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To: OIRA_BC_RPT@omb.eop.gov

cc:

Subject: Center for Progressive Regulation's comments on OMB's 2004 Draft Report to Congress

Attached please find the Center for Progressive Regulation's comments on OMB's 2004 Draft Report to Congress on the Costs and Benefits of Federal Regulations.

Please let me know if you have any problems opening this document. I would very much appreciate knowing that you have received it.

Thank you.

Sincerely,

Lisa Heinzerling
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Member Scholar, Center for Progressive Regulation

- CPR Comments OMB '04 FINAL.doc

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May 20, 2004

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FILED BY ELECTRONIC MAIL
TO OIRA_BC_RPT@omb.eop.gov

Re: Informing Regulatory Decisions: 2004 Draft Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities

Dear Sir/Madam:

These comments are submitted by the Center for Progressive Regulation (CPR or the Center), an organization of academics specializing in the legal, economic, and scientific issues that surround federal regulation. CPR's mission is to advance the public's understanding of the issues addressed by the country's regulatory laws.

The Center is committed to developing and sharing knowledge and information, with the ultimate aim of preserving the fundamental value of the life and health of human beings and the natural environment. One component of the Center's mission is to circulate academic papers, studies, and other analyses that promote public policy based on the multiple social values that motivated the enactment of our nation's health, safety and environmental laws. The Center seeks to inform the public about scholarship that envisions government as an arena where members of society choose and preserve their collective values. We reject the idea that government's only function is to increase the economic efficiency of private markets.

The Center also seeks to provoke debate on how the government's authority and resources may best be used to preserve collective values and to hold accountable those who ignore or trivialize them. The Center seeks to inform the public about ideas to expand and strengthen public decision-making by facilitating the participation of groups representing the public interest that must struggle with limited information and access to technical expertise.

These comments concern the Office of Management and Budget's 2004 Draft Report to Congress on the Costs and Benefits of Federal Regulations [hereinafter "2004 Draft Report," "Draft Report," or "Report"].

The Draft Report raises issues primarily in three broad areas; briefly, the Report:

- 1) purports to identify a large, and inverse, connection between regulation, and wages and economic growth;
- 2) invites commenters to propose a new regulatory "hit list" for the manufacturing sector; and
- 3) provides estimates of the costs and benefits of federal regulation for the period 1993-2003.

Our specific conclusions about the Draft Report can be summarized as follows:

- 1) OMB's observations about the relationship between regulation and economic growth are almost laughably irrelevant to the kinds of regulatory reforms OMB has promoted in the past, and the kinds of reforms OMB invites commenters to propose in this Draft Report.
- 2) OMB's invitation for commenters to propose a new regulatory hit list for the manufacturing sector draws on empirical evidence about the relationship between regulation and manufacturing jobs that does not support OMB's call for proposals for regulatory reform.
- 3) OMB's estimates of the costs and benefits of federal regulation for the period 1993-2003 are misleadingly incomplete and biased against regulation.

I. OMB's Comments on Regulation, Wages, and Economic Growth

OMB draws a connection between regulation on the one hand, and lower wages and lower economic growth on the other. The evidence OMB cites in support of this relationship is exceedingly weak. As for the relationship between regulation and economic growth in particular, OMB relies on studies that are either suspect according to its own assessment or that are palpably irrelevant to the kinds of regulatory programs OMB reviews. OMB compounds the problem by asserting that its own regulatory agenda, described in its 2002 Final Report, matches "fairly closely" the regulatory reforms praised in one of the studies on which it relies in purporting to identify an inverse relationship between regulation and economic growth. This assertion is false; the two agendas have essentially nothing in common.

A. OMB's comments on the relationship between regulation and wages are unsubstantiated and irrelevant

In a brief section of the Draft Report entitled “Impact on Wages,” OMB takes the position that the costs of social regulation, in particular occupational health and safety standards, are borne by employees. (Draft Report at 27.) The only citation OMB gives for this broad claim is a single quotation from one textbook in modern labor economics. (Draft Report at 27, n. 8.) Textbooks, of course, do not all agree with each other, and they do not represent peer-reviewed literature, the standard of proof that OMB requires in other areas. OMB cites no empirical evidence for its claim. OMB should exclude this claim from the Report unless it produces evidence for it. Moreover, if OMB does produce evidence for the claim, it should address the significant evidence that exists on the other side of the issue. For example, University of California-Berkeley economist David Card and Princeton University economist Alan Krueger have written widely on empirical studies of minimum wage laws, finding that – contrary to assumptions in many textbooks – moderate increases in the minimum wage have a zero to slightly positive effect on employment. Their work on the subject has appeared twice in the prestigious *American Economic Review*, and the book-length version has been published by Princeton University Press.¹

