, should provide them with ample incentive to take the initiative.

Investing management time here will help the public as well as profits.

Society urgently needs a markedly increased flow of new pollution-control techniques. Controlled trading provides business the same powerful, bottom-line incentive to find new, more efficient pollution-control methods to cut production costs. In the absence of such innovation we cannot solve the environment’s core strategic dilemma: how to fit a volume of pollution that grows with the economy at a compound rate year after year into the forever fixed carrying capacity of our air, land, and water (see the ruled insert on p. 40).

Controlled trading should also help solve the environment’s second-generation enforcement dilemma—industry’s dismal failure to operate or maintain efficiently its control equipment. Recent EPA studies show that the average “complying” source of air pollution currently emits in excess of 25% more pollution than it legally should, even netting out periods when it emits less. This problem, already critical, will get steadily worse as equipment ages unless we give plant managers and engineers new incentives. Now they commonly neither understand nor care much about their control equipment. However, once they design their own controls, they will have both the understanding and the psychological investment that are critical to keeping them working.

Finally, regardless of how Congress may modify the Clean Air Act’s environmental standards, these benefits will stand. Whatever standards and rules (inevitably wasteful) the EPA sets, managers can always make counterproposals. (See the ruled insert on p. 52 for a summary of steps a business can take to find better, cheaper methods for cleaning up.)

Trading a pound of pollution

Controlled trading is a new reform strategy. Most regulatory reforms have worked to regulate the rules writers—to force them to do a better job. Rules writers must consider everyone’s opinion. They must follow detailed legal procedures; routinely consider environmental, economic, consumer, energy, urban, rural, equal opportunity, and a steadily expanding host of other concerns; and, increasingly, calculate cost-benefit ratios.

Escaping an environmental dead end

The environment is caught in a very dangerous cycle. Every year there are more people in the world, and every year the amount of economic activity per person increases. Consequently, the volume of pollution grows at a compound rate, and every year the absolute increase in our pollution problem grows bigger and harder to manage than the year before. Unfortunately, the amount of air, land, and water never grows.

The resulting accelerating imbalance between pollution and our natural resources is the chief reason our environmental problem is so difficult. Several decades ago people hardly worried about pollution. But by Earth Day in 1970 many felt conditions had become intolerable. Since then, because of strong regulatory interventions, as a nation we've reduced the levels of most traditional pollutants. For example, the air contains 17% less sulfur now than in 1970. Had we not acted, however, sulfur levels would have become dramatically worse, not better. If our country does nothing more for even a few years, sulfur levels will again rise rapidly.

This annual compound growth in the volume of pollution is driving the United States toward a very painful dead end. Just to maintain current, often unhealthful air levels—let alone to make any progress—the EPA and state environmental agencies must move down two very expensive, politically painful, and increasingly resistance-prone paths.

First, growing pressure forces the EPA and state agencies to require those they regulate to remove progressively larger proportions of the pollution they generate. To reduce pollution 85% typically costs much more per additional pound removed than it does to remove 60%—and 98% costs much, much more. As we move up this cost curve, resistance increases. Understandably, people want to know whether it makes sense to remove the next few tons of pollution if it costs as much to do so as removing the last several hundred tons.

The second path is at least as unattractive. Environmental managers are being forced to regulate larger and larger numbers of smaller and smaller people. Whereas the EPA and the states originally regulated only major polluters, they are now struggling to force car owners in some 20 cities to submit to annual inspections of their pollution control equipment. Although this program costs relatively little per ton of pollution removed, few car owners (or the affected local governments) are enthusiastic. Similarly, environmental agencies have been compelled to reach out to small industries like dry cleaners and local printers. Visualize the reaction your local printer had when an environmental officer informed him that some of his presses emitted invisible pollutants and needed expensive controls. With each step down this path, the hassle factor per pound of pollution removed increases geometrically—as do the administrative costs incurred by the environmental agencies.

In other words, as the volume of pollution continues to compound, the real price of maintaining any given level of air quality increases sharply. And as this trend continues, society may eventually be tempted to compromise its public health standards. In either case, it is impoverished.

Finding a third path that leads away from this dead end is the most important strategic objective of thoughtful environmental managers, public or private. The only serious possibility lies in greatly accelerating the rate at which society discovers new, improved means of environmental control. If the country can increase this innovation rate sharply, it may be able to cut control costs as fast as compounding pollution pushes them up.

The EPA's research staff can't possibly do all or even a significant portion of this job. Society will succeed only if it releases the creative energy and focuses the technical ability and specialized knowledge of thousands of managers and plant engineers all across the country on this problem. That is what controlled trading is designed to do and why it is environmentally essential.

Until now almost all controls have been end-of-the-pipe black boxes (scrubbers, bag houses, and so forth). Probably because of the noninvolvement of plant engineers to date, relatively little control has occurred through modification of the underlying production processes. Process change is one of the most obvious areas where the innovation stimulated by the positive incentives of controlled trading should take hold.

We're getting better rules today as a result of these efforts. However, a rule is still a rule—unavoidably overgeneralized and rigid.

Controlled trading doesn't try to regulate the regulators further; rather, it frees managers to find better solutions.

Managers, plant engineers, and corporate environmental officers, unlike rules writers, can identify and install the most sensible mix of controls for each facility, innovating where necessary and taking into account all its unique circumstances as well as those of nearby plants and of the area's air quality conditions. They can do this by negotiating case-by-case trades—if government lets them—in exactly the same ways companies deal with one another in every other aspect of commerce. The essence of EPA's controlled trading reforms is to make such trading possible. They are designed to free management ingenuity and initiative through three key, closely interrelated tools: the bubble, offset trading, and banking.

The bubble: Managers can use this reform to escape the narrow scope of

existing process-by-process regulation and to look at their facilities as a whole. In planning their counterproposals, they can imagine that their facilities are covered by an enormous plastic bubble or dome. Managers may control the several sources of pollution under the bubble in whatever way they think makes sense, as long as no more pollution escapes than would have under the former process regulations. As long as air quality is protected, the bubble can stretch well beyond one plant's boundaries. It applies to all existing processes that emit the same pollutant.

Within nine months of the EPA's announcement of the bubble policy in December 1979, industry had started to develop more than 70 bubble trades. The average trade promises to save more than \$2 million. The trades are as varied as the companies' circumstances:

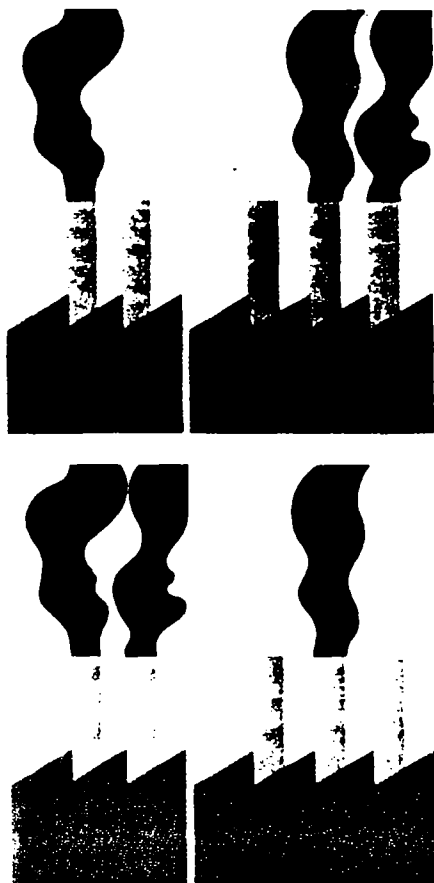
□ With a multiplant bubble covering two of its generating stations in Providence, Rhode Island, Narragansett Electric is saving its customers

upward of \$3 million and the country 600,000 barrels of imported oil per year while cutting sulfur dioxide emissions by 30%. Both stations now burn imported low-sulfur oils; in exchange for use of domestic natural gas at one plant, the company will switch to higher-sulfur oil at the other.

□ Through an analogous fuel switch, Kodak's Eastman Gelatin subsidiary in Peabody, Massachusetts, where unemployment is high, avoided laying off 350 workers. And a small Pennsylvania nursery company proposes similar trades at three of its greenhouses.

□ At its printing and packaging facility in Boulder, Colorado, Coors Beer expects to save between \$300,000 and \$2.5 million per year. Emissions on one printing line can exceed regulatory limits as long as that excess is offset by another line emitting less than it is allowed that day.

□ U.S. Steel's bubble at its Fairless Works will save it \$15 million by substituting the use of low-sulfur fuel in six production processes for the installation of very expensive coke oven gas desulfurization equipment.



The 3M and Du Pont cases discussed previously illustrate two other types of bubble trades.

As business and the EPA continue to gain more experience with this central innovation, they will work out its remaining bugs and make it steadily easier to use. For example, one change New Jersey made in January affecting one industry in that state alone produced 50 new bubble proposals by April. As the volume of bubble trading increases, it will become increasingly easy to use—to the benefit of both the environment and the country's need to modernize its plants and generate new jobs.

Offset trading: It is illegal to build a new facility or expand an existing plant in an area where the air is too contaminated to meet basic health standards if doing so will aggravate the area's air quality problem. To prevent an intolerable conflict between the need for local economic growth and modernization on the one hand and this statutory public health requirement on the other, the EPA developed the offset policy: the new source of pollution can move in as long as it (1) controls its emissions as

tightly as possible and (2) offsets whatever it can't control with reductions not already required by law of the same pollutants from other facilities elsewhere in the community.

□ When Pennsylvania successfully attracted Volkswagen to a site in the western part of the state, one element in its package of inducements was the provision of sufficient offsetting reductions of the area's smog-causing hydrocarbon pollutants to meet this requirement. The state provided these offsets itself in large part by shifting to water-based rather than petroleum-based asphalt in its road building and repair work in 16 nearby counties. The VW plant now needs additional offsets, and it and the state are exploring several prospects at nearby steel facilities.

□ The chambers of commerce in Shreveport and Oklahoma City made room for new General Motors plants in their communities by inducing local oil companies to close marginal facilities and reduce storage tank emissions.

□ Management of General Portland Cement paid Parker Brothers \$520,000 to install dust collectors on its facility in New Braunfels, Texas so that General Portland could add a new coal-fired preheater to its plant there without pushing the area over the health standards for particulates.

During the start-up years of 1978 and 1979, business completed nearly 700 documented offset trades. The third and newest element of controlled trading, banking, will make such trading much easier and should increase its volume substantially.

Banking: Swapping clean-up requirements among pollution sources is the essence of controlled trading. Where one source can provide the same pollution reduction far more cheaply than another, everyone gains. When the sources lie beyond a company's boundaries, however, trading becomes more difficult. Companies, especially those opening a facility in an unfamiliar community, have inadequate information regarding both what reductions are available elsewhere and what their price tags are. Consequently, despite the opportunities offered by huge variations in the costs of removing a pound of the

same pollutant both among companies and industries, 95% of all completed offset trades have involved different parts of the same company.

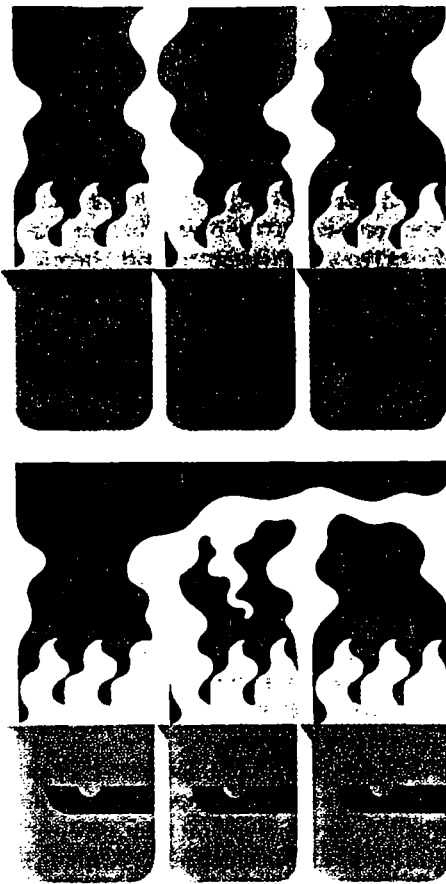
Trading is difficult for another reason: most clean-up decisions involve capital investments that are implemented at one moment in time. Even if two planned investments are obvious trades, a switch may nonetheless prove impossible if the investments are timed differently. This is especially likely if each decision is driven by independent regulatory deadlines.

Banking solves these problems. A pollution reduction bank works simply: it (1) purchases or takes emission reduction credits (for abatement beyond what the law requires) on consignment from pollution sources in its service area, (2) stores them, or (3) acts as a clearinghouse to facilitate subsequent trading. For example, a company may decide to install a larger, more efficient piece of control equipment than it legally must and sell the additional reductions to the bank if the price is attractive. Or a plant may switch to natural gas and sell or consign the resulting pollution reduction to the bank.

Some local governments have been working actively to help their banks build up their emission reduction accounts. Boston, for instance, is considering providing free technical assistance to private building owners seeking to cut their fuel bills in return for control over the offset credits that will flow from the accompanying pollution reductions. By August 1980, San Francisco, Seattle, and Louisville had full-scale banks in operation, and another 20 communities or states were developing them. (Even without such institutions, many companies have stockpiled reductions or potential reductions both to safeguard future growth and, with the help of the bubble, to phase in control investments more economically than existing regulatory deadlines allow.)

A pollution control bank can be a for-profit or not-for-profit organization; in the latter case, local environmental control or economic development agencies or perhaps chambers of commerce are most likely to manage them.

Once it has established such a bank, a community will have a competitive



advantage in attracting industry. As soon as a company expresses interest, the community can immediately offer at a known (perhaps subsidized) price a supply of emission reduction credits that the company can use to satisfy pollution standards. Management saves not only money but also a good deal of regulatory uncertainty, delay, and frustration. A working bank will also benefit established companies. Before investing in expensive controls, a manager can quickly and efficiently determine whether it might be simpler or cheaper to buy a reduction from the bank.

Banks may also provide brokerage services to help extend the efficiencies of controlled trading to smaller companies and make the market more liquid. In this role, a bank can further stimulate the market by providing free audits to help companies evaluate the potential for creating extra reductions. Brokers providing some or all of these services may, of course, operate independently of a bank.

A formal banking system creates a continuing incentive for companies to do more than required when replacing control equipment or meeting new control standards. The banking re-

form helps make these cheap extra reductions valuable commodities that management can use to satisfy future control obligations, to offset planned expansions, or to sell to other companies locating or expanding in the area. The bank charter's legal guarantees can encourage investment in pollution reductions by protecting the credits against confiscation and by specifying what will happen if, for example, the EPA demands further reductions.

Safeguards: This new market approach to regulation could not survive laissez-faire. If the EPA or the states allow these reforms to become loopholes, controlled trading will collapse instantly. The environmental community and the public would, quite sensibly, reject it. Consequently, the EPA has taken great care to design this new approach to be loophole resistant. The bubble policy incorporates a number of safeguards, for example:

- Hazardous elements (e.g., benzene) of a class of pollutants (e.g., hydrocarbons) can be traded only if the volume of that element declines. The presence of trace elements cannot, however, be used to block a trade.

- The EPA discourages trades of road and storage pile dust for production process emissions, chiefly because the former may be less harmful and harder to measure or model. However, the EPA has approved a bubble involving just this sort of trade at Armco's Middletown, Ohio steel plant because Armco actually demonstrated that its counterproposal removed more than six times the pollution—4,000 tons a year instead of only 650 tons. (This bubble saves Armco from \$14 million to \$16 million in capital costs and \$2.5 million to \$3 million a year in operating costs.)

In addition to these substantive safeguards, the EPA has, at least initially, limited both those who can use bubbles and where they can do so. The EPA will only consider bubble applications from companies that have complied with current emission limits or are keeping to an agreed compliance schedule. Frankly, this provision was written to keep cheaters out of the new marketplace, especially during its sensitive start-up years. There are very few such companies. Of Connect-

icut's 12,000 registered sources of air pollution, for example, only 20 to 30 required serious enforcement action during the first four years of environmental regulation in that state. And only 3 or 4 of these were hard-core scofflaws. However, every regulatory agency knows which companies in its jurisdiction these few are. (The staff has suffered at their hands before.) To let one of these companies be an early applicant would be to ensure a worst-case response, setting a precedent that could limit needlessly the bubble's applicability.

The policy's chief geographic limitation is in areas that have not met minimum national air quality standards. Companies in such areas must demonstrate that their bubbles will not interfere with the area's making satisfactory progress toward achieving compliance.

