

2005 Draft Report to Congress on the Costs and Benefits of Federal Regulation

Review comments by
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Thank you for the opportunity to comment on the Draft 2005 Report to Congress on the Benefits and Costs of Federal Regulations. Overall, I think there is much useful information here, although its presentation could be improved in several ways as discussed below. For the most part, my comments will focus on the particular questions in the May 5, 2005 letter from John Graham and the questions posed on p. 40 of the draft report. My comments will be rather EPA-centric, since I am more familiar with that agency and its practices than other agencies. Naturally, what I say here reflects my own personal views and in no way should be considered the views of Resources for the Future.

Chapter 1.

I am not particularly interested in aggregations of costs and benefits over lengthy time periods, so I have no recommendations on the presentation of those results in Chapter 1, beyond suggesting less emphasis on such aggregations in favor of more attention being paid to the annual results, both summed over all regulations as well as the results for individual regulations. Some of this material is presented in Chapter 2, so I will return to it later.

Chapter 1 contains a table, Table 1.4, that runs from page 11 to page 22 and summarizes the results of the 26 regulations requiring private expenditures. There is much useful information in this table, but it interrupts the flow of the chapter, shows benefits for only 11 regulations, and gives results that cannot be directly compared with one another, e.g. annualized cost in current dollars for different years and present values of costs and benefits over different time horizons. In some cases it's not clear what the units are, and in at least one case what is reported as a cost is not a cost at all (p. 12, "140 million in lost exports). After cleaning this table up I would suggest moving it to the Appendix and replacing it with the Appendix table A-1. This table is one page instead of 12 and gives benefits and costs in consistent units (2001 \$). It also and ties into Table 1.1 by giving the by-rule breakdown of benefits and costs in the summary table.

Budgetary programs

This passage on p. 6 caught my eye:

Of the 45 rules, 19 implemented Federal budgetary programs, which caused income transfers usually from taxpayers to another group. Rules that transfer Federal dollars among parties are not included in the benefit-cost totals because transfers are not social costs or benefits. If included, they would add equal amounts to benefits and costs.

If this statement were limited to purely redistributive programs, such as programs that provide cash or in-kind transfers to low income households, it wouldn't be so bad, although even in this case there could be substantial incentive effects on both givers and receivers. But when I came to the list of 19 budgetary programs (p. 23-24), I found these items in the list:

- Conservation reserve program, USDA
- Fishing capacity reduction program for crab species...
- Automotive fuel economy manufacturing incentives for alternative fueled vehicles

To characterize these programs as “rules that transfer federal dollars among parties” is true as far as it goes, but it's like characterizing *Lolita* as “a novel about tennis.” The *intent* of programs like fuel economy incentives is not to help out indigent manufacturers, say, but to encourage them to do something they wouldn't otherwise do. There is no reason whatsoever to suspect that benefits will equal costs, as OMB claims. My bet is that the same can be said of most of the programs in Table 1.5. I also suspect also that most of these programs have been subjected to economic analysis either within the federal government or by academic economists, or at least that models and methods exist that would readily permit such analysis. For the economics of alternative fueled vehicles, for example, one such model has been developed by Jonathan Rubin and Paul Leiby.¹

Personally, I wish OMB did evaluate the benefits and costs of at least some of the programs listed in Table 1.5, but I can understand that the evaluation of budgetary programs may not be part of the mission of OIRA, which is focused on regulation. So be it, but the report shouldn't attempt to justify the inclusion by pretending that expenditure programs have no benefits or costs. I am aware that some expenditure programs are subjected to analysis within the agencies that would be responsible for implementing them, and some additional analysis of proposed legislative programs by the Congressional Budget Office, but I don't believe such analysis is nearly as systematic and comprehensive as the requirement for analyzing regulations.

¹ “The Alternate Fuel Transition: Results from the TAFV Model of Alternate Fuel Use in Light-Duty Vehicles 1996-2000” <http://www.umaine.edu/mcsc/Research/envpol/TAAFTMP/TAAFTMP.htm>, accessed June 15, 2005.

Impact of federal regulation on local governments, etc.

This is an odd section, a grab-bag of topics that fully reflects its origin as a list of statutory requirements to be checked off. But despite its desultory character, there is some interesting and useful material here.

Impact on local governments. For the most part, the regulations described in this subsection regulate local government not as a governmental entity, but as a provider of services that are also provided by some firms in the private sector. It wasn't clear to me why these regulations were treated separately from regulations on firms, or why none of the regulations had benefit estimates, only costs.

Impact on small business. While regulation of any sort can be a special burden for small business, this section should point out that many federal regulations, especially environmental regulations, include significant exceptions for small business. The lumping together of all federal regulations in the Crain and Hopkins study may obscure this point. This section made me wonder whether anyone had ever tried to quantify the effect of the small-business exemptions in various types of federal regulations.