OMB goes on to state a tautology (“Viewed in terms of overall welfare, the regulatory benefits of health, safety, and environmental improvements for workers can outweigh their costs, assuming the regulation produces net benefits”), followed by a concession that in some cases workers might not be hurt by occupational health standards. They will likely be better off with such standards, OMB says, “if health benefits exceed compliance costs *and* such costs are not borne primarily by workers.” (Draft Report at 28 (emphasis added).) In fact, however, the conjunction is misplaced; workers will be better off if *either* of the conditions cited by OMB is true. If health benefits (which accrue to the workers themselves) exceed compliance costs, then even if workers bear the full cost of the regulation they obtain a net benefit. Furthermore, if workers do not bear the costs of the rule, then they will be better off with a rule that protects their health than they would be without such a rule. (Of course, workers may also be better off if workplace rules protect their lives and health, even if some of the costs are ultimately imposed on the workers themselves.)

In addition to the factual problems OMB manages to insert into this brief section, it is also very unclear why this section even exists in the Report. While it is true that OMB is charged with describing the effects of regulation on wages, OMB has chosen to discuss only one type of regulation – occupational health and safety – and to use its discussion to embrace, once again, cost-benefit analysis as a decision principle in

¹ See David Card and Alan B. Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton University Press 1995); David Card and Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania*, 81 *American Econ. Rev.* 772 (1994); and David Card and Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: A Reply*, 90 *American Econ. Rev.* 1397 (Dec. 2000).

regulatory matters. But the federal statute on occupational health and safety, the Occupational Safety and Health Act, does not permit cost-benefit analysis in standard-setting. See *American Textile Manufacturers' Institute v. Donovan*, 452 U.S. 490 (1981) ("Cotton Dust" case). Unless OMB has something more illuminating to say about the impact of regulation on wages, it should concede that it has nothing new to add this year and omit this section from the Report.

B. OMB's comments on the relationship between regulation and economic growth are misleading

OMB cites several studies in support of its conclusion that economic development is inversely related to regulation.

OMB concedes that the findings of two of the studies, one by the Heritage Foundation and the Wall Street Journal and one by the Fraser Institute, are flawed because they rely on "subjective assessments and survey results" and also because they include non-regulatory interventions in addition to direct regulation.

OMB's third study is "Doing Business in 2004, Understanding Regulation," conducted by the World Bank. The World Bank considered, as OMB states, "five of the fundamental regulatory aspects of a firm's life cycle: starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business." The World Bank found that some of the richest countries in the world were the least regulated along these dimensions. The World Bank also found, according to OMB, that "clearly defined and well-protected property rights enhance prosperity," and that rich countries regulate business consistently, unlike poor countries. (Draft Report at 30.) The United States is a rich country, one of the least regulated, according to the World Bank's study, and it also guarantees property rights and, through legal norms such as the equal protection clause, protects consistency in its treatment of business. Moreover, the kinds of regulation considered by the World Bank – such as enforcing contracts – are not the kinds of regulation typically reviewed by OMB. It is thus hard to see what the World Bank's conclusions have to do with OMB's role in reviewing regulation in the United States.

If, by citing the World Bank report, OMB means to suggest that the United States will prosper even more, the more regulations it cuts, then OMB has strayed far from the empirical evidence of the report in making this suggestion. OMB has cited no evidence to show that countries grow richer by chipping away at the kinds of regulations OMB likes best to chip – health, safety, and environmental protection. Indeed, a careful look at the World Bank study reveals that its broad comparisons embody some surprising assumptions. For instance, in comparing regulations affecting market entry, the World Bank assumes a business that, among other things, (1) "is not using heavily polluting production processes," (2) is not subject to industry-specific regulations, and that (3) is operating in the country's "most populous city."² Obviously, however, many of the rules

² The World Bank Group, *Doing Business: Methodology—Starting a Business*, available at <<http://rru.worldbank.org:80/DoingBusiness/Methodology/EntryRegulations.aspx>>.

reviewed by OMB pertain to heavily polluting industries which are subject to industry-specific regulations and which are not operating in New York City.

OMB also errs by equating wealth and well-being.³ If one looked at average infant mortality and average life expectancy at birth as alternative measures of well-being, one would make quite startling rearrangements in the rankings of countries according to well-being.⁴ The Human Development Index, created by the United Nations Development Program, was created to address this point; its annual rankings (based on a combination of income, life expectancy, and enrollment in education) show that the countries with the highest well-being are not always those with the highest money incomes. For 2001 (the latest available), the US ranks second in per capita income, but seventh in the Human Development Index, behind five European countries and Australia – all of which have noticeably lower incomes.⁵

Perhaps most absurdly, OMB uses the World Bank report to justify its own regulatory agenda. OMB states that its own proposals for reform match the World Bank's recommendation "fairly closely." One wonders on what theory OMB believes this. The World Bank's preliminary recommendations are ones the U.S. already has taken to heart: avoid unnecessary interference with competitive markets, enhance property rights, expand technology, reduce court involvement in business matters, and make reform a continuous process. These simple precepts are a far cry from cost-benefit analysis, peer review of agencies' findings, centralized executive oversight, and the like. In fact, OMB's intrusive process of agency oversight is, if anything, in tension with the World Bank's generalized warnings against excessive bureaucracy.