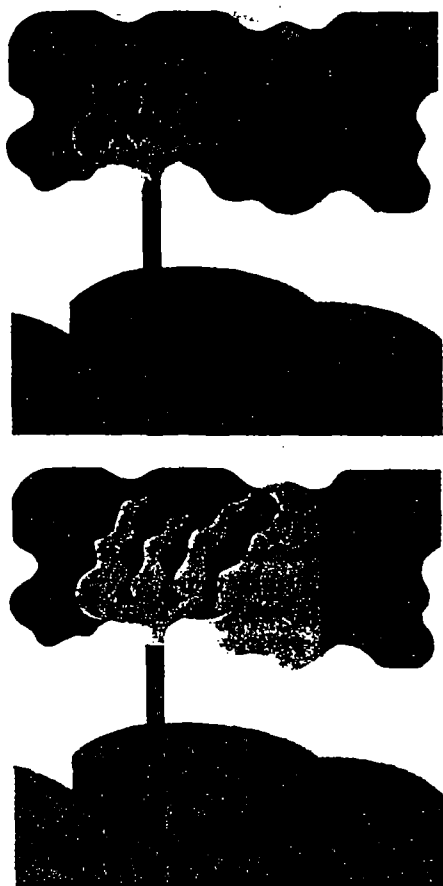
The ultimate safeguard of everyone's interest is, of course, the environmental agencies' final reviews of each counterproposal. Acting in the public interest, these agencies will approve a trade (or bank transaction) only if it respects their policies and, most important, passes the cornerstone tests of environmental equivalency and equal enforceability.

Now let's look at the U.S. experience with controlled trading to date, point up what the problems have been, and summarize the major outstanding policy issues.

Making a regulatory market work

Turning the idea of a regulatory market that supports extensive controlled trading into reality is an ambitious undertaking. Literally thousands of people—business managers and engineers, state and local officials, EPA staff, legislators, environmental activists, and the press—must learn to use regulation and to work with one another in fundamentally new ways. Although controlled trading is now a proven, widely used approach producing very substantial benefits, it will still take years before it is fully institutionalized where it is most crucial—in these people's heads. (It took 15 years for American farmers to accept hybrid corn.)

Over the next several years the Congress, the EPA, the states, and both



the business and environmental communities will continue to develop and refine the reform's basic legal structure. They will close the odd loophole. More important, they will extend the market's coverage and continue to loosen restrictions that prove unnecessary. Business must also organize to take advantage of this new opportunity; it must provide the chief case-by-case initiative.

The experience so far: The simple common sense of the counterproposal idea quickly won full support. Although initially some environmentalists feared that the reform might become an enforcement loophole or take too much staff time, much of this initial concern has abated with actual experience and as the reform's environmental advantages have become more apparent. Recently, one environmental leader commented that this approach is probably the wave of the future. A number of line managers quickly saw the practical implications for their companies. John Barker, Armco's director of environmental engineering, described his first bubble as follows: "We can control six times as much [pollution] for one-third the

cost in half the time and at a tiny fraction of the energy consumption."

After several years and more than a thousand completed trades, offset trading is reasonably well established. Because so little cross-company trading occurs, however, much of the possible benefit remains untapped. The new banking and brokerage reforms should help.

The bubble is now beginning to gain considerable momentum. Its start-up year was much slower, in large part because the EPA was very cautious when it launched the bubble policy in December 1979. It took great care to avoid either falling on its face administratively or creating an enforcement loophole (which it felt might well prove politically fatal to the whole policy).

The agency was probably too cautious, however. It imposed a series of restraints on the policy that—in fact or as a matter of perception—frustrated many of the state environmental agencies and companies seeking to use it and that, with 20-20 hindsight, were not necessary. Irving Shapiro of Du Pont, one of the bubble policy's early supporters, expressed this common frustration in an April 1980 letter to the EPA: "I am quite concerned that procedural problems may prevent its [the bubble's] effective implementation."

Midcourse correction: In September 1980, the EPA convened a conference of businessmen, congressional and White House staffs, environmentalists, and state and local environmental agency managers to help it design a midcourse correction for the bubble policy. Since then it has removed a number of unnecessary barriers:

□ The EPA will now approve classes of trades proposed by the states rather than insist on reviewing each case itself. This change responds to the most loudly voiced complaint of both industry and the states. They have found the added delay and second-guessing of a formal federal review of each counterproposal, on top of a formal state review, maddening. The EPA responded first by offering to do its review simultaneously with the state whenever the state and company were willing.

Then, in November 1980 the EPA agreed to allow New Jersey to ap-

prove hydrocarbon bubbles by direct permit changes as long as the procedure met a few simple criteria. The EPA would have 20 days to object to such bubbles, but federal approval would no longer be required. (New Jersey believes that this one small change will in 1981 permit that state alone to approve up to 300 chemical companies' bubbles, worth several hundred million dollars in savings.) The EPA has urged other states to develop similar generic regulations governing bubble approvals, and a growing number are doing so. State and industry initiative is what's needed now.

□ The EPA no longer routinely requires detailed mathematical modeling—the time-consuming, expensive, and unavoidably judgment-filled black art of air pollution regulation. For 90% of the applications, where much easier tests of environmental equivalence will suffice, that's all the government now requires.

□ The EPA no longer restricts trades in areas with unacceptable air quality across the different processes emitting hydrocarbons for which it has developed technical guidelines.

□ The agency now allows the can-coating industry to exceed its emission limits with some batches of cans as long as it offsets those excesses. This change will be worth \$135 million to this small industry in 1981 alone—another precedent other industries can follow.

□ In March 1981, the Reagan administration changed the definition of source in the EPA's nonattainment regulations. This change allows companies locating large new facilities at existing sites to trade control requirements between new and old parts of the plant. Two refineries and two GM plants in California will be immediate beneficiaries.

These and a number of other simple recent changes have made it much easier to use the bubble.

Four major, difficult issues are still outstanding, however. How they are resolved will importantly influence the speed and degree to which our country benefits from controlled trading:

1. *Should government limit the use of the bubble in areas that have not met national air quality standards for health—that is, most of our cities?* During the year after it announced

the bubble policy, the EPA in effect prohibited its use in nonattainment areas with two limited exceptions—if a company could demonstrate that, taking all sources of pollution into account, either its part of the city did meet air quality standards or had an adequate plan for doing so or, alternatively, that certain limited types of hydrocarbon trading (exempted for historical purposes) were involved.

This sweeping restriction is not what the EPA intended. The original policy approved trading once an area had a fully accepted plan for coming into compliance. The agency then expected to approve plans for most areas within months after the bubble policy was promulgated. Good intentions notwithstanding, however, although the agency has partially or conditionally approved a great many state plans, it has given final permission to very few even now. Consequently, urban bubbles proved to be available to only those few companies that could fit into one of the two exceptions.

Now the EPA allows bubbles in nonattainment areas regardless of the finality of the state/local compliance plan. It has, however, imposed a new condition: companies proposing bubbles in such areas must meet a higher standard of control, "reasonably available control technology," than previously applied to them. The rationale for this added requirement is that, once the area gets a finally approved control plan in place, the company will probably have to meet a higher standard. If the government lets the company go ahead with capital investments that fall short of this future need, it will, a year or so later, either have to force the company to go through expensive retrofits or accept inadequate levels of controls.

This new condition will clearly discourage some, perhaps many, companies from proposing bubbles. A higher standard is a more expensive standard, and only the more profitable trades are likely to make accepting these extra costs worthwhile. However, if managers believe that in a few years they will face a higher standard in any case, they will probably give only limited weight to this temporarily increased expense. They may even prefer to get an early, firm reading of what will eventually be required.

Delay and uncertainty are likely to be a more serious barrier. Definitions of reasonably available control technology do not exist for a great many processes. Must a plant manager seeking to develop a bubble under this provision first get his or her state agency to define standards for those processes the plant wishes to put under a bubble and for which no standard has yet been set? If so, given the difficulty of setting such standards and the press of many other demands on state air pollution agencies' staffs, the manager may have to wait some time to get an answer.

Fortunately, in most cases governments that allowed companies to use the bubble without this added requirement would not be confronted with a retrofit-or-nothing Hobson's choice. As long as a company or its community has a number of ways of reducing pollution, there will be no need to force sources that have just executed a trade to retrofit. If the government revises a community abatement plan and asks companies in the area to reduce their emissions, they can comply by controlling any source of the same pollutant within the area using controlled trading techniques.

Most cities are not suffering extreme levels of pollution and could meet clean air standards in a number of different ways. At least these cities could approve bubbles within the limits of existing requirements without risking the inability to meet standards. Such a liberalization would go a long way toward realizing the full potential of the bubble.

2. *Should the companies that must be in compliance with air quality standards by 1982 (or face financial penalties) have to install unduly expensive control equipment because they cannot get their bubble proposals approved in time?* The EPA has taken a step toward solving this problem by informing companies that are interested in using the bubble and that are proceeding satisfactorily toward compliance that it won't use its limited enforcement resources to investigate their cases, thus de facto removing the penalty deterrent to using the bubble.

3. *How can managers be assured that the reduced control requirements they purchase in exchange for a greater abatement effort elsewhere won't be expropriated?* Some managers have

Finding a better way

Each plant's managers should try to find better, less expensive ways of cleaning up their processes than are required by the several rules that apply to their plant. The procedure is simple:

- Calculate the marginal cost of cleanup for every process emitting the same pollutant.
- See if it is feasible and still economical to cut more emissions from the least expensive sources (or from any easy-to-control unregulated sources of the same pollutant).
- Check to see if any nearby sources of the same pollutant might be willing to sell a reduction inexpensively (which is easy if a bank serving the plant's community already exists).
- Make a counterproposal to the state environmental agency and let the EPA know.

expressed concern that these relaxed requirements will prove an all too easy and visible target for environmental agencies looking for new ways to offset the compounding growth of pollution. Many business people need strong guarantees against such capital expropriations before they enter the controlled trading market. Policy and the law must safeguard against seizures either of a banked or otherwise stored pollution reduction credit or of a relaxed permit requirement purchased with offsetting reductions elsewhere.

Ultimately, business's chief protection is the fact that both legislatures and the courts understand how counterproductive expropriation is. If allowed, expropriation would wreck the market. The EPA will certainly oppose any threat of expropriation as strongly as it can. It is now working on a regulation designed to settle this and a number of other controlled trading issues permanently.

4. *Should new plants be prohibited from trading emissions reductions with existing facilities?* At present, new plants must meet very specific, tight standards. They cannot lower the often steep marginal costs of these controls by purchasing reductions from existing nearby facilities. Supporters of this policy argue that new sources should be controlled as tightly as possible: they will be with us for a long time and should be built to perform at a high standard. Whereas it may never be politically possible to

clean up existing plants efficiently, it is much easier to regulate new sources. Some environmentalists consequently believe that the gradual replacement of dirty existing facilities by tightly controlled new plants is the only hope for cleaning the air.

Those who hope to allow new plants to trade respond that it doesn't make sense to force a company to pay up to 10 times more to remove a pound of pollutant than it could by trading the undiminished cleanup responsibility with another facility. They ask, Why should the EPA care how companies discharge their responsibilities as long as they do? They also point out that the "new" control equipment installed in the early 1970s is already old and in growing need of replacement. The vision of solving the country's air quality problem without existing sources bearing much of the load is a chimera.

Cleaning up

Encouraging industry to counterpropose better ways of getting the public's job done is as basic and broadly applicable an idea as it is simple. Many different kinds of regulation—such as those controlling noise in factories, allocating airport landing rights, or even governing children's supervision in our schools—could be revised to allow industry to propose cheaper, but still effective, control methods.

The United States needs this smarter form of regulation. Over the last few years, business and the EPA have demonstrated that it works. Public and business managers must now finish the job both of implementing the reform in the air pollution area and of extending it to new areas. ▢

The Business Roundtable

1615 L Street, N.W.
Washington, D.C. 20036
202 872-1260



The Business Roundtable

Toward Smarter Regulation

Table of Contents

Executive Summary	i
I. Introduction	1
II. Twelve Tenets of Rational Regulation	6
1. Risk-Based Priorities and Public Education	6
2. Risk Assessment and Risk Management	12
3. Sound Science	14
4. Benefit-Cost Analysis	17
5. Market Incentives and Performance Standards	21
6. Productivity, Wages, and Economic Growth	21
7. Coordination Among and Within Agencies	26
8. Openness	28
9. Periodic Review	29
10. Federalism	31
11. Paperwork Burdens	34
12. Regulatory Budget	37
III. Conclusion	40
Endnotes	43
Selected References	46
Summary of Recommendations	51

Executive Summary

America is experiencing a dramatic increase in government regulation, with the most significant growth in the environmental, health, and safety areas. While the goals of many of these regulations may be laudable, there is a growing realization that we are wasting resources: Legislatures and agencies simply are not allocating limited resources in a cost-effective manner. We could achieve as good or better protection of human health and the environment at far less cost by regulating smarter.

Regulations are like "hidden taxes" that impose costs that are not readily apparent, yet are enormous. Just as the public must pay for government spending programs through higher taxes, they must also pay a high price for regulations – as customers, employees, and stockholders. The soaring costs of regulation stifle productivity, wages, and economic growth. Regulations also undermine jobs and international competitiveness. The increasing strain on our nation's resources brings into sharp focus the challenge for the '90s and beyond: The nation must not only reduce regulation, but when we choose to regulate, we must regulate smarter.

Regulators cannot regulate smarter unless their leaders allow it and demand it. Strong leadership must change the current incentives that drive agencies to create new regulations with little restraint, but offer virtually no reward for reforming or eliminating existing regulations or obviating the need for new ones.

Business is not alone in calling for regulatory reform; taxpayers, state and local governments, academics, members of Congress, the President and the Vice President have all expressed concern about the rising tide of regulations. To provide a framework for smarter regulation, The Business Roundtable recommends that federal, state, and local governments implement the following twelve tenets of rational regulation:

1. Risk-Based Priorities and Public Education: To provide more cost-effective protection to human health and the environment, regulatory priorities should be based upon realistic considerations of risk. Agencies must educate the public about the level of risks proposed for regulation compared to risks familiar to the public, as well as the cost of reducing that risk. The government should estimate the relative risks posed by different substances, products, or activities and decide whether, and

how, to regulate based on those risks. Resources should be committed where the greatest risks can be reduced at the least cost. The government should ensure that the public understands the magnitude of each risk compared to more familiar risks, as well as the costs of reducing that risk.

2. Risk Assessment and Risk Management: Risk assessment methodologies should be continuously improved, and agencies should establish a clear distinction between assessing risks and deciding how to manage them. The scientific process of risk assessment should be made as objective as possible, and uniform standards should be applied. Any necessary policy or scientific judgments should be disclosed. Cost-effective approaches to managing risks should be promoted.

3. Sound Science: Agency decision making should be grounded on the most advanced scientific knowledge currently available. New regulations should be based on the most advanced and credible scientific knowledge, and existing regulations and methods should be regularly updated to incorporate scientific advances. In making decisions and setting priorities based on risk, agencies should use “best estimates,” not worst-case estimates of risk.

4. Benefit-Cost Analysis: Benefit-cost analysis should be utilized by agencies when developing regulations, with preference given the least costly regulatory alternative that accomplishes program objectives. First, agencies should use benefit-cost analysis to determine whether or not a proposal should be considered for adoption. Second, agencies should use cost-effectiveness analysis to select the regulatory option that achieves regulatory objectives in the least costly way.

5. Market Incentives and Performance Standards: Market-oriented solutions and performance standards should be favored over command-and-control regulation. Market-based regulatory approaches reproduce the efficiency of a free market by internalizing the cost of a regulated activity or substance. They allow regulated parties to meet or exceed regulatory goals in the least costly way. Moreover, market incentives and performance standards adapt to changed circumstances more quickly than government command-and-control regulation.

6. Productivity, Wages, and Economic Growth: Methodologies should be implemented and continuously improved to assess the impact of major regulations on productivity, wages, and economic growth, as well as the adverse impact on jobs and international competitiveness in industries that bear the burden of regulation. For our economy to grow, regulatory and economic goals must become complementary, not conflicting. Government must be more sensitive to the impact of regulation on wages, prices, jobs, and international competitiveness.

