

regulatory or otherwise, of other departments or agencies. This is largely attributable to specialization and division of labour necessary in such a huge organization as the federal government. Second—and most ironically—regulators often create large negative externalities because—aside from the administrative costs—they do not spend their own resources, or even their department's resources, in achieving compliance with their regulations. Rather, these costs fall on firms, individuals, and other organizations in the private sector. Thus, "in the absence of a mechanism that forces regulators to internalize these costs, they will engage in regulatory activities that require too much private expenditure for the results achieved"⁴

11. The third source of inefficiency is the fact that regulators are not required (in practice) to regulate only when and to the extent that the benefits to society exceed the costs. They are not (in practice) even required to ensure that the most cost-effective method of regulation is chosen—let alone the most cost-effective method of governing instruments.

12. Fourth, in most cases departments and agencies are constrained in adopting more efficient or cost-effective methods of intervention. One obvious reason for this is that in statutes, Ministers, the Cabinet, or both, are given the power to create various types of subordinate legislation (regulations). The imposition of a tax, the creation of a tax expenditure, or the payment of a subsidy would require approval of the Minister of Finance, the Cabinet and, ultimately, Parliament. Regulations are easier to create for they are still viewed as simply "technical" means to give effect to legislation. In contrast, raising taxes or raising expenditures is very likely to require a debate among ministers on the policy issues.

13. If regulation is to improve allocative efficiency, government must correctly address a hierarchy of decisions. These are (a) whether to regulate or not more generally, whether to intervene or not; (b) how to regulate or, more generally, which governing instrument should be used; and (c) how stringent the regulation should be. Litan and Nordhaus explain that

Efficiency requires at each point that the overall benefits from the effort be compared with the costs. Regulation should occur, therefore, only when the total benefits outweigh the total costs. The type of regulation should be chosen that attains the highest net benefit. And the stringency of the regulation should be increased only as long as the incremental benefits are greater than the incremental costs.⁵

14. To optimize the allocation of society's scarce resources devoted to regulation, the federal government must

- determine the overall level of regulatory activity (perhaps measured by the social costs of this form of intervention) in a given period, say annually
- establish regulatory priorities across the many departments and agencies of the government
- establish criteria which all new regulations must meet, notably that the total benefits to society exceed the total costs to society ($B \geq C$)
- establish a process to evaluate and modify existing regulatory programs.

⁴ Litan and Nordhaus (1983), p. 89.

⁵ *Ibid.*, p. 90.