Finally, OMB cites a study (apparently unpublished) by Giuseppe Nicoletti, finding that, as OMB puts it, the relationship between "excessive regulation and economic performance" holds true even when the countries studied are limited to the 30 highest-income countries in the Organization for Economic Cooperation and Development (OECD). (Draft Report at 31.) According to this study, the United States is, behind Great Britain, the second-least-regulated country in the sample. OMB cites no evidence from the study that cutting regulations of the kind OMB commonly reviews – such as health, safety, and environmental regulation – will help the U.S. speed past Great Britain and become the least-regulated of all these countries, and thereby gain an even greater economic advantage over countries such as Greece (one of the most regulated of the countries studied).⁶

³ For an argument against such equation, see Robert R.M. Verchick, *Feathers or Gold? A Civic Economics for Environmental Law*, 25 HARVARD ENVIRONMENTAL LAW REVIEW 95, 109-15 (2001).

⁴ Testimony of Robert R.M. Verchick, Hearing on Regulatory Accounting, House Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, Committee on Government Reform (Feb. 25, 2004).

⁵ UNDP, Human Development Report 2003; rankings at http://hdr.undp.org/reports/global/2003/pdf/hdr03_HDI.pdf.

⁶ Although OMB characterizes Nicoletti's paper as a "major effort[] to determine the effect of regulatory policies on economic performance" (Draft Report at 31), we have been unable to locate this paper, cited by OMB in note 15 on page 31. It would be helpful if OMB could provide more information about this paper – including where to find it, whether it has been published, and whether it has been subject to peer review – in the final Report. Given OMB's insistence on the importance of peer review for the research relied upon

In short, OMB's brief excursion into the international literature on the relationship between regulation and economic performance has little or nothing to do with OMB's day-to-day regulatory business. Moreover, given the incompleteness of OMB's discussion, it does not even make for a good literature review. Not only does OMB fail to recognize alternative measures of well-being, as already noted, but it also fails to review a large literature that finds a positive correlation between levels of environmental regulation and per capita income.⁷ OMB misses other important contributions to the recent peer-reviewed literature, including: evidence that investment in Mexican industry has grown at a time when Mexican regulations were becoming much stricter, consistent with the "Porter hypothesis";⁸ the fact that growth is positively correlated with pollution reduction within the Los Angeles area;⁹ the intriguing discovery that restrictions on timber harvesting caused by protection of the spotted owl under the Endangered Species Act may have had net benefits for timber companies, by raising the value of their non-protected timber;¹⁰ and the demonstration that some occupational safety and health regulations increase productivity in manufacturing in Quebec.¹¹ In view of the one-sided and incomplete treatment of these issues in the draft, this The section should be omitted from the Report.

II. OMB's Call for a New Regulatory Hit List

In less than four years, the United States has lost almost 3 million manufacturing jobs.¹² Economists have linked these job losses to factors such as increased productivity, technological changes, and corporate tax policy, including corporate tax rates benefiting companies that send work overseas. The 2004 Economic Report of the President also blamed the recession, acknowledging that the recent economic downturn has been "particularly hard on manufacturing industries."¹³ Some economists have also cited free trade policies as a reason for job losses. Indeed, the head of President Bush's Council of Economic Advisers, N. Gregory Mankiw, has gone so far as to say that the "outsourcing" of U.S. jobs to overseas markets is the "latest manifestation of the gains from trade that

by other agencies, it would also be informative to know whether the other studies relied upon by OMB, especially the studies sponsored by the Heritage Foundation, Wall Street Journal, and Fraser Institute, were subject to peer review.

⁷ See, e.g., Dasgupta, S., A. Mody, S. Roy and D. Wheeler, 1995, "Environmental Regulation And Development: A Cross-Country Empirical Analysis," World Bank Policy Research Department Working Paper, No. 1448, March (examining data from 31 countries showing positive correlation between stringent air pollution regulations and per capita income), available at http://www-wds.worldbank.org/servlet/WDS_IBank_Servlet?pcont=details&eid=000009265_3970311121743.

⁸ Ebru Alpay et al., Productivity Growth and Environmental Regulation in Mexican and U.S. Food Manufacturing, 84 American J. Agricultural Economics 887 (Nov. 2002).

⁹ Matthew E. Kahn, Smog Reductions Impact on California County Growth, 40 J. Regional Science 565 (Aug. 2000).