7. Coordination Among and Within Agencies: Coordination of regulatory activities among and within agencies should be improved to eliminate inconsistencies, duplication, and unnecessary regulatory burdens. To address problems within the jurisdiction of multiple agencies, a strong interagency committee should engage in strategic planning and develop a coordinated response before regulations are proposed. Each agency should also coordinate its programs that address different aspects of the same problem.

8. Openness: The entire regulatory process, including centralized Executive review and management of agency rule making, should be open to public scrutiny, to promote the quality, integrity, and responsiveness of agency decisions. Secrecy should be removed from the regulatory development and review process. More rules should be developed through regulatory negotiation, which involves open negotiations between regulators and interested parties.

9. Periodic Review: Programs and regulations should be periodically reviewed for purposes of determining whether they should be reformed, discontinued, or consolidated. Periodic review allows for government-wide priority setting through reforming or eliminating regulations, updating scientific methodologies, reorganizing an agency, or reallocating responsibility among agencies. Where appropriate, legislatures can ensure a stricter review process by setting firm deadlines by which they will be compelled to evaluate and vote for continuation of a program, or the program will terminate.

10. Federalism: Regulatory authority should be more rationally allocated among the federal, state, and local governments, and federal regulatory programs should avoid unfunded mandates.

Many activities and substances are controlled by a mix of federal and state regulation. Modern commercial realities demand a more cost-effective balance of federal and state regulation. The federal government is primarily responsible for achieving this balance and should carefully consider whether to preempt and regulate a field or leave the field to the states. The federal government should also refrain from directing state and local governments to administer or comply with federal programs without providing the necessary funds.

11. Paperwork Burdens: Paperwork burdens caused by regulatory programs should be expressly assessed and substantially reduced.

The massive paperwork burdens imposed on business, the public, and governments themselves must be reduced. The Paperwork Reduction Act and OIRA's paperwork control responsibilities should be strengthened. Moreover, administrative process costs – the inflexibility, unresponsiveness, and delay that characterize many regulatory programs – should be examined and reduced.

12. Regulatory Budget: A framework should be developed to account for expenditures required by regulations and to promote greater fiscal restraint on regulatory programs.

There is a pressing need for government to be more sensitive to the cumulative costs of regulations. Under a regulatory budget, agencies would have a powerful incentive to regulate in a more cost-effective manner; each agency could be limited in the amount of regulatory costs imposed on the economy each year.

* * *

A unique opportunity for meaningful regulatory reform presents itself. There is a growing consensus not only on the need for regulatory reform, but also on how to achieve it: Government must assess the seriousness of risks proposed for regulation, compare risks to be regulated to risks familiar to the public, disclose the costs of regulation, regulate only if the benefits outweigh the costs, and select the most cost-effective, market-driven method possible. This is smarter regulation. And smarter regulation is better regulation, for consumers, governments, and business alike. President Clinton's Executive Order on Regulatory Planning and Review espouses many of these principles for improving both regulations and the regulatory process itself.

However, the White House, Congress, agencies, and the states must all commit themselves to smarter regulation. The Business Roundtable recommends that governments at all levels implement these twelve tenets. *Our nation cannot afford to ignore the challenge to regulate smarter.*

I. Introduction

Since the 1970s, our nation has implemented far-reaching regulatory programs to protect human health and the environment. Congress created new agencies – such as the Environmental Protection Agency, the Occupational Safety and Health Administration, and the Consumer Product Safety Commission – with broad responsibilities to reduce risks to public health, safety, and the environment. Older agencies, such as the Food and Drug Administration, have been given expanded regulatory authority. Sweeping legislative mandates have directed agencies to reduce risk to the environment, health, and safety, almost without compromise.

Some government intervention in the economy may be necessary to achieve desirable goals such as a cleaner environment, safer working conditions, and safer products. In many instances, specific regulations have been well-conceived and reasonably implemented. These efforts have produced substantial benefits for the country and its people.

And yet, even with the best of intentions, government simply is not allocating limited resources in a cost-effective manner. Despite a dramatic increase in environmental, health, and safety regulation, experience has taught us that often our regulatory efforts have been more costly and less effective than they could have been. Moreover, the enormous costs of federal and state regulations exert a heavy drag on the economy. They depress wages, stifle productivity and economic growth, drive up prices, and impede innovation. They also burden federal, state, and local governments. In our increasingly global economy, excessive regulation seriously undermines the competitiveness of U.S. businesses. Ultimately, the American public suffers.

The costs of regulation are undeniably high, and the costs of many regulations plainly outweigh their benefits. The annual cost of federal regulation was conservatively estimated at \$581 billion for 1993; it is projected to rise to \$662 billion by the year 2000.¹ Almost 75% of that cost increase is expected from additional environmental, health, and safety regulation.² According to EPA projections, by the year 2000 the United States will spend \$160 billion annually on pollution control alone – almost 90 percent more than was spent in 1987.³ Although economic regulation in areas such as transportation and energy has declined, cost reductions from earlier reforms have been dwarfed by new regulation in the environmental, health, and safety areas.⁴

Beyond the problems caused by the rising costs of government

regulation, the regulatory process itself has become unduly rigid, unresponsive, and inconsistent. These problems have sparked increasing concern about the rationality of the regulatory process and a growing determination to do something about it.

The Need For Priorities and Reform

Consumers, business, and governments all have a stake in regulatory reform. Federal, state, and local governments, like business, are part of the regulated community. The enormous liability of federal facilities and municipalities for Superfund cleanups is but one growing regulatory crisis faced by governments at all levels. To absorb the costs of regulation, businesses may be forced to raise prices, reduce production, eliminate jobs, cut research and development, or even go out of business entirely. Likewise, federal, state, and local governments may raise taxes or reduce services; some local governments may even face the prospect of bankruptcy.

Although the direct costs of regulation typically are imposed on businesses and governments, they ultimately are passed on to the American consumer through higher prices, diminished wages, reduced quality or availability of products and services, as well as through increased taxes. Per household, these costs total about \$5,900 per year.⁵

These soaring costs of government regulation come at a challenging time. The national debt now exceeds \$4 trillion – \$16,600 for every man, woman, and child in America.⁶ This expanding deficit makes it painfully obvious that our resources are limited. Many government priorities – including crime prevention, education, and defense – must compete for these limited resources. Any increase in regulation must be weighed against other legitimate priorities, as well as against its adverse impact on wages, productivity, and economic growth.

Too many regulations and regulatory programs have suffered from inadequate analysis and discipline. Both the Legislative and Executive Branches must share responsibility – first, to address this problem, and second, to cure it. The Business Roundtable believes that existing and proposed regulatory programs should ensure that:

- Stated goals are in fact attainable.
- Each program or regulation is worth the added cost to the nation (in increased prices and lower wages and productivity, for example).

- Each regulation is the most efficient means to achieve its objective and minimizes adverse economic impacts.

Toward "Smarter" Regulation

The regulatory process must be reformed. Governmental resources at all levels must be allocated more rationally. And business must devote its resources to becoming more innovative and productive. The question is not only how the nation can reduce regulation, but also how we can regulate smarter. This question is crucial in both good and bad economic times.

The concept of smarter regulation is not novel. The increasing regulatory burden has led to a growing demand for reform across a spectrum of American society – from leaders of all business sizes, academics, public interest groups, government officials, and the general public. This demand has already sparked some important steps toward reform; indeed, Vice President Gore's recent National Performance Review report expressed alarm at the cost of regulation and concluded:

We must clear the thicket of regulation by undertaking a thorough review of the regulations already in place and redesigning regulatory processes to end the proliferation of unnecessary and unproductive rules.⁷

To this end, President Clinton signed Executive Order 12866 on Regulatory Planning and Review on September 30, 1993. This Order carries forward the concern of the last three Administrations by calling for a vigorous regulatory planning and review process and embracing many principles that would improve both the regulatory process and regulations themselves.

However, the hard work necessary to "reinvent" regulation still lies ahead. To further this worthy goal, The Business Roundtable recommends that governments at all levels implement the following twelve tenets of rational regulation:

1. *Risk-Based Priorities and Public Education:* To provide more cost-effective protection to human health and the environment, regulatory priorities should be based upon realistic considerations of risk. Agencies must educate the public about the level of risks proposed for regulation compared to risks familiar to the public, as well as the cost of reducing that risk.

2. *Risk Assessment and Risk Management:* Risk assessment methodologies should be continuously improved, and agencies should establish a clear distinction between assessing risks and deciding how to manage them.
3. *Sound Science:* Agency decision making should be grounded on the most advanced scientific knowledge currently available.
4. *Benefit-Cost Analysis:* Benefit-cost analysis should be utilized by agencies when developing regulations, with preference given the least costly regulatory alternative that accomplishes program objectives.
5. *Market Incentives and Performance Standards:* Market-oriented solutions and performance standards should be favored over command-and-control regulation. They allow regulated parties to meet or exceed regulatory goals in the least costly way.
6. *Productivity, Wages, and Economic Growth:* Methodologies should be implemented and continuously improved to assess the impact of major regulations on wages, productivity, and economic growth, as well as the adverse impact on jobs and international competitiveness in industries that bear the burden of regulation.
7. *Coordination Among and Within Agencies:* Coordination of regulatory activities among and within agencies should be improved to eliminate inconsistencies, duplication, and unnecessary regulatory burdens.
8. *Openness:* The entire regulatory process, including centralized Executive review and management of agency rulemaking, should be open to public scrutiny to promote the quality, integrity, and responsiveness of agency decisions.
9. *Periodic Review:* Programs and regulations should be periodically reviewed for purposes of determining whether they should be reformed, discontinued, or consolidated.
10. *Federalism:* Regulatory authority should be more rationally allocated among the federal, state, and local governments, and federal regulatory programs should avoid unfunded mandates.
11. *Paperwork Burdens:* Paperwork burdens caused by regulatory programs should be expressly assessed and substantially reduced.

12. *Regulatory Budget:* A framework should be developed to account for expenditures required by regulations and to promote greater fiscal restraint on regulatory programs.

Each of these tenets is explored in greater detail below.

II. Twelve Tenets of Rational Regulation

1. Risk-Based Priorities and Public Education: To provide more cost-effective protection to human health and the environment, regulatory priorities should be based upon realistic considerations of risk. Agencies must educate the public about the level of risks proposed for regulation compared to risks familiar to the public, as well as the cost of reducing that risk. The escalating costs of regulation and limited resources available make it imperative to establish priorities in environmental, health, and safety regulation. Despite the vast and expanding investment in programs to protect public health and the environment, there is a growing realization that we are not spending our money in the most cost-effective manner to achieve the greatest possible advances. All too often, regulatory priorities are based on misguided public perceptions of risk instead of valid scientific knowledge and reasoned analysis. Accordingly, there is a pressing need to establish a risk-based approach to environmental, health, and safety regulation and to provide the public with better information for evaluating and comparing risks that are candidates for regulation. The goal is not to put economic values before human values, but to achieve effective risk reduction at a lower cost.

Risk-Based Priorities

The problem of protecting human health and the environment may best be defined as the management of risk. The failure to manage risk effectively and to establish priorities rationally translates ultimately into a failure to protect health, safety, and the environment. Through the use of *comparative risk assessment*, the government can estimate the relative levels of risk posed by different substances, products, and activities and can establish priorities in determining whether, and how, to regulate. The government, with public input, should use comparative risk assessment to compare the magnitude of various risks and set priorities where we can achieve greater protection of human health, safety and the environment in the most cost-effective manner.

- The Environmental Protection Agency has recognized the urgent need for a risk-based regulatory approach employing comparative risk assessment. In its landmark report, *Reducing Risk*, EPA warned: "There are heavy costs involved if society fails to set environmental priorities based on risk. If finite resources are expended on lower-priority problems at the expense of higher-

priority risks, then society will face needlessly high risks. If the priorities are established based on the greatest opportunities to reduce risk, total risk will be reduced in a more efficient way, lessening threats to both public health and local and global ecosystems."

Unfortunately, public fears and political expediency – not scientific analysis – often dictate the priorities set by legislatures and agencies. As a result, government risk-reduction efforts have been unplanned, uncoordinated, and inconsistent. Many risk-reduction programs simply have not been effective:

- Some very costly programs and regulations do not address the more serious risks.
 - ▶ Congress originally estimated that the Superfund program would cost \$5 billion when it was enacted in 1980. Independent estimates now project the program will cost between \$106 and \$302 billion for Superfund and between \$372 and \$744 billion for related remedial programs* (in total, up to 25% of the national debt). Notwithstanding these enormous costs, a group of EPA professionals have ranked risks associated with hazardous waste sites well below other problems receiving far less resources."
- Regulations based on uncertain or unsound scientific information are not revised when more reliable data is produced.
 - ▶ In January 1991, EPA's Office of Drinking Water eliminated the primary standard for silver because it determined that there were no adverse human health effects of silver in drinking water; yet the Office of Solid Waste continues to maintain silver on RCRA's toxicity characteristic list, even though the RCRA silver standard was based on the obsolete drinking water standard."
- Some regulatory actions actually increase risk.
 - ▶ Early in the 1980s, government scientists argued that asbestos exposure could cause thousands of deaths. Congress responded by passing a sweeping law that led cities and states to spend between \$15 and \$20 billion to remove asbestos from public buildings. But three years ago, EPA officials acknowledged after further research that ripping out the asbestos had been an expensive mistake; it raised the exposure of the public because asbestos fibers had become airborne during

removal.² It also delayed the opening of many schools and other buildings.

Executive Order 12866 (Sec. 1(b)(4)) states:

In setting regulatory priorities, each agency shall consider, to the extent reasonable, the degree and nature of the risks posed by various substances or activities within its jurisdiction.

The White House, the Office of Information and Regulatory Affairs, Congress, each agency, and the states should vigorously promote this policy. The Executive Branch should develop a current inventory of known risks, rank them, and periodically update the inventory every two to four years in light of new information. It should seek extensive public involvement in the process. EPA started towards this goal by creating and implementing two seminal reports, *Unfinished Business* and *Reducing Risks*. These reports were prepared by environmental experts who assessed, compared, and ranked the various environmental risks regulated by EPA.

- *Unfinished Business* (1987) found that EPA and Congress in most instances had directed resources to problems based on misguided public fears, instead of objective scientific evidence.
- *Reducing Risks* (1990), produced by an independent committee of the Science Advisory Board, revised the risk rankings set forth in *Unfinished Business* and encouraged EPA to base its programs on the severity of risks and the availability of cost-effective options that would reduce the risks and not violate the Agency's statutory mandates.

The other health and safety agencies – including FDA, OSHA, USDA, and CPSC – would benefit from similar projects. Agencies should address highest priority risks first, rank new risks as they are identified in the future, and routinely communicate this information to the public. A coordinating group should be used to facilitate communication and long-term planning among agency leaders; Executive Order 12866 (Sec. 4(d)) provides such a mechanism by establishing the Regulatory Working Group.

Many other efforts could further the establishment of risk-based priorities. For example, President Clinton might issue guidance to agencies to require the use of risk analysis as a tool for making pollution prevention decisions. This would complement the President's

recent Executive Order 12856, which was designed to make pollution prevention central to government operation and procurement. Moreover, a task force composed of scientific experts from the environmental, health, and safety agencies should create a government-wide manual on the regulation of risk. The manual would provide guidance to regulators on how to manage risks.

In the end, the responsibility lies with Congress and state legislatures to promote a risk-based approach to environmental, health, and safety regulation. The most effective legislation for controlling risk will promote risk assessment while providing the agencies with sufficient flexibility to incorporate state-of-the-art scientific knowledge. In the short term, Congress and state legislatures should require the risk-reduction agencies, such as EPA, to conduct comparative risk assessments to set priorities. An Office of Risk Analysis should be created in EPA and other agencies that need increased expertise in analyzing and ranking risks. As statutes are reauthorized, reformed, and created, Congress and state legislatures should require – not inhibit – the consideration of risk, costs, and benefits in designing regulatory policy. Legislatures should set clear goals for regulatory programs, and these goals should be understandable to the regulated community and the public.

Public Education: Improved Risk Communication

Risk communication is critical to establishing risk-based priorities that are acceptable to the public. The government must educate the public about the level of risks proposed for regulation compared with familiar risks, as well as the costs of regulating them. Agencies often fail to regulate in a cost-effective manner because priorities are based on misguided public fears. All too commonly, agencies fail to inform the public adequately about risks proposed for regulation or misinform the public by making biased or exaggerated risk estimates. This distorts the public's perception of risk, which in turn influences the legislature's agenda and leads to irrational and costly regulatory mandates.