Impact on economic growth. This is a concise, thoughtful and fair-minded review of a rapidly growing and important literature. It takes pains to point out (in the final paragraph of the section) that most of the empirical results in this literature are concerned with economic and not social regulation, while most (but not all) of the regulation discussed in this report and that falls under OMB oversight is social regulation. That said, it is also true that most social regulation is also "economic" regulation in a larger sense, for many of those regulations (especially regulations of the environment, consumer products, workplace health and safety, etc.) have economic consequences. Rather than breaking down regulations by "economic" v. "social," then, it may be more important to break down regulations by more detailed characteristics that indicate just how they intervene in the economy.

Chapter 2

The title of this chapter is not descriptive, since "validation" is discussed only in the latter half of the chapter. Rather than change the title, perhaps a better response would be to reorganize the manuscript somewhat, by moving the first part of the chapter into the first part of chapter 1, which discusses similar material.

Trends in federal regulatory activity

This first part contains what I was looking for in Chapter 1, a year-by-year presentation of aggregate benefits and costs of monetized regulation. It would be easier to follow if the two figures 2.1 and 2.1 were superimposed, especially since the vertical scales are different. Visual comparison of the two charts might suggest to the casual reader that the costs exceed benefits in some years, when in fact they are almost always lower than costs. Combining these two figures also obviates the need of Figure 2.3.

The repeated reference to the performance under Bush (43) relative to previous administrations tends to politicize the report, it seems to me. Is this the intent? Is OMB claiming that the regulatory performance of the Bush (43) administration has been superior to previous administrations? If so, wouldn't it be appropriate and useful to go into some detail concerning the particular decisions, procedural innovations and reforms that were implemented by the current administration and indicate how those changes affected regulatory performance? If not, this section could easily be reworded to refer to dates, not administrations.

The benefits of the Bush(43) years are driven largely by the recent fine particulate regulations, and many of the regulations issued during Bush (43) were initiated in earlier administrations. In fact, perhaps it could be argued that the appearance of these regulations under Bush(43) was an accident in timing. Those regulations could proceed only after the epidemiological evidence became persuasive enough to support a revision of the NAAQS to include a PM_{2.5} standard. As pointed out in the text, that happened in 1997, in the middle of the Clinton years. But for a legal challenge to the new NAAQS, which wasn't resolved until 2003, some of these particulate regulations might have been implemented before the Bush (43) administration began.

The regulatory trends discussed in this section refer only to the benefits and costs of the regulation. Your readers might also be interested in trends in the quality and quantity of analysis found in the RIAs. Have there been improvements? Has there been an extension in the categories of benefits that can be monetized? If so, do the charts in this chapter attempt to adjust for this expansion?

Validation and ex post analysis

I'm very glad to see a section in the report on ex post analysis. The issue was raised in the comments to the 2003 report, as I recall, when one commenter suggested that OMB review past estimates of regulatory costs and compare them to actual costs. OMB replied that its role was one of encouraging such studies, which were best carried out by think tanks and universities. Is this still OMB's position?

In any event there seems to be growing interest in ex post analysis not just at OMB, but at other institutions as well. The Health Effects Institute, for example, has a major program in demonstrating "accountability," the HEI's term for a set of empirically persuasive linkages connecting an air quality regulation to health outcomes. (Not all of these studies are full-blown ex post analyses; HEI's accountability studies, for example, are restricted to analysis of benefits only.) While these developments are welcome, a few cautions are in order.

First, the notion that an ex post study "validates" or sits is judgment of the RIA may not always be accurate or fair to the RIA. There may be instances where RIA cost estimates are intended to be upper bounds rather than estimates of the mean; in those cases it would be understandable to find in the ex post study that the costs of compliance were overestimated. Likewise, there may be features of the rulemaking process that encourage bias in cost estimates. In notice-and-comment rulemaking, for example, commenters

from industries affected by the rules are more likely to point out underestimates of costs than overestimates. Also: the RIA cost and benefit estimates are prepared on the proposed regulation, and there may be cases when the RIA does not get updated to correspond to the final rule. Finally, in our comparison of regulatory benefits and costs,² we found that the two main reasons for costs to be estimated were unanticipated technical change and incomplete implementation of the regulation. In other words, the ex ante and ex post estimates might differ substantially without indicating poor quality of the former.