¹⁰ Ted W. Chiles, Jr., and Joy Clark, Environmental Regulation and the Spatial Distribution of Capital and Resources, 29 Review of Regional Studies 51 (Summer 1999).

¹¹ Charles Dufour et al., Regulation and Productivity, 9 J. Productivity Analysis 233 (May 1998).

¹² Louis Uchitelle, Surge in Jobs Mostly Bypasses the Factory Floor, New York Times, p. C1 (May 11, 2004).

¹³ N. Gregory Mankiw, Remarks to the National Economists Club and Society of Government Economists (Feb. 17, 2004), available at www.whitehouse.gov/cea/economic_report-20040217.html.

economists have talked about” and “just a new way of doing international trade. More things are tradable than were tradable in the past and that’s a good thing.”¹⁴

Now comes OMB’s 2004 Draft Report, in which OMB purports to find a new culprit for the troubles besetting the manufacturing sector: government regulation. In Chapter II of the Draft Report, OMB invites proposals for reforms of regulations affecting the manufacturing industry. (Draft Report at pp. 56-57.) One would have hoped that given OMB’s past experience with inviting such a regulatory “hit list,” it would have learned its lesson and not repeat its past errors in judgment. As we discuss, however, not only has OMB failed to learn from past mistakes; it has, in the Draft Report, called for a new hit list based on the skimpiest of evidence that reform to regulations affecting the manufacturing industry will cure the problems that ail the industry.

A. OMB’s Experience With Hit Lists

In 2001, OMB invited commenters on its annual Report to suggest regulations that were in need of reform. Industry obliged by submitting 71 proposals for reform. Of these 71 proposals, 44 were submitted by the Mercatus Center at George Mason University (Mercatus). (67 Fed. Reg. 15022) Mercatus, which is perhaps best described as a conservative think-tank, is funded primarily by industries that are directly regulated by the rules that were targeted, including Enron, International Paper, the American Chemistry Council, and David Koch, the Executive Vice President and member of the board of Koch Industries, a company with interests in refining, asphalt, natural gas, gas liquids, chemicals, plastics, chemical technology equipment, minerals, fertilizers, ranching, and financial businesses. (For additional information, see <http://www.kochind.com>.)

In response to these self-interested suggestions, OMB prioritized the proposals by ranking them from one through three. (67 Fed. Reg. 15022) Twenty-three regulations were ranked one, or “high priority,” on the basis of skeletal, summary statements by Mercatus and others who nominated them. (Appendix B to *Draft 2002 Report*, 67 Fed. Reg. 15036-37; see also Mercatus’s one-page submissions, available in the OIRA reading room.) OMB put covered agencies and departments through their paces on these priority items, prompting many to take action on the skeletal complaints offered by the nominators. This approach not only distorted agencies’ priority-setting process on the basis of the limited information provided to OMB, but it also took up agency resources that could have otherwise been devoted to the development of other proposals. OMB’s first hit list has had a real impact, serving to spread the powerful impression throughout the federal government that OMB is an escape valve for disgruntled industries that have been unable to achieve their deregulatory ends through other, more transparent means.

Despite our request that it do so, OMB never did explain how it chose the rules that made the first hit list. OMB’s call for a new hit list, specifically targeted to rules affecting the manufacturing sector, repeats this same mistake. Although OMB directs

¹⁴ Jonathan Weisman, Bush, Adviser Assailed for Stance on ‘Offshoring’ Jobs, Washington Post, p. A6 (Feb. 11, 2004).

commenters to “consider” certain factors (such as the feasibility of cost-benefit analysis, agency authority for any reforms, consistency with free trade policies, and the importance of the programs in question) in nominating programs for reform (Draft Report at pp. 56-57), OMB does not provide any specific, written guidance as to how it will “evaluate the reform nominations.” (Draft Report at p. 57.) OMB seems unable to follow its own, oft-cited precepts about transparency in, and objective criteria for, government policymaking.

B. OMB has not justified its call for a new hit list

OMB precedes its call for a new hit list with a discussion of regulatory costs imposed on firms in general, and on manufacturing firms in particular. OMB also discusses the effects of regulation on the competitiveness of U.S. firms, focusing especially on plant location decisions. OMB’s discussion of both regulatory costs and competitiveness is one-sided and incomplete. Moreover, as a prelude to the call for a new regulatory hit list, the discussion amounts to a giant non sequitur. Nothing in OMB’s discussion paves the way for regulatory reform in the manufacturing sector.

There are many problems with OMB’s discussion and with its call for a new hit list. We discuss the most significant here.