Government has the responsibility to accurately inform the public about the level of risks and to minimize distortion and exaggeration of risks. *Risk communication* is an interactive process in which government, the public, business, media, and the environmental and scientific communities exchange information and opinions about risk

and related concerns. In the past, risk communication has been viewed as a one-way channel from experts to the public, but risk communication should be a two-way street. Effective risk communication should satisfy the public that they are informed about the relevant issues within the limits of available knowledge. It should also generate information on which decision makers base their choices. This framework for effective risk communication should extend to all levels of the regulatory process.

To allow public involvement in the important decisions about whether, and how, to regulate various risks, government must educate the public about the risks to be regulated – in terms nonexperts can understand. This can be achieved through the process of *risk comparison*. Risks proposed for regulation that are unfamiliar to the public should be compared to familiar risks to convey the magnitude of the risk involved.

Risk comparison is critical to permitting the public to engage in the regulatory decision-making process. Moreover, risk comparison techniques are improving. One technique, risk ladders, improves the validity of risk comparisons by providing a range of probabilities for a single class of risk. Risk comparisons are most useful when they involve risks that occur in the same decision context, exhibit similar risk-perception attributes (such as whether they are voluntary or involuntary), and have similar outcomes. Multiple comparisons often will be more helpful than single comparisons. While the nature of different risks often varies in some respects, there should not be inflexible rules for comparing risks. The goal of risk comparison should be to enable the public to make informed choices about the risks they incur and the costs of reducing those risks. Government should inform the public about the relative magnitude of regulated risks, as well as those proposed for regulation, compared to risks commonly encountered and understood by the public. The government must also disclose to the public the potential cost of regulating those risks.

Environmental, health, and safety agencies should develop public risk communication programs. As part of their risk communication programs, agencies should summarize relevant qualitative and quantitative information on the nature of each risk, the nature of the benefits that might be achieved if the risk were reduced, the available alternatives, and uncertainty about risks, costs, and benefits. Agency

risk messages should include an estimate of the magnitude of the risk as well as a characterization of the current or potential efforts to reduce it. This includes the cost and adverse consequences of regulating the risk, who must pay the cost, the effectiveness of various regulatory options, and whether regulation of the risk creates additional risks of its own. Agencies should use risk communication to educate the public so they can be involved in formulating policies and establishing priorities – not to generate support for predetermined conclusions.

Effective risk communication also requires that when agencies assess the size of risks and decide how to manage those risks, decision making should be open to the public. To improve the quality of risk communication with the public, agencies should: distinguish policy or judgmental considerations from scientific considerations when estimating the size of risks and deciding how to manage them; instead of using single-value or worst-case risk estimates, identify a range of credible risk estimates and their corresponding probabilities of occurrence; and disclose and explain any uncertainties in data or scientific knowledge. The important value judgments that must be made in deciding how to manage risks should be disclosed.

Risk communication should be based on a written record that is available to the public. A record facilitates understanding and improvement of the agency's decision. It also prevents surprise when information on a particular risk is disseminated and enhances the consistency and accuracy of that information.

Comparative risk assessment and risk communication provide the means for implementing a more effective and efficient approach to environmental, health, and safety regulation. Comparative risk assessment allows agencies to estimate the size of various risks so that rational priorities can be established and risk can be reduced in the most cost-effective manner. Risk communication enables the public to understand the magnitude of a risk proposed for regulation compared to familiar risks, as well as the costs of reducing that risk. If elected officials and regulators fail to implement this risk based paradigm, we will lose the opportunity to better protect human health and the environment at less cost and to increase public confidence in the regulatory process itself.

2. Risk Assessment and Risk Management: Risk assessment methodologies should be continuously improved, and agencies should establish a clear distinction between assessing risks and deciding how to manage them. Recent scientific and technical advances have made it possible to improve the core of the regulatory process, risk assessment and risk management.

Risk assessment is the technical process for estimating the level of risk posed by a product or process – that is, the probability that a given harm will occur. Risk assessment, as applied to a substance, proceeds in four major steps: (1) hazard identification, determining what kinds of adverse health effects a substance, product, or activity can cause; (2) dose-response assessment, predicting the degree of adverse effects at a given exposure level; (3) exposure assessment, estimating the amount of exposure; and (4) risk characterization, combining the foregoing into a numerical range of predicted deaths or injuries."

Once risk assessment estimates the risk, *risk management* – the policy-oriented or political determination of what to do about the risk – should be employed. Unfortunately, agencies often merge the primarily scientific process of risk assessment with the primarily political process of risk management. This undermines both the validity and quality of agency decision making.

Separate Risk Assessment and Risk Management

Risk assessment and risk management should be separated as much as possible – both by agencies when conducting risk analyses and by legislatures when designing statutes.

The risk assessment should constitute an agency's best effort to employ the most advanced scientific and technical methods to predict accurately the size of the risk. Because risk assessments often require assumptions to fill information gaps, however, the intrusion of subjectivity into science cannot be totally eliminated. This subjectivity has two components: scientific (or professional) judgment and policy judgment. Nevertheless, most intrusions of scientific and policy judgments can be identified, and these value judgments made in the risk assessment process should be clearly and fully disclosed to the public."

Once the agency makes the most accurate and objective estimate of the relevant risks in the risk assessment process, it can then make an open decision on how best to address that risk in the risk management phase.

Improve Risk Assessment and Risk Management Methodologies

A number of steps can be taken to improve the risk assessment and risk management processes. First, risk assessment methodologies and guidelines should be reviewed and updated to reflect the state of the art. In the short-term, agencies should review their risk assessment guidelines and methodologies and make improvements where appropriate.

- The Clean Air Act Amendments of 1990 created a Risk Assessment and Management Commission and directed the National Academy of Sciences to prepare a report on EPA's risk assessment methodology. This helped motivate EPA to reconsider and update its risk assessment guidelines.

The White House and Congress should strengthen the expertise of the Office of Science and Technology Policy in risk analysis. OSTP could be assigned the responsibility to develop detailed guidance for agencies on how best to use science in the evolving risk assessment process and to develop government-wide risk assessment guidelines. Uniform risk assessment guidelines could also be developed by an interagency committee or by experts outside of government. Those guidelines would:

- bolster the credibility of agency risk assessments;
- prevent duplication and foster joint risk assessment efforts among agencies regulating the same substance;
- define the types of data and interpretations relevant to agency testing procedures and help the regulated community to understand agency decisions; and
- promote uniform risk assessment procedures among the states.

Greater efforts are also needed to develop a more complete and current database of relevant scientific data to be used in the risk assessment process. The lack of scientific data and the uncertainty about various risks significantly hinder measuring and comparing risks accurately. The growing volume and reliability of scientific data, however, have greatly improved the risk assessment field. The data decrease the need to rely on inference and informed judgments to bridge gaps in scientific knowledge.

The government should establish a mechanism that would allow new

scientific information to be easily and quickly incorporated into the risk assessment process. This mechanism should allow for information to be provided by the agencies, academia, business, and the general public. Agencies also should establish procedures to reevaluate risk assessments and risk management decisions in light of scientific advances.

In addition to improving risk assessment methodologies, agencies should favor cost-effective approaches in the risk management phase as a matter of policy. Once the risk assessment process identifies the level of risk posed by a substance, product or process, policymakers should consider the full range of options for reducing or eliminating the risk. The principle for choosing among options should be reducing risk in the most cost-effective manner. Regulatory options should be analyzed in light of the full spectrum of costs and benefits (including risks of alternatives and the economic consequences of the regulation).

Risk assessment and risk management are promising tools for helping regulators achieve the ultimate goal of our environmental, health, and safety programs – greater reduction of risk to health and the ecology with our limited resources.

3. Sound Science: Agency decision making should be grounded on the most advanced scientific knowledge currently available.

The difficulty of allocating limited resources for maximizing risk reduction is compounded by the common failure of agencies to base their analyses on the most advanced scientific principles. Without sound science, risks cannot be accurately assessed and effectively compared.

Science and technology are constantly evolving and improving; often they outpace the life cycle of regulations. Indeed, some regulations may become obsolete before they are adopted. This makes it all the more imperative that agencies use the most advanced and precise scientific methods to calculate risk estimates that form the basis for agency decisions. Moreover, agencies should regularly update their regulations and programs to incorporate advances in scientific knowledge.

To establish priorities and make regulatory decisions, agencies often must compare the size of various risks by using risk assessments. Unfortunately, agencies often lack complete data, leading to scientific

uncertainty. To compensate for scientific uncertainty, agencies must rely on default assumptions, which are sometimes codified in inference guidelines. To increase the reliability and credibility of their risk assessments, agencies should strive to structure their default assumptions and inference guidelines so that they will accurately reflect real risks. In characterizing risks, agencies should consider the probability that estimated risk values approximate the true size of the risks.

When faced with gaps in scientific data, agencies all too often have used a series of worst-case default assumptions and upper-bound probability estimates throughout the risk assessment process. The cumulative effect of these highly conservative assumptions may be to produce greatly exaggerated estimates of risk.

Agencies often base their decision on single-point estimates of risk, which assign a single value for a risk estimate. Typically, agencies incorporate policy judgments into single-point risk estimates by basing them upon highly conservative or worst-case estimates. Single point estimates, however, do not reveal the degree to which risk estimates are both uncertain and highly conservative. Unrealistic risk estimates, however, undermine the credibility of agencies' scientific methods, can cause undue public alarm, prevent cost-effective regulations, and limit the public's ability to understand and respond to regulatory decisions.

Common agency practices contribute to biased risk estimates:

- Agencies often use highly conservative or worst-case assumptions for exposure estimates when more accurate data are available.
 - OSHA bases occupational cancer risks on the assumption that a hypothetical worker is exposed at the permissible exposure limit 8 hours per day, 5 days per week, and 50 weeks a year, for 45 years.¹⁶
 - EPA sometimes assumes that an individual is exposed to emissions at a distance of 200 meters from the factory, 24 hours a day, every day, for 70 years.¹⁷
- Regulators often assume that there is a linear relation between the dose of a substance and its response or effect when there is no scientific rationale for the assumption.¹⁸
- Researchers sometimes base their research on reactions of animals that are most sensitive to the substance under review, instead of

using animals that would best replicate a human reaction to the substance.¹⁸

When regulators lack information for a value or parameter needed for a risk estimate, they should use uncertainty analysis techniques. Uncertainty analysis techniques identify a range of possible values and their probability of occurrence. To promote public accountability, agencies should explain assumptions, inferences, and value judgments made in the risk assessment and characterize their impact on the estimated value of the risk.

Although risk assessments should provide a range of risk values to indicate data limitations and scientific uncertainty, the "best estimate" of risk – the most credible estimate possible from available scientific information – should be provided for policymakers and the general public in the risk management phase.

The use of sound science is only one tool for improving regulation, and it does not relieve political leaders and regulators of the responsibility for making the inevitably difficult decisions required. But it will help prevent misallocating vast resources to reduce inconsequential risks, will promote open decision making, and will increase public confidence in the regulatory process. Ultimately, the public will benefit.

Executive Order 12866 (Sec. 1(b)(7)) emphasizes the importance of sound science:

Each agency shall base its decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation.

The White House should work with agencies to promote this goal and should hold them accountable for adhering to it throughout the regulatory review process, and state agencies should apply this same principle.

Moreover, agency scientific and technical expertise can be improved at the federal and state level. As EPA has proved, agencies can effectively use outside experts to analyze internal scientific capabilities and to recommend structural improvements. Federal agencies such as OSHA and state environmental agencies should emulate EPA and FDA and create scientific advisory panels to participate actively their strategic planning and internal reform processes.

Science should be institutionally represented in agency decisions that depend on scientific evidence. Scientists can validate analytical methods and procedures, even if the ultimate regulatory decision will be based partially on science and partially on policy. Periodic outside review procedures bolster the scientific credibility of agency decision making.

Emphasis on the scientific soundness of the regulatory process will make that process more credible and transparent. It should reduce the tension among the White House, Congress, the agencies, and the states and should increase public confidence in regulatory policy.

4. Benefit-Cost Analysis: Benefit-cost analysis should be utilized by agencies when developing regulations, with preference given the least costly regulatory alternative that accomplishes program objectives.

Every regulatory program consumes financial resources – of the government that is regulating, of the regulated community that must comply with the regulations, and, ultimately, of the consumers of the product or activity that is regulated. Since resources are limited, the government should maximize the benefits and minimize the costs of regulation, so that resources are not squandered. To further this goal, agencies should make better use of benefit-cost analysis, in which the benefits are weighed against the costs of a regulatory proposal *before* decisions are made and regulations are implemented.

Benefit-cost analysis generally proceeds in the following four steps: (1) identifying relevant impacts, (2) calculating monetary values for impacts, (3) discounting for time and risk, and (4) choosing among policies. First, all relevant impacts of a proposed action must be identified and classified as either costs or benefits. Second, impacts must be valued. When there is no organized market to value an impact, innovative techniques are required. Third, values should be discounted for time and risk. Costs and benefits accruing in different time periods should be discounted to their present values. When costs and benefits involve uncertainties, analysts should attempt to assign probabilities to various contingencies so that expected net benefits can be calculated. Finally, when efficiency is the primary goal, the combination of policies that maximizes net benefits should be preferred.

Even when values other than efficiency are important, or major impacts cannot readily be estimated in monetary terms, benefit-cost

analysis is still useful since its first step – identifying and categorizing impacts as benefits or costs – can provide a starting point for better decision making.

In the first instance, federal and state agencies should use benefit-cost analysis to decide whether or not a proposal should be a candidate for adoption – whether its benefits exceed its costs. Second, agencies should use cost-effectiveness analysis to select the regulatory option that achieves regulatory objectives in the least costly way. This analysis should be applied both to substantive regulations and to the administrative process established to implement them, including procedures for issuing permits and reviewing compliance. Benefit-cost analysis should be promoted by the Legislative and Executive Branches at the federal and state levels.

The White House and governors can and should play a central role in promoting the use of sophisticated benefit-cost analysis. Without tight constraints imposed by centralized Executive review under a benefit-cost standard, each agency has an incentive to pursue whatever goal has been set for it by the legislature without regard for other, equally important programs outside of its jurisdiction. This leads to inconsistent, duplicative, and burdensome regulatory requirements, as well as the misallocation of government resources.

To counter this tendency, the White House, through OIRA, as well as governors, can emphasize the importance of benefit-cost analysis and encourage all agencies to set priorities based upon this analysis. The potential gains to be realized by strong centralized review of proposed regulations under a benefit-cost standard, coupled with joint planning by an interagency group, are clear: better policy coordination; enhanced political accountability; and, ultimately, more balanced regulatory decisions.

Executive Order 12866 (Sec. 1(b)(6), (5)) directs agencies to use benefit-cost and cost-effectiveness analysis:

Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.

* * *

When an agency determines that a regulation is the best available method of achieving the regulatory objective, it shall design its regulations in the most cost-effective manner to achieve the regulatory objective.

Agencies thus are required to conduct a full benefit-cost analysis of significant regulatory actions as part of the decision-making process. Sec. 6(a)(3)(C). The White House and governors should hold agencies accountable for vigorously implementing this basic principle.

Federal and state agencies themselves should promote improved benefit-cost analysis by developing and using standardized guidelines for analyzing the costs and benefits of their regulations. Agencies that already have such guidelines – such as EPA – should periodically review and improve their guidelines in cooperation with other agencies and with the White House or the governor.

Further, when agencies estimate costs, they should attempt to estimate the *full* costs of regulations, not just *compliance* costs. Regulators should carefully consider the potential impact of each regulatory option. Agencies also should consider as a cost the potential benefits foregone by regulation of an activity or substance. If some costs and benefits are nonquantifiable, they should at least be identified.

- Various regulatory options can have different impacts on behavior; behavior induced by some options can actually increase risk.
 - The National Highway Traffic Safety Administration was confronted with data suggesting that a refusal to relax its fuel efficiency standards for automobiles could increase fatalities from auto accidents. All other things being equal, a large car is safer than a smaller car. However, NHTSA failed to consider whether its “corporate average fuel economy” standards, which promoted smaller cars, could increase automobile fatalities. Accordingly, the D.C. Circuit remanded a CAFE rulemaking decision to NHTSA for further consideration of the potential safety costs of its fuel-efficiency regulations.”
- Regulatory costs include foregone benefits.
 - If a pesticide is banned, food may cost more because less could be produced.”

Finally, Congress and state legislatures should promote, not inhibit, benefit-cost analysis. In many instances, agencies are constrained by

restrictive legislative requirements or oversight.

