

markets may underreact or overreact depending on the rules-of-thumb and other mental assumptions that people use to cope with difficult issues. Regulators should be aware of such mental quirks and not adopt policies based on a misunderstanding of the underlying reality.

#### 4. Other Social Purposes

There are justifications for regulations in addition to correcting market failures. A regulation may be appropriate when you have a clearly identified measure that can make government operate more efficiently. In other cases, regulation may be used to reduce unfairness. Regulatory action may also be appropriate to protect privacy or to promote civil rights or permit more personal freedom.

#### *B. Showing That Regulation at the Federal Level Is the Best Way To Solve the Problem*

Even where a market failure clearly exists, you should consider other means of dealing with the failure before turning to regulation. Alternatives to regulation include the courts acting through the product liability system, antitrust enforcement, consumer-initiated litigation, or workers' compensation systems.

In assessing whether Federal regulation is the best solution, you should also consider the possibility of regulation at the State or local level. In some cases, the nature of the market failure may itself suggest the most appropriate governmental level of regulation. For example, problems that spill across State lines (such as acid rain whose precursors are transported widely in the atmosphere) are probably best addressed by Federal regulation. More localized problems, including those that are common to many areas, may be more efficiently addressed locally.

A diversity of regulation may generate gains for the public as governmental units compete with each other to serve the public, but duplicative regulations can also be costly. Where Federal regulation is clearly appropriate, for example, to address interstate commerce issues, you should try to examine whether it would be more efficient to reduce State and local regulation. For example, the burdens on interstate commerce arising from different State and local regulations such as compliance costs for firms operating in several States, may exceed any advantages associated with the diversity of State and local regulation. Your analysis should consider the possibility of reducing as well as expanding State and local rulemaking.

The role of federal regulation in facilitating U.S. participation in global markets should also be considered. Harmonization of U.S. and international rules may require a strong Federal regulatory role. Concerns that new U.S. rules could act as non-tariff barriers to imported goods should be evaluated carefully.

#### *C. The Presumption Against Economic Regulation*

Government actions can be unintentionally harmful, and even useful regulations can impede the efficiency with which markets function. For this reason, there is a presumption against certain types of regulatory action. In light of both economic

theory and actual experience, a particularly demanding burden of proof is required to demonstrate the need for any of the following types of regulations:

- Price controls in competitive markets;
- Production or sales quotas in competitive markets;
- Mandatory uniform quality standards for goods or services if the potential problem can be adequately dealt with through voluntary standards or by disclosing information of the hazard to buyers or users; or
- Controls on entry into employment or production, except (a) where indispensable to protect health and safety (e.g., FAA tests for commercial pilots) or (b) to manage the use of common property resources (e.g., fisheries, airwaves, Federal lands, and offshore areas).

## II. Alternative Approaches To Consider

Once you have determined that Federal regulatory action is appropriate, you will need to consider alternative regulatory approaches. Ordinarily, it will be possible to eliminate some alternatives through a preliminary analysis, leaving a manageable number of alternatives to be evaluated according to the formal principles of the Executive Order. The number and choice of alternatives selected for detailed analysis is a matter of judgment. There must be some balance between thoroughness and the practical limits on your analytical capacity. With this qualification in mind, you should nevertheless explore modifications of some or all of a regulation's attributes or provisions to identify appropriate alternatives. The following is a list of alternative regulatory actions that you should consider:

#### *A. Different Choices Defined by Statute*

When a statute establishes a specific regulatory requirement and the agency plans to exercise its discretion to adopt a more stringent standard, you should examine the benefits and costs of reasonable alternatives that reflect the range of the agency's statutory discretion, including the specific statutory requirement.

#### *B. Different Compliance Dates*

The timing of a regulation may also have an important effect on its net benefits. For example, costs of a regulation may vary substantially with different compliance dates for an industry that requires a year or more to plan its production runs efficiently. In this instance, a regulation that provides sufficient lead time is likely to achieve its goals at a much lower overall cost than a regulation that is effective immediately, although delay would also typically lower the value of the benefits.

#### *C. Different Enforcement Methods*

Compliance alternatives for Federal, State, or local enforcement include on-site inspections, periodic reporting, and compliance penalties structured to provide the most appropriate incentives. When alternative monitoring and reporting methods vary in their costs and benefits, you should consider promising alternatives in identifying the most appropriate enforcement framework. For example, in some circumstances random monitoring or

parametric monitoring will be less expensive and nearly as effective as continuous monitoring in achieving compliance.

#### *D. Different Degrees of Stringency*

In general, both the benefits and costs associated with a regulation will increase with the level of stringency (although marginal costs generally increase with stringency, whereas marginal benefits may decrease). You should study alternative levels of stringency to understand more fully the relationship between stringency and the size and distribution of benefits and costs among different groups.

#### *E. Different Requirements for Different Sized Firms*

You should consider setting different requirements for large and small firms basing any difference in the standards on perceptible differences in the costs of compliance or in the expected benefits. The balance of costs and benefits can shift depending on the size of the firms being regulated. Small firms may find it more costly to comply with regulation, especially if there are large fixed costs required for regulatory compliance. On the other hand, it is not efficient to place a heavier burden on one segment of a regulated industry solely because it can better afford the higher cost; this has the potential to load costs on the most productive firms, costs that are disproportionate to the damages they create.

You should also remember that a rule with a significant impact on a substantial number of small entities will trigger the requirements set forth in the Regulatory Flexibility Act.

#### *F. Different Requirements for Different Geographic Regions*

Rarely do all regions of the country benefit uniformly from government regulation and it is also unlikely that costs will be uniformly distributed across the country. Where there are significant regional variations in costs and/or benefits, you should consider the possibility of setting different requirements for the different regions.

#### *G. Performance Standards Rather Than Design Standards*

Performance standards are generally superior to engineering or design standards because performance standards give the regulated parties the flexibility to achieve regulatory objectives in the most cost-effective way. This is only possible, of course, if there is more than one feasible way to meet the performance standard. In general, you should consider setting a performance standard if performance can be measured or reasonably imputed and where controlling performance provides a scope appropriate to the problem the regulation seeks to address. For example, compliance with air emission standards can be allowed on a plant-wide, firm-wide, or region-wide basis rather than vent by vent, provided this does not produce unacceptable local air quality outcomes (such as "hot spots" from local pollution concentration).