Definition of manufacturing. OMB defines manufacturers as “establishments engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products.” (Draft Report at p. 50.) The definition is so broad as to include a large portion of American industry, including, perhaps, even service industries. As N. Gregory Mankiw suggested in remarks on the 2004 Economic Report of the President, even making a hamburger in a fast food restaurant might be deemed manufacturing under a broad definition of that term. As Mankiw pointed out, “the blurriness of the definition would matter if policies were based on it.”¹⁵ Now that OMB is proposing to shape policies specifically for the manufacturing sector, it matters a great deal how OMB defines the term. OMB’s broad definition threatens to encourage all manner of American businesses to come to OMB with special pleadings about the burdens of regulation on their interests. The manufacturing hit list thus threatens to become a deregulatory free-for-all.

No mention of regulatory benefits. Although OMB concedes that it is not enough simply to cite regulatory costs in deciding whether an industry sector is overly burdened by regulation (Draft Report at 50, 51), it does not discuss the benefits of regulations that are imposed on the manufacturing sector. Rather, based on limited data on regulatory costs, OMB jumps to the conclusion that there must be a need for a new regulatory hit list specifically tailored to this industry sector. The conclusion is unwarranted based on the skimpy data OMB provides.

For the same reason, OMB’s new “time series” analysis of regulatory costs (Draft Report at p. 51) is uninformative. To hear that regulatory costs have increased tells the

¹⁵ See Mankiw Remarks, cited in note 13, *supra*.

public nothing about what those costs have bought us. This is the message OMB elsewhere constantly preaches; OMB should heed its own message here.

No recognition of relative contribution of manufacturing to environmental problems. Based on a study by Crain and Hopkins (2001), OMB concludes that the burdens of regulation, particularly environmental regulations, fall most heavily on the manufacturing sector. (Draft Report at 52.) Crain and Hopkins made this finding based on a 1990 study by Michael Hazilla and Raymond Kopp, which undertook a general equilibrium analysis in estimating regulatory costs.¹⁶ For environmental regulations, Hazilla and Kopp's study focused exclusively on air and water pollution regulation.¹⁷ They found that 99 percent of the costs of such regulation were imposed on the manufacturing and "other" sectors (which include the mining, oil and gas, and electric utility sectors). They found no environmental costs (*zero*) for the trade sector, and 1 percent of the total costs imposed on the services sector.¹⁸

If one focuses on air and water pollution regulation (especially at the stage when Hazilla and Kopp did their study – almost 15 years ago), it comes as no surprise that the manufacturing and energy sectors would incur the overwhelming majority of environmental regulatory costs. Most of the air and water pollution in this country *comes from* these sectors. Yet OMB seems to want to use the Crain and Hopkins study, and by extension the dated Hazilla and Kopp study, as evidence that manufacturing is bearing a disproportionate burden when it comes to the costs of environmental protection. But there is nothing disproportionate about this burden if manufacturing produces a large portion of the environmental problems studied by Hazilla and Kopp. OMB should not use these dated statistics, in this misleading way, in its Report.

Incomplete set of studies. OMB's review of the literature on regulatory costs is incomplete and almost wholly one-sided. For example, OMB fails to discuss or even cite the following important studies of regulatory costs: Thomas O. McGarity and Ruth Ruttenberg, *Counting the Cost of Health, Safety, and Environmental Regulation*, 80 Texas L. Rev. 1197 (2002); Ruth Ruttenberg & Associates Inc., *Not Too Costly, After All: An Examination of the Inflated Cost-Estimates of Health, Safety, and Environmental Protections* (report prepared for Public Citizen, Feb. 2004); Nicholas A. Ashford and Charles C. Caldart, *Technology, Law, and the Working Environment* (Island Press 1996); Eban Goodstein, *Polluted Data*, American Prospect (Nov.-Dec. 1997); Eban Goodstein, *The Trade-Off Myth: Fact and Fiction About Jobs and the Environment* (Island Press 1999). International literature making the same point includes a study commissioned by Environment Canada (*A Retrospective Analysis of Control Measures for Chlorinated Substances*, prepared for Environment Canada by Cheminfo Services, March 2000), and a study from a European nonprofit organization, examining both American and European

¹⁶ Crain and Hopkins (2001) at p. 18, citing Michael Hazilla and Raymond Kopp, *The Social Cost of Environmental Quality Regulations: A General Equilibrium Analysis*, 98 *Journal of Political Economy* 853 (1998).

¹⁷ See Robert W. Hahn and John A. Hird, *The Costs and Benefits of Regulation: Review and Synthesis*, 8 *Yale J. on Regulation* 233, 272 (1991) (discussing Hazilla & Kopp study).

¹⁸ See Crain and Hopkins (2001), at p. 18.

examples (Cry Wolf – Predicted Costs by Industry in the Face of New Regulations, from the International Chemical Secretariat, www.chemsec.org). OMB should do its homework, and incorporate the findings of these studies into the discussion in its Final Report.