- The Clean Air Act prohibits EPA from considering costs of any kind, much less using benefit-cost analysis, in setting air quality criteria.²²
- The Supreme Court has interpreted the Occupational Safety and Health Act to prohibit OSHA from basing certain regulations on a formal benefit-cost test.²³

Accordingly, there is a pressing need for fundamental legislative reform to incorporate benefit-cost principles in statutes. Congress and state legislatures should design legislation to avoid an "at-any-cost" approach to achieving regulatory goals.

- Since EPA, OSHA, and CPSC were established in the early 1970s, many of the larger, more obvious risks have been reduced. As agencies continue to try to reduce smaller, more intractable risks, the cost and complexity of regulations are sharply rising.²⁴
- Sometimes programs have standards so stringent that they impose unreasonably high costs without achieving significant additional safety benefits.
 - In environmental cleanups, for example, it can be extremely expensive to achieve cleanup levels beyond a certain point. At one Superfund site that was mostly cleaned up, an added \$9.3 million was spent to meet the program's stringent cleanup standards. The benefits were miniscule: the extra expenditure theoretically meant that the children could safely eat dirt for 245 days per year instead of 70 days annually. But there were no children in the area because it was a swamp. And children were not likely to be there in the future because future development was improbable. Finally, half the volatile organic chemicals probably would have evaporated by the year 2000.²⁵

Congress and state legislatures should encourage agencies to balance costs and benefits when designing regulatory programs. Otherwise, federal and state agency efforts to improve regulation may be frustrated by inflexible legislative mandates.

- The Toxic Substances Control Act is a well-designed risk-reduction law based on sound benefit-cost principles. Section 6 of TSCA authorizes EPA to impose a range of controls on a chemical substance or mixture if it poses an "unreasonable risk of injury

to health or the environment." In applying the concept of "unreasonable risk," EPA must balance the health or environmental risk of a chemical against the economic or social disadvantages of eliminating or restricting the availability of the chemical.

Estimating benefits and costs can be difficult, especially in areas where many benefits are by their nature difficult to quantify. Nonetheless, because limited resources necessitate difficult trade-offs, *agencies must make best estimates for benefits and costs – stating clearly and publicly the bases for those estimates – and regulate only where the benefits justify the costs.* Once a regulatory goal is established, agencies should select the least costly option for meeting that goal.

5. Market Incentives and Performance Standards: Market-oriented solutions and performance standards should be favored over command-and-control regulation. When properly calibrated and used, market-based approaches and performance standards cost less and accomplish more than government commands and controls. The past three Administrations have advocated that regulators use market mechanisms as much as feasible. Most recently, Executive Order 12866 (Sec. 1(b)(3), (8)) states:

Each agency shall identify and assess available alternatives to regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices may be made by the public.

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Each agency shall identify and assess alternative forms of regulation and shall, to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt.

Market Incentives

Market-based regulatory schemes attempt to reproduce the efficiency of a free market by internalizing the costs of the regulated activity or substance, such as pollution, into private production or investment decisions. Market incentives allow regulated parties to achieve compliance in the least costly way, reward innovators who meet or exceed regulatory goals, and adapt to changed circumstances more quickly than government commands and controls.

Typically, regulations apply to a wide variety of activities and firms. Because compliance costs can differ dramatically among activities and firms, uniform standards often impose widely varying incremental costs for achieving a specific benefit. Economic incentives minimize regulatory costs; they allow firms unable to achieve compliance efficiently to buy permits or allowances from low-compliance-cost firms, while encouraging firms that can meet regulatory goals to do so most efficiently. In short, market incentives divert fewer public and private resources and reduce adverse economic consequences to obtain the same – or greater – benefits.

- The acid rain trading allowance program for sulfur dioxide emissions exemplifies the market-incentive approach to regulation. This program provides substantially reduced regulatory costs by providing an economic incentive for least-cost emissions sources to reduce their emissions first. The Clean Air Act Amendments of 1990 set a limit on yearly sulfur dioxide emissions that power plants must meet by the year 2010 (with lesser caps at intermediate deadlines). EPA will allocate annual allowances for emissions sources to meet their individual emissions limits, which are based on reducing their historical average emissions. The allowances can be banked for future use or sold to other emission sources that have higher compliance costs. EPA has estimated that the program could reduce compliance costs by nearly \$1 billion per year – about one-fourth of the total cost of achieving its goal without emissions trading.²⁶

Economic incentives also induce innovators not only to develop less costly means of meeting a regulatory standard, but also to find ways to exceed the minimum standard and to reap rewards for doing so through cost savings or revenues from credits sold to firms who do not meet the minimum requirements. In contrast, command-and-control regulations provide no incentive for regulated parties to exceed a regulatory goal;²⁷ they may actually punish firms that do so.

Finally, market incentives are flexible; they allow firms to adapt as their relative compliance costs change over time. Command-and-control regulations usually cannot adapt to changed circumstances without the burdensome costs and delays of new regulatory action. Accordingly, market incentive approaches should be favored over command-and-control regulation.

Performance Standards

To set a regulatory standard, agencies can choose between basing the standard on design or performance. Design standards specify how a product should be built, what technology should be used, or precisely how to reach a regulatory goal. Performance standards, on the other hand, establish the ultimate regulatory goal. They free regulated parties to achieve that goal in the best way they can find. Performance standards generally are superior to design standards: They allow the regulated community to meet or exceed the regulatory goal in the most cost-effective manner.

Design standards may be more attractive to the government because they sometimes are easier and cheaper for agencies to enforce than performance standards. For example, inspectors can verify compliance simply by determining whether a manufacturer is using mandated equipment. But typically, the “savings” from imposing design standards are illusory. Any administrative savings usually are far outweighed by the large costs imposed on the regulated community by design standards. These costs are passed on to the public through higher prices and diminished wages, productivity, and economic growth.

Design standards freeze technology and impede innovation that can produce better results at less cost. An innovative firm that invents a more cost-effective way to meet or exceed a regulatory goal must overcome the heavy burden of changing the agency’s standard before it can implement its better method. Accordingly, performance standards should be used when performance can be measured or reasonably estimated. It simply makes no sense to impose the enormous costs and inefficiencies associated with design standards to reduce enforcement costs by a relatively small margin.

In contrast to design standards, performance standards promote innovation to increase safety and reduce costs. Because agencies must consider the comparative performance of different machines or products to write the regulatory standard in the first place, it can be as easy for the agency to base its standard on performance goals, such as fewer injuries or cleaner air.

In some instances, “performance” and “design” standards tend to converge. A standard should not be characterized as a performance standard if there is only one feasible way to meet it; such a standard

is a design standard. Although agencies sometimes transpose performance and design standards, there is a fundamental tension between allowing innovation to improve safety and reduce costs and setting a rigid, easily identifiable standard merely to make the agency's enforcement job easier.

- Under the Resource Conservation and Recovery Act, firms must treat hazardous wastes under "best available technology" standards. Instead of setting a clear standard based on health and environmental risks, the BAT standard changes with each advance in waste treatment. This design standard imposes enormous costs without regard to the actual threat to human health or the environment.

In light of the vital importance of encouraging continual improvements in safety at less cost, performance standards should be preferred over design standards.

Both statutes and regulations should favor market mechanisms and performance standards over commands and controls. Instead of trying to mandate what technologies business should use or how to meet a standard, legislatures and agencies should set standards and then allow the market to develop the most efficient ways to attain them. Mandating *ends*, not *means*, usually offers the most effective form of regulation.

6. Productivity, Wages, and Economic Growth: Methodologies should be implemented and continuously improved to assess the impact of major regulations on productivity, wages, and economic growth, as well as the adverse impact on jobs and international competitiveness in industries that bear the burden of regulation. American businesses of all types, large and small, face increasing competition from foreign competitors in a global economy. Today's global competition is heightened by significant world-wide industrial overcapacity – a factor many believe will be the defining characteristic for the 1990s.

- In key industries – steel, coal, chemicals, textiles, pulp and paper, automobiles, shipbuilding, aircraft, computers, home appliances, and defense – global overcapacity is resulting in a major restructuring.
- Those firms that cannot compete on price and quality will be

driven out of business, which means that jobs will be lost, wages weakened, and tax bases eroded.

- Efficiency and productivity will determine who are the winners and losers; government policies can either advance or retard these objectives.

In response to these economic pressures, successful American corporations are significantly altering the way they conduct their business to become leaner, more flexible, and faster. In this new economic world, the slow-moving, pyramidal corporate structure of the past is facing extinction.

For our economy to grow, regulatory and economic goals must become complementary, not conflicting. Government must make greater efforts to promote productivity, economic growth, and innovation within the regulatory framework and must become more sensitive to the impact of regulation on wages, prices, jobs, and international competitiveness.

Executive Order 12866 (Sec. 6(a)(3)(C)(ii)) requires that benefit-cost analyses of significant regulatory actions include an assessment of their impact on employment, competitiveness, and productivity. The nation would benefit from greater consideration of the industry-wide and economy-wide impacts of regulation.

- A 1993 report by the National Commission for Employment Policy recommended the development of economic models to assess the effects of regulations on jobs and wages.
- In Section 811 of the Clean Air Act Amendments of 1990, Congress directed the President to report on the economic impact of air pollution controls on the international competitiveness of U.S. manufacturers. The American Automobile Manufacturers Association has compiled a report documenting that their competitors operating in countries with more flexible and less prescriptive rules enjoy a significant cost/production advantage over U.S. automobile manufacturers that face onerous requirements on their manufacturing facilities. The new permit rules under Title V of the Clean Air Act can unnecessarily restrict production and operational flexibility without commensurate environmental benefit; this flexibility is critical to the ability of U.S. manufacturers to respond to dynamic market conditions and international competitive pressures.

- A study recently conducted for the U.S. Census Bureau found a strong correlation between regulation and reduced productivity. The study found that significantly regulated plants have substantially lower productivity and slower productivity growth rates than less regulated plants. The magnitude of the impacts were found to be larger than expected: A \$1 increase in pollution abatement costs reduced productivity by about \$3 - \$4.¹¹

More information is becoming available on the negative effects of regulation on wages, productivity, and economic growth, as well as the differential economic impact on jobs and international competitiveness in many industries. Because these issues are vitally important to the American people, they should be directly considered when legislatures and agencies make regulatory decisions. The Legislative and Executive Branches at the federal and state levels should promote the use and improvement of state-of-the-art analytical tools to assess the economic impacts of regulations.

7. Coordination Among and Within Agencies: Coordination of regulatory activities among and within agencies should be improved to eliminate inconsistencies, duplication, and unnecessary regulatory burdens. Regulatory agencies have a variety of mandates that overlap - among agencies, including federal and state agencies, and even between different programs of a single agency. Consequently, there is a need for greater coordination of regulatory activities among and within agencies.

Interagency Coordination

To reduce duplication and inconsistency, a strong coordinating committee is needed to identify and address interagency problems. Executive Order 12866 (Sec. 4(d)) provides for the establishment of an interagency committee - the Regulatory Working Group - that can perform this function at the federal level.

Through the Regulatory Working Group or a similar interagency committee, agencies should engage in strategic planning to address problems before regulations are proposed. Where significant environmental, health, or safety problems demand action from multiple agencies, the interagency committee should coordinate common risk-reduction approaches for the agencies involved. The committee should rank the relative risks posed by particular problems in an effort to maximize risk-reduction in a cost-effective way. The relative risk

rankings could be updated periodically. An interagency committee could also promote the exchange of information among agencies and make each agency more sensitive to existing regulations from other agencies. The committee also could identify common research needs and allocate responsibility for fulfilling those needs among agencies. Finally, to address overlap and inconsistency originating in statutory requirements, the interagency committee could develop a forward-looking, comprehensive legislative program.

The strategic planning process should be open, incorporating views from the general public, including business, academia, and public interest groups. This strategic planning process could be used to educate Congress and involve the public in the decision making. Agencies could exchange information, data, and feedback, which would facilitate improvements in regulations and laws. These tenets of rational regulation should guide this process.

Intraagency Coordination

In addition to interagency coordination, there is a need for greater coordination of programs within each agency as well. Individual program offices within an agency often are assigned responsibility for implementing a specific law or part of a law. This narrow approach, and the growing complexity of statutes and regulations, has fragmented many programs, even within the same agency. Different programs often attempt to control different aspects of the same problem. Without coordination of programs, inconsistencies, unproductive duplication, and outright conflicts may result.

- EPA's Office of Solid Waste and Emergency Response at one time designated trace levels of carbon tetrachloride and chloroform found in chlorofluorocarbons as hazardous waste, thus discouraging refrigerator recyclers by threatening them with Superfund liability. Meanwhile, EPA's Office of Air and Radiation was urging that refrigerators be recycled to preserve the ozone layer. At the same time, the FDA allowed CFC's to be used in asthma inhalers.¹²

Agency efforts to coordinate regulatory programs should focus on reducing risks in the most cost-effective way. When properly designed and implemented, regulatory programs that address multiple environmental media, such as air, water, and land, have great potential to reduce both risk and costs. Unfortunately, the emphasis on highly prescriptive media-specific regulation in current environmental laws

often creates obstacles to cost-effective regulation.

- An ambitious joint pollution prevention study recently conducted by EPA and Amoco Corporation illustrates the cost of inflexible, media-specific regulation. The study found that if Amoco's Yorktown, Virginia refinery had been free to pursue a flexible, performance-oriented approach to pollution prevention, 90% of the emissions reductions required under applicable regulations could have been achieved for 20-25% of the cost of meeting the specific regulatory requirements. In particular, if a performance-oriented approach to emissions reduction had been followed, releases at the refinery could have been reduced at an average cost of \$510 per ton, as opposed to the \$2,400 per ton average cost of achieving reductions under EPA's prescriptive command and control regulations."

The Executive Branch has the responsibility to ensure that its programs are coordinated and consistent. Fulfilling that responsibility should become a higher priority.

8. Openness: The entire regulatory process, including centralized Executive review and management of agency rulemaking, should be open to public scrutiny to promote the quality, integrity, and responsiveness of agency decisions. Openness is indispensable to the entire regulatory process, including regulatory planning and development, as well as centralized Executive review of agency rulemaking. Openness brings obvious benefits:

- The input of an informed public and the regulated community improves the quality of agency decisions.
- Openness will help ensure that the values and concerns of the public are addressed by regulators.
- A better informed public will have greater confidence in the regulatory process and the validity of decision making.
- With a better understanding of the regulatory requirements, the regulated community can more faithfully comply with them.
- Fewer legal challenges to final regulations are likely to ensue.

Removing Secrecy

The regulatory process should be open to maximum public involvement at the earliest stages. Executive Order 12866 (Sec. 6(b)(4)) recognizes the need for openness. This policy should be nurtured and

expanded. For example, OIRA should disclose written communications from those outside of the government before a rule is published. The White House should also require agencies to publish their Regulatory Plans when they are submitted to OIRA for review. Regulatory analysis documents that detail the costs and benefits of regulations also should be available to Congress and the public, even if they include information or considerations that the agency may not actually use to create a rule. More generally, the public should have access to the identities and positions of participants in the regulatory process.

Regulatory Negotiation

Agencies also could make better use of negotiated rulemaking, or "reg neg." To draft a rule, an agency can bring together representatives of interested parties for face-to-face negotiations, with the goal of achieving consensus on the proposed language. The primary goal of "reg neg" is to produce better rules, but it also avoids protracted litigation and reduces enforcement costs.

President Clinton recognized the benefits of regulatory negotiation in a Directive that accompanied Executive Order 12866. The Directive requires each agency to identify at least one rulemaking to be developed through negotiated rulemaking.⁴ Although not always feasible, agencies should consider using "reg neg" more often, on a wider basis, and earlier in the regulatory planning process. Typically, the short-term costs of regulatory negotiation are fully justified by its many benefits.

In sum, openness can improve the quality and integrity of agency decisions and increase public confidence in the regulatory process.

9. Periodic Review: Programs and regulations should be periodically reviewed for purposes of determining whether they should be reformed, discontinued, or consolidated.

As circumstances and technology change, regulations can become outmoded, duplicative, or unnecessary. As an indispensable part of good regulatory management, Congress, the White House, agencies, and states should periodically review existing regulatory programs to determine whether they should be reformed, discontinued, or consolidated.

Legislatures ordinarily operate under the assumption that programs should continue unless there is an overwhelming reason to curtail

them. By conducting periodic review, legislatures can ensure that government resources are allocated to best address the needs of the public. Periodic review should allow for government-wide coordination and priority setting through reforming or eliminating regulations, updating scientific methodologies, reorganizing an agency, or reallocating responsibility among agencies.