Furthermore, there might be a misconception on the part of some observers in the policy community that these studies tell us the “truth”: what the benefits and costs actually were. In fact, the ex post benefits and costs are estimates, just as surely as the ex ante estimates were. They are also in at least some measure hypothetical, and the larger the rule’s impacts, the more hypothetical they are, because benefits and costs are measured against an unobservable baseline, i.e. what would have happened without the rule. The ex post study is similar in most respects to the ex ante study, except that new information has been generated. Probably, most of the *available* new information will be concentrated on the benefit side of the ledger, and in particular in the physical changes, such as numbers of injuries or estimates of premature mortality. (The ex post study will not normally produce any new information about the unit values of those effects.) Although there will generally be new information on compliance costs as well, it may not be publicly available. And while cost information may be elicited from regulatees by interviews or surveys just as in the ex ante study, responses may be strategic.³

Of the ex post studies listed in the document, about half are by NHTSA. I looked at two or three, and each was concerned exclusively with the effectiveness of the regulations, in particular, the effect on fatalities and injuries. None contains a cost estimate.

The following are brief responses to some of the questions on p. 40.

1. Scope of the review of ex post studies The usefulness of ex post analyses is not limited to the validation of ex ante studies, and ex post analysis can be very useful even in the absence of an ex ante analysis. In fact, probably the most valuable use of an ex post study is a validation of the regulation itself. The ex post analysis can provide essential ground-truthing on the effectiveness and costs of the regulation, as well as the importance of any unintended consequences.

2,3. Additional useful studies. There may be some useful examples the references to our article,⁴ but they are likely to be getting pretty old. But there are a couple of other *types* of studies that could be useful in assessing RIA cost and benefit estimates.

²Harrington, Winston, Richard D. Morgenstern and Peter Nelson. 2001. “On the Accuracy of Regulatory Cost Estimates.” *Journal of Public Policy and Management* 19(3).

³ One of the generally unremarked-upon virtues of economic incentive approaches to environmental regulation (e.g. tradable emission permits or emission taxes) is the property of truthful cost revelation, at least at the margin.

⁴ Harrington et al., *op. cit.*

Some authors have examined the content of RIAs directly,⁵ e.g. whether they are internally consistent, easy to read and comprehend, and contain all the components of a good benefit-cost analysis. These studies typically show that RIAs frequently have serious deficiencies. However, the quality of an RIA tends to be related to the importance of the regulation, so that unweighted tallies of the problems of RIAs may overstate the problem. As far as I know these studies don't go the next step and try to relate the deficiencies identified to inaccuracies in estimating benefits and costs that emerge from the ex ante-ex post comparison, or to other problems that may occur during implementation of the rule. That might be a useful way of combining the "checklist" studies with existing ex post analyses to get a grip on the effect of analytical quality on outcomes.

Another type of study that would be useful would be comprehensive analysis of all the regulations affecting a single outcome. For example, there are multiple Clean Air Act regulations since 1990 designed to reduce ambient ozone or fine particulate concentrations. Likewise, NHTSA has devised numerous regulations designed to reduce traffic fatalities, and state governments have implemented their own regulations. In these and similar situations it is not often easy to determine the relative importance of the various regulations, not to mention other variables affecting outcomes. In the ex ante studies, analysts are able to make some assumptions and hold the other regulations constant, but that is not possible in an empirically-based ex post study. Sorting out the effects of multiple regulations would probably require some pretty high quality panel data sets, but it is becoming easier and easier to assemble such data sets.

4. *Data.* Typically, EPA regulation delegates many permitting, monitoring and enforcement tasks to the states, and as a result the states end up being important collectors of data on regulation and implementation. Some of these data do not have to be reported back to EPA headquarters. Where there are reporting requirements, there may not be consistency in formats or frequency. As a result, there are datasets that would be useful for ex post analysis, but data assembly and data cleaning would be formidable exercises. If OMB wishes to promote ex post analysis, perhaps it should encourage more attention to data collection and centralization of important data sets.

Suggested reforms.

- A renewed commitment to the PACE survey—and a better survey, one useful for regulatory evaluation. The biggest problem with the PACE survey when it was conducted between 1978 and 1994 (or thereabouts) was that there was no mention of the regulations that gave rise to the reported expenditures and no connection drawn between them.

⁵ e.g. Hahn, Robert W., Jason K. Burnett, Yee-Ho I. Chan, Elizabeth A. Mader, and Petrea R. Moyle. 2000. "Assessing Regulatory Impact Analyses: The Failure of Agencies to Comply with Executive Order 12866." *Harvard Journal of Law and Public Policy* 23(3) pp. 859-884.

- Major regulations should contain a provision requiring the implementing agency to establish a data collection system that would facilitate ex post analysis of the regulation at some point in the future.
- Line agencies often do not have proper incentives to conduct or support ex post evaluations. Earmarked funds for the support of ex post regulatory evaluation could be a partial solution.
- One of the most difficult parts of conducting an ex post study is to obtain data on the costs incurred by subject firms in coming into compliance with the regulations. These difficulties are exacerbated by OMB rules under the Paperwork Reduction Act limiting data collection from firms and individuals.