Casual rejection of Porter hypothesis. OMB does cite one study that departs from its pre-analytic vision of excessive regulatory costs: Porter and Van de Linde (1995). Michael Porter, a professor at the Harvard Business School, has become well known for the so-called “Porter hypothesis,” the idea, as OMB says, that well-designed environmental regulations can improve competitiveness. (Draft Report at 53.) OMB quickly asserts, however, that “most economists are resistant to this idea, since it implies that firms are not pursuing profitable activities without the help of government intervention.” (Draft Report at 53.) OMB should not use the intuitive prejudgments of “most economists” (unidentified here) to undermine Porter’s empirical studies of the potentially competition-enhancing effects of regulation. OMB also cites the Morgenstern et al. paper (2001) in claiming that the paper “found no empirical support for the claim that environmental regulation is overall cost saving.” (Draft Report at 53.) But this claim is unresponsive to Porter’s point. His point is not that regulation is “overall cost saving” – that is, cost saving in all instances, or across the board – but that well-designed environmental regulation can enhance competitiveness. OMB’s economists might themselves be personally “resistant” to Porter’s ideas, but this should not prevent them from taking a clear-eyed, professional look at the actual evidence on the effects of regulation on competition.

Reliance on Crain and Hopkins (2001). OMB relies heavily on a 2001 study by Crain and Hopkins. OMB uses the Crain and Hopkins study directly in asserting that manufacturing bears an extra large burden in regulatory costs. (Draft Report at 52.) OMB uses this study indirectly in suggesting that “recent” evidence of the effect of regulation on competitiveness indicates that regulation may now be having a more pronounced effect on international competitiveness. The study cited for this latter claim is a report by Leonard (2003), sponsored by the National Association of Manufacturers. (Draft Report at 56.) Leonard relies on the Crain and Hopkins study for its estimates of regulatory costs imposed on the manufacturing sector.¹⁹ The recentness of the Leonard study is, however, an illusion caused merely by its date of publication. The crucial data points in the Crain and Hopkins study on which Leonard relies – data points including the costs of environmental regulation and the allocation of costs to industry sectors such as manufacturing – are from studies done years ago. The costs of environmental regulation, used by Leonard and drawn from Crain and Hopkins, come primarily from Hahn and Hird’s 1991 study, which in turn used Hazilla and Kopp’s 1990 general equilibrium study.²⁰ Likewise, the allocation of regulatory burdens to the manufacturing sector – reported in Crain and Hopkins and relied upon in Leonard – comes, as we have noted, from the 1990 Hazilla and Kopp analysis. Note, too, that Crain and Hopkins report that

¹⁹ Jeremy A. Leonard, How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness (Prepared for The Manufacturing Institute of the National Association of Manufacturers) (2003), at 18.

²⁰ See Crain and Hopkins (2001) at p.8, citing Hahn and Hird (1991).

they deliberately chose a high-end cost estimate because they thought regulatory costs were usually underestimated in advance of regulation²¹ – a conclusion at odds with the many studies documenting *ex ante* overestimation of regulatory costs.

Tracing the origins of the National Association of Manufacturers’ “recent” findings on regulation and competitiveness is enough to make the head spin. But once one expends the effort to do this – as OMB perhaps has not – one discovers that the only thing “recent” about this research is the publication date of the NAM report.

Disconnect between OMB’s findings and its call for a hit list. OMB’s discussion of regulatory costs does not justify a regulatory hit list because, as noted above, OMB nowhere explains what the regulations might have produced in return for imposing costs. Moreover, its discussion is incomplete and one-sided. OMB’s discussion of the effect of regulation on international competitiveness is even less tied to its call for a new hit list. OMB spends some time explaining that there is little good evidence that free trade policies have led firms to relocate firms overseas (creating “pollution havens”). (Draft Report at pp. 55-56.) Nevertheless, based on the single study sponsored by the National Association of Manufacturers,²² which reaches an implausible conclusion (US labor costs due to regulation have been rising rapidly, despite the apparent lack of new regulations, and are now higher than in other industrial countries, despite the widespread belief that Europe and Japan have more stringent regulatory regimes overall), OMB continues on its merry way to calling for a regulatory hit list for the manufacturing sector. (Draft Report at p. 56.)

OMB follows this one citation with a ludicrously inaccurate discussion of the European Union’s proposed new chemicals policy, first describing the draft circulated last October as a policy that has been “adopted” (in fact, the EU is not expected to make a final decision on this proposed policy until 2006), then making the mathematically impossible claim that a switch from an unspecified other standard to a 7% discount rate would more than triple the estimated cost of the policy. (EU analyses use lower discount rates; so a switch to a 7% rate should lower the estimated cost of a multi-year policy.) OMB then notes that this information has “generally not yet [been] captured in the literature” (Draft Report at p. 56), a fact that may reflect the lack of plausibility and factual accuracy in OMB’s account.