In appropriate instances, Congress and states legislatures can ensure a stricter review process by incorporating sunset provisions in regulatory programs. Sunset is a powerful tool for managing the proliferation of government programs: Within set deadlines, the legislature is compelled to evaluate and vote for the continuation of a program, or it will terminate. This forces a review of priorities. Programs that are not rational or justifiable – perhaps because they have simply outlived their usefulness – can more readily be eliminated or incorporated into other programs. Routine periodic review of duplicative or overlapping programs provides an opportunity for Congress to consolidate them, even if it decides the programs should be continued. If similar programs are reviewed at the same time, Congress can more readily compare their effectiveness and streamline and rationalize them.

Regulatory programs would also benefit from periodic review by the Executive Branch. Executive Order 12866 (Sec. 5(a)) requires each federal agency to develop a program for periodically reviewing its existing significant regulations to determine whether they should be modified or eliminated to make the agency's regulatory program more effective, less burdensome, and more consistent with the President's priorities and principles set forth in the Executive Order. However, the White House does not now have in place a formal process for timely oversight and execution of these important reviews; it should develop and implement such a process without delay. The President also should issue a Directive, like the Negotiated Rulemaking Directive, to require each agency to identify and review at least three significant regulations.

Finally, agencies – individually or through an interagency coordinating group – should themselves initiate periodic review of their programs to eliminate outdated, duplicative, and irrational regulations. Where legislative authority is required to terminate or modify unproductive, outdated programs, the Executive Branch should aggressively pursue legislative action.

10. Federalism: Regulatory authority should be more rationally allocated among the federal, state, and local governments, and federal regulatory programs should avoid unfunded mandates. The expansion of government regulation has raised concerns about the rational allocation of regulatory authority and costs among federal, state, and local governments.

Allocation of Regulatory Authority

The growth of government regulation in recent decades has taken place at both the federal and state levels. In some cases, such as pollution control and waste disposal, new and expanded federal programs have supplanted state and local regulation. In other cases, states have added new and costly regulations of their own – both in areas that were traditionally matters of state policy (such as automobile insurance) and in areas that were traditionally matters of national policy (product labeling). The growth of state regulation has been encouraged by Supreme Court decisions that take a more lenient approach toward state policies affecting and burdening interstate commerce.

The mix of centralized national regulation in some areas and an array of state regulations in other areas has not always been a good one for American consumers and businesses. The traditional virtues of federalism – decentralization and responsiveness to varying local circumstances – remain important today. At the same time, however, markets, production technology, and business organization have become increasingly national and international in scope. State regulation that made sense at a time of primarily local markets can produce highly costly and wasteful conflicts and duplication where national businesses are affected. This is often the case today. For businesses whose products are sold nationwide and abroad, inconsistent and duplicative state regulation increases prices and chills productivity, wages, economic growth, and innovation.

Modern commercial realities demand a more cost-effective balance of federal and state regulation; achieving this balance is primarily the responsibility of the federal government. In general, three factors should be considered in determining whether the federal government should preempt and regulate a field itself or leave the field to the states:

- Is the problem primarily a national one, with little variation in the

nature of the problem among states and regions?

- Will state regulation lead to needless duplication of effort, costly conflicts among differing state rules applicable to national markets and national business firms, or opportunities for individual states to pursue local policies at the expense of citizens of other states?
- Does the policy in question present important controversies and uncertainties, so that state policy experimentation may produce new information to resolve the uncertainties?

These guidelines will not resolve every controversy over regulatory jurisdiction, but they do suggest several areas where large improvements could be made. For example, to the extent that regulation of the labeling of foods, beverages, and other products that are distributed nationally is appropriate, these regulations should be national rather than local. The costs of differing labels in different states is very large, while the benefits are small or nonexistent.

On the other hand, many pollution problems are primarily local or vary in severity from locality to locality; federal regulation to address these problems may still be justified (where a single item of commerce is involved, such as automobiles, or where necessary to overcome "NIMBY" – Not In My Backyard – problems), but should be resorted to with care. Transportation regulation presents states with numerous opportunities for imposing price and service controls that are paid for by citizens of other states, and the trend toward greater preemption in this area is appropriate and should be continued.

When Congress appropriately determines to preempt state regulation, it should not adopt a one-way approach that preempts only weaker, but permits more stringent, state regulation. This approach loses the benefits of preemption without gaining offsetting benefits from state experimentation.

Unfunded Mandates

The federal government also regulates state and local governments directly in the course of administering federal expenditures and federal programs. As the federal budget deficit has soared, Congress has increasingly used unfunded mandates. *Unfunded mandates* require state and local governments to administer or comply with federal programs, but do not include funding for the costs of administration or compliance. These unfunded mandates burden state and local governments in the same way that regulations burden business.

Unfunded mandates force state and local governments to raise taxes, cut services, or potentially to face bankruptcy. Likewise, regulations require businesses to raise prices, eliminate jobs or product lines, cut research and development, or even go out of business entirely.

Congress has imposed numerous obligations on the states to fund programs designed to achieve federal objectives. While this pattern has been familiar for some time, it has become even more significant in the 1990s. Unfunded programs do not appear in the federal budget deficit, yet they impose very real costs at the state and local levels. These programs threaten to overwhelm state and local governments who fear that raising taxes for businesses and consumers will stifle economic growth and jobs and hence erode the tax base.

- The City of Columbus, Ohio has had to comply with 67 new environmental mandates since 1988. Columbus is expected to spend \$1.3 billion to \$1.6 billion on environmental compliance from 1991 to 2001. In 1991, the average Columbus household paid \$160 for environmental protection; by 2001 this cost is projected to rise to \$856 per household, or more than the per-household cost of fire or police protection.²⁵

The federal government should not burden state and local governments with unfunded mandates, especially where the benefits of a program do not fully accrue at the state or local level. Clearly, duplicative and inconsistent regulation must be prevented. Nonetheless, programs should be sufficiently flexible to facilitate innovation at the state and local level. In some instances, the federal government could define a program's objective (comparable to performance standards), but allow state and local governments to achieve those outcomes by the means they think best. When practical, agency leaders should grant waivers to allow state and local governments to experiment with innovative programs that may more efficiently achieve regulatory goals.

Executive Order 12866 (Sec. 1(b)(9)) recognizes the need to reduce unfunded mandates and to provide greater flexibility to state, local, and tribal governments:

Whenever feasible, agencies shall seek views of appropriate State, local, and tribal officials before imposing regulatory requirements that might significantly or uniquely affect those governmental

interests. Each agency shall assess the effects of federal regulations on State, local, and tribal governments, including specifically the availability of resources to carry out those mandates, and seek to minimize those burdens that uniquely affect such governmental entities, consistent with achieving regulatory objectives. In addition, as appropriate, agencies shall seek to harmonize Federal regulatory actions with related State, local, and tribal regulatory and other governmental functions.

This policy is supplemented by Executive Order 12875, which calls for reducing unfunded mandates; increasing waivers from federal requirements for state, local, and tribal governments; streamlining the process for applying for waivers; and providing greater consultation with those governments on federal matters that uniquely affect their interests. These concepts should be vigorously implemented and should be applied to regulated businesses as well.

11. Paperwork Burdens: Paperwork burdens caused by regulatory programs should be expressly assessed and substantially reduced. In our vast regulatory system, paperwork burdens impose huge costs. Federal paperwork burdens alone have been conservatively estimated to consume over 6.4 billion person-hours per year in the private sector – at a cost of at least \$128 billion – merely to collect, report, and maintain information.* This does not include the massive person-hours federal employees spend on processing and evaluating the information.* Furthermore, paperwork burdens are a symptom of unreasonable administrative process requirements – complex, bureaucratic, and adversarial procedures for obtaining permits, reviewing compliance, and the like. These administrative processes impose massive and unnecessary costs by causing delay, frustrating innovation, and impeding process and facility changes that U.S. business must make to meet world competition.

Congress recognized the need to reduce the paperwork burden by passing the Paperwork Reduction Act of 1980, but this statute has not been effectively implemented.

- The Paperwork Reduction Act of 1980 was designed to minimize the federal paperwork burden for individuals, small businesses, state and local governments, and other persons; to minimize the cost of information collection to the federal government; and to maximize the usefulness of the information to the federal govern-

ment. The Act established OIRA and delegated it responsibility for coordinating government information policies, including reviewing and controlling agency collections of information.

Despite the many benefits promised by the 1980 Act, it requires much stronger implementation, and further initiatives to reduce paperwork are imperative. Stringent goals for reducing paperwork requirements are needed at all levels of government. The anticipated paperwork requirements of future legislation should be thoroughly assessed prior to enactment, and these assessments should be disclosed to the public. Alternative information technologies that can reduce the paperwork burden should be adopted.

The Administration should strengthen OIRA's paperwork control responsibilities. Moreover, the Administration and Congress should strengthen and amend the Paperwork Reduction Act. Sound legislative proposals include a government-wide goal of at least a 5% annual reduction in paperwork. In the absence of a legislative mandate, the Executive Branch should nonetheless commit itself to this goal and should annually report its progress in achieving it.

The new legislation should also address the problem of "third party" disclosures of information. The Paperwork Reduction Act was intended to limit the ability of federal agencies to impose paperwork requirements on the public. However, in *Dole v. United Steelworkers of America*, the Supreme Court held that the protections of the Act do not apply where an agency requires that information be provided to a third party (and not the government).¹⁷ An agency can circumvent OIRA's paperwork review simply by not requiring that the information be submitted to the federal government. In that event, OIRA cannot review the agency's information requirement and has no authority to stop it. To remedy this problem, Congress should legislatively overrule *Dole* when it amends the Paperwork Reduction Act.

Excessive paperwork burdens often are caused by unreasonable administrative process requirements. These administrative process costs – the inflexibility, unresponsiveness, and delay that characterize many regulatory programs – are an increasing threat to the competitiveness of U.S. businesses in global markets.

Many major EPA programs, for example, are based on a multi-layered administrative process for permitting, compliance review, and

the like. Facilities otherwise ready, willing, and able to comply with the environmental controls can be rendered noncompetitive by the rigidity and delay of the administrative process. Many of the industries that hold the greatest promise for jobs and economic growth in the nation's manufacturing sector must be able to respond quickly to technological change at a pace dictated by international competition, not the regulatory process. Among these vital industries are electronics, advanced materials, aerospace, custom and specialty chemicals, pharmaceuticals, and automobile manufacturing. In these highly competitive industries, time is precious. They cannot wait for regulatory processes that take years when their products go through entire life cycles in less time. Despite the massive costs imposed by these complex administrative processes, the agencies do not have procedures for considering the costs and benefits of these administrative processes themselves or their potential for being streamlined.

Congress and the agencies should continually examine administrative processes. They should look beyond the direct costs of regulatory controls and take into account the incremental costs and benefits of each layer in the administrative process.

More generally, the adversarial, legalistic nature of the regulatory system must be reassessed. All too often, conflict – not consensus and compromise – characterizes decision making, enforcement, and the relationship among government, business, interest groups, and the public. And increasingly, legislatures and agencies are criminalizing regulatory violations that traditionally were addressed by civil and administrative remedies. In the environmental area, for example, errors in reporting, sampling, record keeping, and the like now are potentially subject to criminal sanctions. At the same time, the growing complexity of environmental regulation increases the likelihood that these errors will occur.

The antagonistic nature of the American regulatory system imposes enormous and unnecessary costs; these include exacerbating litigation and other transaction costs, prolonging delay, and chilling innovation. These costs, like paperwork and administrative process costs, ultimately are borne by customers, employees and stockholders of the regulated community.

The government should strive to achieve absolute paperwork reductions, streamline administrative processes, and reduce the adversarial

nature of our regulatory system. Only where their benefits clearly exceed their costs should mandatory paperwork or complex and adversarial administrative process requirements be imposed.

12. Regulatory Budget: A framework should be developed to account for expenditures required by regulations and to promote greater fiscal restraint on regulatory programs.

The costs of regulation affect us all. They are, in effect, "hidden taxes." American workers see their tax burden on their Form 1040 and state tax reporting forms, but they are told nothing about their regulatory burden. To compound the problem, the decisions to create and impose regulations, especially at the agency level, are remote from public view. Although the public may see that increased government spending will require that they or their children eventually pay the price in higher taxes, they plainly do not realize that collectively they also must pay for regulations – as customers, employees, and stockholders.

Regulatory programs create an illusion that business absorbs their costs. In contrast to taxing and spending programs, regulatory programs impose costs that do not appear in government budget figures, and therefore seem "free." In the end, however, the public pays the price just the same – through higher prices, fewer products, and diminished wages, productivity, and economic growth.

Despite the enormous cumulative burden of regulations, there is no process for setting priorities and forcing trade-offs among different programs or goals. Government spending programs face some discipline through the budgetary process because current spending limits create an incentive to establish rational priorities and to spend money in a more cost-effective way. However, there is no formal budgeting process for the statutory and regulatory programs that direct non-federal resources to achieve public purposes. Regulations are created as their need is perceived, without budgetary constraints or forced trade-offs with other important regulations. Government must become more sensitive to the cumulative costs of regulations.

An accounting system for regulatory costs could measure the cumulative effect of regulations and promote a more efficient regulatory system. Under a regulatory budget, agencies would have a powerful incentive to regulate in a more cost-effective manner; each agency could be limited in the amount of regulatory costs imposed on the

economy each year. If the budget limit had been reached, an agency wishing to add a new regulation would be required to repeal or modify an existing regulation to offset the cost increase from the new regulation. If the agency were unable to offset the cost of the new regulation from other regulations for which it is responsible, the government would have to produce an offsetting reduction from another agency.

In light of the similarities between fiscal and regulatory expenditures, the fiscal budgetary process has been proposed as a model for a similar budgetary process to discipline regulatory expenditures. There have been bipartisan efforts in the Executive Branch and Congress to develop an accounting framework to monitor expenditures directly required by regulation. This work should be encouraged.

The goal of regulatory accounting is worthwhile. Nonetheless, it should be recognized that measuring the private expenditures required by federal regulation raises its own set of problems. The regulated community should not be unduly burdened with extensive and costly record-keeping requirements to validate projected budget estimates. It is also difficult to distinguish expenditures due to regulation from those that would have occurred regardless of regulation. And special challenges arise in estimating the indirect costs of regulation, including lost opportunities for consumers to purchase goods due to higher prices, less desirable products, or complete bans of products or substances. Regulatory accounting must consider these indirect costs, but they can only be estimated with complicated statistical models. Moreover, combining estimates of indirect costs with direct cost estimates could be difficult. Yet, because bans primarily cause indirect costs, measuring only direct costs could encourage agencies to institute bans rather than regulatory controls.

These challenges make regulatory accounting more complex than fiscal accounting, but there are good reasons to persevere in the development of a regulatory budget:

- Although regulatory budgets would require forecasts of private spending on regulations, the forecasts need not be exact to constrain spending (like spending forecasts for fiscal budgets).
- The measurement problem concerning the proper baseline for direct regulatory costs diminishes if an incremental budget approach is used.
- The potential for agencies to use bans to avoid regulatory budget

constraints is outweighed by their tendency to impose costs on the public absent a regulatory budget; rules for estimating indirect costs can be developed.²²

While a regulatory budget has not yet been perfected, it holds promise for measuring and disciplining the cumulative burden of regulations and allocating resources more effectively. The starting point for a regulatory budget is to develop an accounting system that would use information available from both the fiscal budgetary process and the information-collection budget established by the Paperwork Reduction Act. The important work to develop a regulatory budget should continue.

III. Conclusion

Government regulation can and must be improved. Although some regulations have been beneficial, there is great need – and much room – for a smarter, more cost-effective approach to regulation. To ask how much regulation we should have or how we should best regulate in specific situations is not to put dollars before people. To the contrary: it is to make dollars work more effectively for people.

Regulations exact a heavy toll on wages, productivity, economic growth, prices, and innovation. They burden federal, state, and local governments. We do not see the factories never built, the products never made, the services never provided, or the entrepreneurial ideas drowned in the sea of regulatory process. But, in the end, all of these costs of regulation are borne by the public – as employees, consumers, stockholders, and taxpayers.

Regulatory reform must be a national priority. Because our nation has limited resources and many competing expectations, the soaring costs of regulation make it imperative to reform regulation and to reduce its burdens on the economy. There is growing consensus not only on the need for regulatory reform, but also on how to achieve it: Government must assess the seriousness of risks proposed for regulation, compare these risks to risks familiar to the public, disclose the costs of regulation, regulate only if the benefits outweigh the costs, and select the most cost-effective, market-driven method possible. This is smarter regulation. And smarter regulation is better regulation, for consumers, governments, and businesses alike.

The White House, Congress, agencies, and the states must all commit themselves to smarter regulation. The Business Roundtable recommends that governments at all levels vigorously implement these twelve tenets of rational regulation. Many promising ideas have been proposed to “reinvent” regulations and the regulatory system; President Clinton’s Executive Order on Regulatory Planning and Review takes an important first step. However, the hard work necessary to achieve meaningful reform remains to be done.

It will take strong leadership to reform the culture of regulation that permeates government at all levels. Government leaders must remove incentives for regulators to impose burdensome new regulations and red tape, and reward innovators who reform or eliminate irrational regulations or who obviate the need for new ones. Government employees, like private-sector employees, must put the “customer”

first and be more accountable for achieving results, not for developing or following Byzantine rules.

If we fail to regulate smarter, and if we fail to change the culture of regulation, then the American public – not just governments and businesses – will suffer. Regulating smarter is a challenge our nation cannot afford to ignore.

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1. Risk-Based Priorities and Public Education:

Risk-Based Priorities

- The government should use comparative risk assessment to compare the magnitude of various risks and set priorities for achieving greater protection of human health, safety and the environment in the most cost-effective manner.
- Using comparative risk assessment, the Executive Branch should develop a current inventory of known risks, rank them, and periodically update the inventory every two to four years in light of new information.
- Federal and state health and safety agencies should utilize experts to assess, compare, and rank the risks regulated by each agency.
- An interagency coordinating group should be used to facilitate communication and long-term planning among agency leaders.
- The President should issue guidance to encourage the use of risk analysis as a tool for making pollution prevention decisions.
- In the short term, Congress and state legislatures should require the risk-reduction agencies, such as EPA, to conduct comparative risk assessments to set priorities.
- In the long term, as environmental, health, and safety statutes are reauthorized, reformed, and created, Congress and state legislatures should require - not inhibit - the consideration of risk, costs, and benefits in designing regulatory policy.
- Legislation for controlling risk should promote risk assessment while providing agencies with sufficient flexibility to incorporate state-of-the-art scientific knowledge.
- An Office of Risk Analysis should be created in EPA and other agencies that need increased expertise in analyzing and ranking risks.
- A task force composed of scientific experts from the environmental, health, and safety agencies should create a government-wide manual on the regulation of risks. The manual would instruct regulators on how to manage risks.
- Legislatures should set clear goals for regulatory programs, and these goals should be understandable to the regulated community and the public.

Public Education: Improved Risk Communication

- Agencies should improve the risk communication process, which

includes educating the public on the nature of risks potentially subject to regulation; the costs and benefits of regulation; available alternatives; and uncertainty about risks, benefits, and costs.

- The government should educate the public about the level of risks proposed for regulation; risks unfamiliar to the public should be compared to familiar risks.
- Environmental, health, and safety agencies should create public risk communication programs to inform and respond to the public on relevant risks and the costs of managing those risks.
- Risk communication should be based on a written record that is available to the public.

2. Risk Assessment and Risk Management:

- The risk assessment and risk management phases of the regulatory process should be separated as much as possible – both by agencies in conducting risk analyses and by legislatures in designing statutes.
- Risk assessment methodologies and guidelines should be improved; they should be routinely reviewed and updated to reflect the state of the art.
- Professional and policy judgments made in the risk assessment process should be identified and disclosed to the public.
- The White House should issue an Executive Order on risk assessment and risk management policy.
- Congress and the White House should strengthen the expertise of the Office of Science and Technology Policy in risk analysis.
- Uniform risk assessment guidelines for the agencies should be developed by OSTP, an interagency committee, or by experts outside of government.
- Agencies should review their risk assessment guidelines and methodologies and make improvements where appropriate.
- A more complete and current government database of relevant scientific data should be developed for use in the risk assessment process.
- The government should establish a mechanism that would allow new scientific information to be easily and quickly incorporated into the risk assessment process.
- Procedures should be established to reevaluate risk assessments and risk management decisions in light of scientific advances.
- Agencies should favor cost-effective regulatory options in the risk management phase.

3. Sound Science:

- Agencies should use the most advanced and precise scientific methods when making decisions.
- Agencies should regularly update their regulations and programs to incorporate advances in scientific knowledge.
- Agencies that depend on scientific information and judgments but lack scientific advisory boards, such as OSHA, should emulate EPA and FDA and create scientific advisory boards to participate actively in their decision making.
- Periodic outside review procedures should be used to bolster the scientific credibility of agency decision making.
- To increase the reliability and credibility of their risk assessments, agencies should strive to make their default assumptions and inference guidelines accurately reflect real risks.
- When regulators lack information for a value or parameter needed for a risk estimate, they should use uncertainty analysis techniques to identify a range of possible values and their probability of occurrence.
- To promote public accountability, agencies should explain assumptions, inferences, and value judgments made in each risk assessment and should characterize their impact on the estimated value of the risk.
- Although risk assessments should provide a range of risk values to indicate data limitations and scientific uncertainty, the “best estimate” of risk should be provided for policymakers and the general public in the risk management phase.

4. Benefit-Cost Analysis:

- Federal and state agencies should use benefit-cost analysis to decide whether or not to adopt a regulation and should regulate only where the benefits justify the costs.
- Once a regulatory goal is established, agencies should use cost-effectiveness analysis to select the least costly option for meeting that goal.
- Congress and state legislatures should incorporate benefit-cost principles in statutes and avoid an “at-any-cost” approach to achieving regulatory goals.
- The White House and governors should hold agencies accountable for conducting a full benefit-cost analysis of significant regulatory actions.

- Agencies should apply benefit-cost and cost-effectiveness analysis not only to substantive regulations, but also to administrative process, including procedures for issuing permits and reviewing compliance.
- Agencies themselves should develop and use standardized guidelines for analyzing the costs and benefits of their regulations.
- Agencies that already have benefit-cost guidelines, such as EPA, should periodically review and improve their guidelines in cooperation with other agencies and the White House or the governor.
- When agencies estimate costs, they should attempt to estimate the *full* costs of regulations, not just *compliance* costs.
- Agencies also should consider the potential benefits of the activity or substance to be regulated.
- If some costs or benefits are nonquantifiable, they should at least be identified by the regulator.

5. Market Incentives and Performance Standards:

- Both statutes and regulations should favor market mechanisms over command-and-control regulation.
- Performance standards should be favored over design standards in federal and state regulations.

6. Productivity, Wages, and Economic Growth:

- Agencies should directly consider the impact of regulatory options on productivity, wages, economic growth, innovation, jobs, and the international competitiveness of American businesses.
- The Legislative and the Executive Branches at the federal and state levels should promote the improvement of state-of-the-art analytical tools to assess the industry-wide and economy-wide impact of regulations.

7. Coordination Among and Within Agencies:

- To address problems concerning multiple agencies, a strong interagency committee should engage in strategic planning and develop a coordinated response before regulations are proposed.
- Each agency should coordinate individual programs that address different aspect of the same problem.
- Cross-cutting, cost-effective regulatory approaches, such as multi-media environmental regulations, should be favored over piecemeal approaches.

8. Openness:

Removing Secrecy

- The regulatory process should be open to maximum public involvement at all stages.
- OIRA should disclose written communications from those outside of government before a rule is published.
- The White House should require agencies to publish their Regulatory Plans when they are submitted to OIRA for review.
- Regulatory analysis documents that detail the costs and benefits of regulations should be available to Congress and the public, even if they include information or considerations that the agency may not actually use to create a rule.
- The public should have access to the identities and positions of participants in the regulatory process.

Regulatory Negotiation

- Agencies should make better use of negotiated rulemaking.

9. Periodic Review:

- Programs and regulations should be periodically reviewed for purposes of determining whether they should be reformed, discontinued, or consolidated.
- The President should issue a Directive requiring each agency to identify and review at least three significant regulations.
- The White House should establish a formal process for reviewing existing regulations and programs.
- Legislatures should incorporate sunset provisions into regulatory programs to ensure a stricter review process, compelled by termination of the program absent a vote for continuation.

10. Federalism:

- When creating regulatory programs in a field implicating both federal and state interests, Congress should carefully consider whether to preempt and regulate the field itself or leave it to the states; the goal should be to achieve a more cost-effective balance of state and federal regulation.
- The federal government should refrain from burdening state and local governments with unfunded mandates – programs without funding – especially where the benefits do not accrue at the state or local level.
- When practical, agencies should grant waivers to allow state and

local governments to experiment with innovative programs that may more efficiently achieve regulatory goals.

11. Paperwork Burdens:

- Paperwork burdens imposed by all regulatory programs should be assessed and reduced.
- Administrative process costs – the inflexibility, unresponsiveness, and delay that characterize many regulatory programs – should be assessed and reduced.
- The adversarial, legalistic nature of the regulatory process should be reduced where possible.
- The Paperwork Reduction Act should be strengthened; clear and stringent goals for reducing paperwork burdens should be established by Congress and the White House.
- When it amends the Paperwork Reduction Act, Congress should legislatively overrule *Dole v. United Steelworkers of America* to address the problem of “third party” disclosures of information.
- The anticipated paperwork requirements of future legislation should be thoroughly assessed prior to enactment, and these assessments should be disclosed to the public.
- Alternative information technologies should be employed to reduce the paperwork burden.

12. Regulatory Budget:

- A framework should be developed to account for expenditures required by regulations and to promote greater fiscal restraint on regulatory programs.
- Congress should impose a cap on the costs imposed on the economy by regulations each year. If the regulatory budget limit is reached, the government should be required to repeal or modify existing regulations to offset the cost increase from any new regulation.

Interview with Bill Drayton (1980)

Making Innovation a Part of Regulation

Few agencies have had such a heavy impact on the American economy as the Environmental Protection Agency. But, as much of a burden as it has imposed in the past, there could be far more in the future. Poll after poll shows that the American people support environmental regulation and, indeed, think more should be done. Some students now believe we may be reaching the limits of what we can afford to spend on environmental controls. Will this mean we have to stop improving our environment? EPA is being pushed up against the wall.

Recognizing itself as the leading regulatory agency, EPA under Administrator Doug Costle has determined to take the lead in regulatory reform. Responsible for leading these efforts within the agency is Bill Drayton, the Assistant Administrator for Planning and Management. His views of regulation, the type of reforms necessary and the contributions that must be made by the regulatory agencies and the private sector are important guideposts for the future. Drayton summarizes his views on regulation in this interview with REGULATORY EYE.

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Away From The Old Style. The compounding growth of the economy and, consequently, of pollution, will press ever harder against the world's unchanging quantity of air, land and water—forcing society to pay more and more just to maintain current levels of environmental quality. In the 1970's we had easy targets because for relatively little money we could remove large amounts of pollution. In the future, though, the costs per pound of pollution removed are sure to rise. And we will be asking ever-larger numbers of smaller and smaller firms to cut their pollution. Society may eventually decide the price is too high.

Increasing the rate of innovation in environmental control technology and techniques, thereby getting more environmental relief for less cost, is the only way we can avoid this dead end, this cost trap. We will need positive incentives to encourage innovation. We need to turn on the technical skill and creativity of thousands of plant engineers and private sector managers. To do this we need public creativity as well. Making innovation a part of the process is essential to the long-term health of the environmental movement.

We must change the way we regulate. We must avoid the dead-weight loss caused by the fact that rules, unavoidably, are rigid over-generalizations that often force suboptimal solutions in particular cases. The traditional "command and control" of an all-powerful regulator issuing such regulations and forcing their acceptance according to the book must give away.

We need to stimulate among Federal government regulators, officials at the local level and industry, a willingness to innovate with new technologies and more productive control mechanisms. In essence, we have to unleash both our and the States' staffs and industry from the over-rigid constraints of command and control, to encourage them to use their imagination in developing better and cheaper ways to meet our environmental goals.

Eighty-five percent of the environmental regulators in this country are at the State and local level. So is virtually all our industry. We have to find incentives that will allow people outside Washington to develop better ways of getting the job done. No central organization can ever know as much or do as good a job as the people on the spot. We need to develop a system that provides the priorities and an accountability system

from Washington and encourages innovation and reform initiative at the local level.

Finally, we must develop an alliance among industry and government based on a mutual desire to press for needed environmental improvements at the least possible cost. Without the willingness to work together, specific facts only known at the local level will not contribute adequately to the attainment of our national policies and goals.

"Controlled trading" is the chief concept we are using at EPA to provide incentives for innovation in controlling pollution. Under this concept industry is free within a geographic area to choose the most cost-effective methods for reducing pollution, so long as certain minimum reductions are attained. EPA will set the rules and police adherence to national policies. That way, a new source of pollution may be allowed if another existing source in the area reduces its pollution to more than "offset" the amount emanating from the new source. For example, Oklahoma City was able to get several local oil companies to make room for a new \$400 million GM assembly plant by reducing the amount of hydrocarbons they were releasing into the air by an amount greater than the hydrocarbons expected to be emitted from the new GM plant.

We now permit companies to reduce their emissions and "bank" the emissions reductions for sale or trade at a later time to companies moving into the area. We are exploring the possibility of establishing marketable permits to release pollutants which would allow us to control the total level of pollution in an area. Under the marketable permit system, companies could determine the best possible location at a new plant, given the costs of the permits required to release pollutants.

Part of this controlled trading concept will involve the development of brokers to facilitate the transfers of offsets of pollution permits. In Oklahoma City it was the Chamber of Commerce that performed this function. In other areas, State and local governments are picking up this responsibility.

Another use of the controlled trading concept is in the bubble approach to pollution emanating from a single plant. Often there are multiple sources of pollution within the plant and some are more costly to control than others.

DuPont has estimated that it could reduce by 89 percent the total pollution of hydrocarbons from one of its plants for \$5 million. If it had to meet existing standards, it would have to spend \$20 million to get 84 percent control. (EPA hasn't r



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viewed this proposal yet, but we have a great deal of respect for DuPont's technical competency).

Controlled trading alternatives allow business and local authorities to reduce pollution at far lower costs than before. Even more important, it encourages innovation.

Other Reforms. We are exploring more than 40 other regulatory reforms at EPA. Let me quickly list a few examples.

Enforcement against the handful of hardcore scofflaws has been notoriously difficult. Our new economics-based delayed compliance penalties will charge noncompliers what they save by not complying.

We have not overlooked the problems of red tape in EPA programs. We are exploring ways to consolidate the many permits that would be required in the construction of any large industrial facility. We have cut by more than a year the time required to process rural water and sewer grant and loan applications.

A simple further example: We have begun to use Federal procurement to encourage environmentally superior products. We have already done so for relatively quiet trucks, air compressors and lawn mowers.

Finally, we are carefully exploring how we can improve the development and review of regulations. We are working to improve our strategic planning and priority setting mechanisms for future regulatory developments. We are actively coordinating our chemical regulations through the Interagency Regulatory Liaison Group, and through the Regulatory Council. We are looking at the cumulative impact of our air and water regulations on six major industries. We have initiated a major effort to improve the estimating of benefits to be achieved by new regulations. We have also tried to return to the use of English in our regulations.

I do not believe we can reform our regulatory process overnight. Important reforms take years to develop, refine, and implement. Putting the necessary analytical and management capabilities in place and developing broad public understanding and cooperation also takes time. But it cannot take too much time. Every year we are losing ground as the volume of pollution increases and our unchanging amount of environment must absorb more and more compounds. We must innovate in how we regulate in order to induce those we regulate to find new, more efficient ways of controlling pollution. □

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A-28 (No. 243)

REGULATION, ECONOMICS AND LAW

(DER) 12-21-94

occur in tanks, containers, drip pads or builders meeting industry standards, not RCRA standards; and spill response is required, according to Tom Ovenden, project director for NEDA-RCRA.

In addition, those recycling wastes that were produced on-site would have to notify the regulatory agency and adequate records would be maintained to verify compliance with terms of the exemption and ensuring not too much waste is accumulated.

This approach would help build trust between the agency and industry by allowing the industry to operate under a reduced regulatory burden, and allow regulatory agencies to check on the industry through inspecting the facilities and examining records, Ovenden explained.

John Wittenborn, an attorney representing the steel industry for Collier, Shannon, Rill and Scott, said he is encouraged on the progress EPA is making, but is concerned that EPA may subject off-site recycling activities to more stringent controls than needed simply because of the location of the recycling activities.