Moreover, OMB fails to explain why the alleged impact of regulation on manufacturing only appeared in 2001. During the 1990s, US manufacturing faced approximately the same regulatory burden as in the last few years, yet in the economic expansion of the 1990s, the US grew faster than other developed countries and manufacturing expanded. It is difficult to use the same regulatory burden to explain a more recent decline, when it was consistent with an earlier expansion. Was there a large-scale change in regulations that made them become more onerous in 2001? If so, it

²¹ Crain and Hopkins at 9.

²² It would, again, be informative if OMB were to indicate in its Final Report whether Leonard’s 2003 report for the National Association of Manufacturers, on which OMB relies in justifying a hit list (Draft Report at 56), has been published or subject to peer review.

should be identified and explicitly discussed. Did other policies of the 1990s make it possible to offset or reverse the hypothesized harmful effects of regulation? If so, would a return to such policies be a viable alternative to massive deregulation? Lacking any such explanation, many observers would conclude that the idea that contemporary regulations cause great economic harm is simply refuted by the historical experience of the 1990s.

III. OMB's Estimates of the Costs and Benefits of Federal Regulation

The aggregate estimates of the costs and benefits of federal regulation in the 2004 Draft Report are so pervaded by biases, and so riddled by error, that they are virtually worthless as an indicator of the general wisdom of current approaches to federal regulation. These biases and errors surface in OMB's estimates of costs and benefits; in OMB's decisions about what types of federal programs to exclude from cost-benefit review; and in OMB's choices about which federal regulations to exclude from its cost-benefit tables.

A. OMB's Underestimation of Regulatory Benefits

In previous comments, the Center for Progressive Regulation has remarked upon OMB's pronounced tendency to underestimate the benefits of health, safety, and environmental protection. Unfortunately, OMB continues this record with its 2004 Draft Report. We discuss several examples here.

EPA's CAFO Rule. In this Draft Report, OMB reports that only one new EPA rule reflects quantified and monetized costs and benefits: this is the rule regulating concentrated animal feeding operations ("CAFOs") under the Clean Water Act. OMB reports that this rule produced monetized benefits of \$204-355 million per year, and costs of \$335 million per year. In this estimate, OMB has committed a large error. As EPA makes clear in the preamble to its rule,²³ the benefits range of \$204-355 million per year applies only to *large* CAFO operations.²⁴ The benefits for medium and small CAFO operations were not, EPA reports, quantified in time to be included in the agency's estimates.²⁵ The cost figure of \$335 million, however, applies to *all* CAFOs – large, medium, and small.²⁶ Thus OMB has reported a range of benefits that applies only to a portion of CAFOs, while reporting a cost estimating that applies to all CAFOs – thereby inflating the apparent costs in comparison to the benefits. The number that OMB should compare to the benefits range for large CAFOs is the cost of the rule for large CAFOs, which EPA estimates to be \$283 million per year.²⁷

²³ The cite for the preamble to the CAFO rule is 68 Fed. Reg. 7176, not 7175 as OMB reports (see Table 4, p. 15, of 2004 Draft Report). Other rules are also given inaccurate citations in OMB's Draft Report. The New Source Review rule cited at p. 3, n. 4, is located at 68 Fed. Reg. 61248, not 61247 as reported by OMB. The cite for FDA's rule on trans fat labeling is 68 Fed. Reg. 41434, not 41433.

²⁴ 68 Fed. Reg. 7176, 7234, Table 7.1.

²⁵ *Id.*

²⁶ *Id.* at 7242.

²⁷ *Id.*

Moreover, as is often the case, OMB duly reports on the long list of unmonetized benefits while at the same time opining about the likely effect of such benefits on the cost-benefit profile of the rule if the benefits were monetized. (2004 Draft Report, p. 15 Table 4, “other information” on CAFO rule.) If OMB has evidence to permit it to conclude that monetizing the reduction of eutrophication and pathogen contamination of coastal and estuarine waters would “significantly affect the benefits estimate if monetized,” OMB should describe that evidence. Likewise, OMB should explain how – if these benefits have not been monetized – it is able to conclude that the other unmonetized benefits of the CAFO rule would not significantly affect the benefits estimate for the CAFO rule if they were monetized.

Gasoline costs. Several of the rules whose costs and benefits are reflected in the Draft Report reduce fuel costs for operation of automobiles and other engines. OMB estimates gasoline prices of \$1.10-1.30 per gallon. (2004 Draft Report at p. 34.) OMB should explain whether this estimate remains valid at this time, when gas prices have reached historically high levels. Increasing the estimate of the price of gasoline would have the effect of increasing estimates of benefits for rules (such as fuel efficiency rules) that save gasoline.