The steel industry recycles both on-site and off-site. It is difficult to "see a significant difference in the way recycling activities are regulated just because of venue," Wittenborn told BNA.

If EPA is concerned with additional risks in the transportation or commingling of the materials to be recycled off-site, then those risks should be addressed in the conditions that industry must meet to be exempt from RCRA Subtitle C, he explained.

The EPA official told BNA the agency also will try to do a better job distinguishing between commodity-like wastes and materials that are inherently waste-like in deciding how they should be regulated.

In addition, the agency still is considering a version of the controversial toxics-along-for-ride-tests, which would require industry to test their wastes and recycled products for toxicity characteristics to ensure there is no sham recycling.

EPA Assistant Administrator Elliott Laws was briefed by OSW staff in November about the task force recommendations and gave the approval to proceed with the modified approach. The letter outlining the strategy could be released as early as the week of Dec. 26. The actual strategy may not be released until January or later, according to an EPA official.

— By Amy Porter

Government Operations

CLINTON MOBILIZES TEAM TO IMPROVE FEDERAL REGULATORY PROCESS IN 1995

President Clinton has asked a White House team of regulatory advisers to propose ideas early next year to improve the federal regulatory process in a way that builds on "the principles and the philosophy" he described in his September 1993 executive order on regulatory policy, Sally Katzen, administrator of the Office of Information and Regulatory Affairs at the Office of Management and Budget, told BNA Dec. 20.

Any and all ideas that would promote "good government" are on the table, Katzen said, including actions

Clinton can take under his own authority, as well as those that would require congressional action.

The president mobilized a team of White House advisers in November after he received a report from Katzen describing the progress made in the year since Clinton issued his executive order, EO 12866. The report, which Katzen sent to the president in November and OMB released to BNA on Dec. 20, states: "We continue to be pleased with the progress that has been made in achieving the objectives of the executive order, but at the same time, we are acutely conscious of the work that remains to be done to realize the full benefits that we had hoped to achieve."

The president's 1993 order described his regulatory philosophy, including the need to weigh costs and benefits of federal rules and information about risk. It described a regulatory review process designed to be more open and accessible to public scrutiny, and a system intended to reduce the number of regulations reviewed by the White House by targeting those deemed "significant" because of their estimated impact on the economy, or the novel issues they present.

White House Focus Sharpened In September

Clinton's recent instructions to his regulatory advisers were the result of discussions within the White House that had been taking place since Labor Day, which was the one-year anniversary of the president's regulatory order, Katzen said. In taking stock of the regulatory review process after 12 months under EO 12866, "I had a clear sense of where we were and where we wanted to go," she said.

According to Katzen, the president's focus on regulatory policy was sharpened long before the Nov. 8 elections that brought a Republican majority to the House and Senate. Nevertheless, Clinton's public statements about relieving the public of the intrusive burden of the federal government, including the regulatory process, sharpened after the elections. The White House is keenly aware that it faces a popular "regulatory relief" movement in Congress led by Republicans, but joined by many Democrats, that could — in its most extreme versions — shut federal regulatory agencies down through broad reform legislation, the appropriations process, or possibly through an amendment to the Constitution.

House and Senate lawmakers this month asked the president to impose a moratorium on federal regulations, much like the flexible freeze on rulemaking imposed by President Bush. Clinton, through Katzen, refused the invitation Dec. 14, calling it "blunderbuss" (239 DER A-13, 12/15/94).

Asked if the White House regulatory improvement team is considering ideas included in regulatory "reform" legislation and amendments proposed this year as additions to almost every bill that looked to be heading to the floor of the House or Senate, Katzen responded, "This is a focused effort on specific improvement to the regulatory system. We are looking at cross-cutting issues and are gathering information from all sources. ... A lot of ideas were floated [in Congress], some of which would be properly conceived as enhancements to 'good government.'"

12-21-94 (DER)

REGULATION, ECONOMICS AND LAW

(No. 243) A - 27

Clinton Asks For New Approaches To Regulation

The president has asked his regulatory advisers to provide him "some very real options" for "alternative, innovative approaches to regulation that can achieve the objective in a more cost-effective fashion," Katzen said. In asking for "real options," the president wants ideas that are "achievable, realistic, important improvements to the system," she added.

Katzen said she expected the options to build on the contents of the president's 1993 executive order, rather than seek to drastically change its focus.

Clinton wants the proposals by "early spring" 1995, Katzen told BNA. Vice President Al Gore, who heads the president's Regulatory Working Group, which was established under EO 12866, and his staff are coordinating the regulatory improvement project at the White House. Katzen, as chair of the Regulatory Working Group and administrator of the White House office in charge of reviewing significant federal regulations, is playing a key role in providing information and ideas.

Looking At Industry Sectors

The advisers are organizing their work under two tracks:

- First, examining general cross-cutting issues that relate to the regulatory process generally (which Katzen heads); and

- Second, a look at the needs of specific sectors of the economy, such as transportation, and food safety, Katzen told BNA.

She declined to list all the industry sectors currently identified by the group, or the members of the regulatory team in charge of looking at those sectors. Those involved are all from the White House and OMB, she said.

Clinton's Regulatory Working Group includes representatives from OMB, the Council of Economic Advisers, the National Economic Council, the Domestic Policy Council, the National Security Council, the Office of Science and Technology Policy, the office of White House Counsel, the office of environmental policy, and the office of intergovernmental affairs. The working group also includes representatives from at least 20 federal departments and agencies.

The Regulatory Working Group has had for almost a year four subgroups assigned to examine specific issues within the regulatory arena, two of which — risk analysis and cost-benefit analysis — are hot-button issues among Republicans on Capitol Hill. The other two teams are studying federal information dissemination, and "streamlining government."

Clinton Seeks To Reduce 'Interference'

"The president asked the vice president to spearhead the effort and to pull together all the regulatory advisers and establish a process of looking at alternative, innovative approaches to regulation that can achieve the objective in a more cost-effective fashion," Katzen said.

At a Dec. 19 White House event to focus on proposed spending cuts to pay for middle-class tax breaks, Clinton — joined by Gore — said the administration

was beginning a second phase of reinventing government that included the regulatory process.

"I have called on the vice president to review every single government program and department for further possible reductions," Clinton said. "He's also going to review the federal regulatory process, and we have spent a good deal of time on that already, so that we can get better results for the public with less interference in their lives."

Gore echoed the president's comments, noting that phase two of his reinventing government efforts would target decisions about what the government "should stop doing."

"We will stop producing red tape and start paying more attention to results than we do to processes," Gore said. "And, as you have asked, Mr. President, we're going to also see about reinventing the government's approach to regulatory issues and to regulatory process. That's well under way also."

Katzen Concedes Limitations Of Regulators

The 43-page one-year status report on the implementation of EO 12866 sent by Katzen to the president in November praises the overall successes, but notes the difficulty in measuring the success of the president's instructions to agencies in terms of his regulatory philosophy and principles.

These are identified in the report as "development of alternatives, setting regulatory priorities, obtaining the best reasonably available information, assessing benefits and costs, considering federal, state, local, and tribal needs, [and] coordinating with other agencies."

Katzen told Clinton and other White House officials who received copies of the report that "the principles of the order are not a simple check list of tasks. Instead, they are a complex and interactive body of standards that require reasoned judgment, difficult decisions, and balances of competing priorities."

For many reasons, Katzen reported that she could not tell Clinton that "the philosophy and principles espoused in the order either have or have not always been met by the agencies in their regulatory programs," but she said the results indicate that agencies are "applying the principles in many and diverse rulemakings."

The president's regulatory principles, which Katzen said "appear simple and straightforward," are sometimes difficult for federal regulators to apply.

"Agencies are often faced with imperfect information and limited personnel and financial resources to devote to analysis," she wrote. "And they ultimately face what must be acknowledged as a daunting task: In a society composed of complex and changing webs of institutional and individual behavior, they must predict the future, attempting to control behavior harmful to the common good, without impeding or unwittingly restraining acceptable and beneficial activities."

Katzen took aim at Congress for increasing the amount of regulation and for making the task of regulating the public more difficult. In doing so, she suggested that the administration believes the situation may be worse in the GOP-controlled 104th Congress.

A - 28 (No. 243)

REGULATION, ECONOMICS AND LAW

(DER) 12-21-94

"Agencies today face unusual pressures to regulate," she wrote. "With budgetary constraints so tight, and with the difficulty of enacting new legislation in the highly partisan atmosphere that characterized the last Congress, the only means left for the agencies to implement their initiatives is through regulation. This puts inordinate pressure on any attempt to hold steady or reduce the amount of regulation in which they are engaged."

Katzen Says White House Reviews Fewer Rules

Because Clinton's executive order was designed, in part, to reduce the number of proposed and final rules that must undergo centralized review within the White House, Katzen's report includes a one-year statistical update.

Six months after the president issues his order, Katzen's office reviewed 755 rules, and the total for one year was 1,143 reviews. Katzen said the figure was half the average reviews per year for the previous decade, which was more than 2,200 reviews.

Between Jan. 1, 1994, and Sept. 30, 1994, OIRA reviewed 661 rules. At that rate, Katzen predicted that 1994 would close with a record of fewer than 900 rules reviewed by her office, which she said would be a 60 percent reduction from the annual average for the previous decade under Republican administrations.

"Thus, the number of rules OIRA reviews has been reduced substantially," she concluded.

Of the rules reviewed by OIRA, Katzen's office returned 58 percent to the agencies without changes,

and sent back 35 percent with changes. The remaining 7 percent were withdrawn by the agencies, or were cleared on an expedited basis for other reasons, Katzen said.

Just looking at figures from April 1, 1994, and Sept. 30, 1994, — the second six-month period of the order — Katzen said six agencies accounted for 76 percent of OIRA's reviews: Health and Human Services (82), Department of Agriculture (65), Environmental Protection Agency (47), Education (35), Housing and Urban Development (34), and Transportation (31).

Of the 388 rules reviewed by OIRA during the second six months since issuance of EO 12866, 66, or 17 percent, were "economically significant," while 322, or 83 percent, were deemed significant for other reasons and were therefore subjected to review.

EPA and USDA were responsible for the majority of economically significant rules in the second six-month period of the order, similar to the statistics in the first six months of EO 12866.

Text of Katzen's one-year report appears in Section M.□

CORRECTION

A report on block grants to address employment and training and welfare programs, in 240 DER A-10, 12/16/94, should have stated that Sen. Nancy Kassebaum (R-Kan) does not have a formal position on giving states block grants for job training programs. The senator opposes block grants for welfare programs.□

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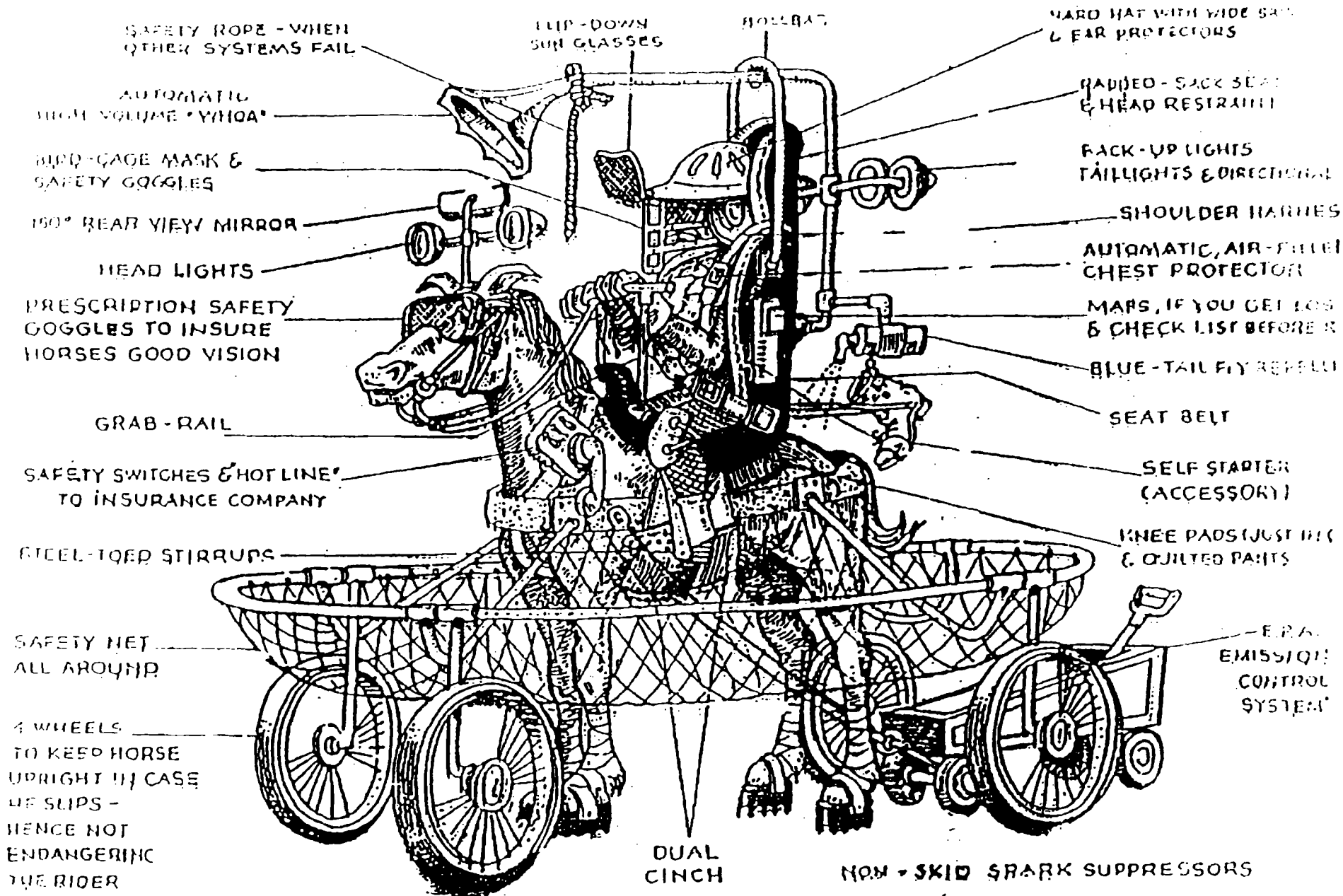
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Regulatory Policy Reviews
(As of 1/5/95)

	Phone	Fax	INTERNET address
OVP (NPR staff)			
Elaine Kamarck	456-2816	456-6429	
Bob Knisely	366-3282	366-3640	kniz@tmn.com
Jean Logan	632-0344	632-0390	jean.logan@npr.gsa.gov
Jeff Lubbers	254-7050	254-3077	jlubbers@acus.mhs.compuserve.com
Steve Tidrick	632-0150 x126	632-0390	tidrick@cais.com
OIRA			
Sally Katzen	395-4852	395-3047	
Don Arbuckle	395-7343	395-7285	
Art Fraas	395-3084	395-7285	no internet address
Gary Rowe	395-1247	395-3047	
OEP			
Katie McGinty			
Keith Laughlin	456-6224	456-2710	no internet address
NEC			
Michael Deich	456-2801	456-2223	deich_m@a1.eop.gov
Ellen Seidman	456-2802	456-2223	seidman_e@a1.eop.gov
Peter Yu	456-2801	456-2223	yu_p@a1.eop.gov
CEA			
Joe Stiglitz			
Jonathan Baker	395-5614	395-6809	no internet address
OSTP			
Jack Gibbons	456-7116	456-6021	sbachtel@ostp.eop.gov
MRC Greenwood	456-6130	456-6027	mrcgreen@ostp.eop.gov
Mark Schaefer	456-6080	456-6025	mschaefer@ostp.eop.gov
Skip Johns	456-6033	456-6023	ljohns@ostp.eop.gov
DPC			
Carol Rasco	456-2216	456-7028	
Paul Weinstein	456-5577	456-7028	weinstein_p@a1.eop.gov
Jennifer Klein	456-2599	456-7028	klein_j@a1.eop.gov
Gaynor McCowan	456-5575	456-7028	mccowan_g@a1.eop.gov
Mike Schmidt	456-5567	456-7028	schmidt_m@a1.eop.gov
WH Counsel			
Abner Mikva			
Steven Neuwirth	456-2632	456-1647	neuwirth_s@a1.eop.gov

Fax changes to Steve Tidrick at 632-0390



Cowboy after O.S.H.A.