Use of Discounting. In this Report, OMB continues its bizarre use of the technique of discounting. We disagree, in general, with the practice of discounting the benefits of health, safety, and environmental regulation.²⁸ But OMB manages to make this controversial practice even more problematic than it needs to be. We cite two examples here. First, in this Draft Report, OMB reports on the benefits of FDA’s rule requiring the labeling of trans fatty acids in food. (Draft Report at 17.) One must dig deep into FDA’s explanation of its rule, however, to find the strange and problematic use of discounting in estimating the benefits of this rule. For one thing, one of the ways FDA measured benefits was to look at the life-years saved by its rule. Rather than simply tallying the life-years saved, however, FDA discounted the life-years saved from the year in which they would have been lived. We have criticized this practice in the past (see CPR’s comments on last year’s Draft Report), as the practice has the effect of concluding that no person ever loses the full measure of a life. Indeed, according to this analysis, a three-year-old child with 75 expected life-years remaining would lose only about 14 years of life if she died today. FDA compounded this problem by then discounting benefits *again* in monetizing the value of life-years saved. (See FDA’s preamble to its rule for a detailed discussion of its methodology.) OMB should not condone this “double-discounting” of regulatory benefits.

Another example of an especially problematic use of discounting comes from the terrorism-related measures cited in OMB’s Draft Report. (Draft Report at 11-12.) In estimating the benefits of these measures, the Coast Guard tried to estimate (through reliance on the subjective judgments of experts) the number of “risk points” reduced by these security measures. Once these risk points were determined, they were discounted at 7 percent according to OMB’s instructions on discounting. But “risk points” are merely

²⁸ For more detailed discussion, see Frank Ackerman and Lisa Heinzerling, *Priceless: On Knowing the Price of Everything and the Value of Nothing* (The New Press 2004), chapter 8.

points in a continuum of security, designed to judge how much more secure a terrorism-related precaution might make us. OMB should explain why it is appropriate to discount such points according to its estimate of the prevailing rate of return on financial investments.

Value of Life. In the Draft Report, OMB offers a new estimate, or rather range of estimates, for the value of human life: \$1 million to \$10 million. OMB bases this new range of estimates on two recent meta-analyses reviewing the literature on the value of statistical life. (2004 Draft Report at p. 36.) Given the large range OMB has now embraced, and the large effect it has on OMB's benefits estimates for a variety of rules (2004 Draft Report at pp. 36-37), OMB should explain in more detail why it has chosen this range. In particular, OMB should explain why it chose the lower end of the values found in the Mrozek and Taylor (2002) analysis, when the authors themselves cite a likely value of \$2 million in 1998 dollars. (See Mrozek and Taylor (2002), version posted on Taylor's website, at p. 24.) OMB should also explain, in technical detail, whether Mrozek and Taylor's, or Viscusi's alternative meta-analysis, is the more reliable. It is not acceptable for OMB just to throw up its hands and offer a range of estimates that are an order of magnitude different from each other, and to mistakenly label its range of estimates (produced from two different studies) a "confidence interval." (2004 Draft Report at 36.) Without the kind of explanation we seek, one fears that OMB is once again – as it did when it required EPA to use the ill-fated "senior death discount" in analyses prior to last spring – leaving no stone unturned in search of methodologies and studies which reduce the value of human life.

B. OMB's Arbitrary Exclusion of Deregulatory Actions from Cost-Benefit Review

Once again this year, OMB excludes from this year's Draft Report analysis of some of the most high-profile agency activities of the recent past: that is, actions taken to reduce regulatory requirements for private industry. By subjecting regulatory actions to cost-benefit review, but allowing deregulatory actions a free pass, OMB exhibits its clear bias toward deregulation and against government intervention.

This bias is nowhere clearer than in OMB's approach to EPA's "reform" of the Clean Air Act's New Source Review ("NSR") program. In its 2001 Report, OMB published its now-infamous "hit list" of 23 regulations, targeted by OMB for reform. The New Source Review program was one of those that made OMB's hit list. (2001 OMB Report at p. 102.) OMB at the time provided no explanation as to how it chose the rules on its list, and, as we noted above, has to this day provided no such explanation, despite calls from commenters (including the Center for Progressive Regulation) for an explanation. All OMB has done in subsequent reports is to report on the progress of "reform" of the rules on the hit list. (2003 Final Report, Appendix C, p. 116.) Thus OMB targeted the NSR program for reform without ever explaining why it was doing this.

Equally remarkably, OMB reviewed the ultimate reforms adopted by EPA without ever requiring the agency to conduct a cost-benefit analysis of those reforms. On

December 31, 2002, EPA issued its first rule weakening the NSR program.²⁹ In the preamble to the rule, EPA briefly discussed Executive Order 12866, and stated that it had submitted the rule to OMB for review because OMB had concluded that the rule was a “significant regulatory action.”³⁰ Period, the end. OMB did not require EPA to conduct a cost-benefit analysis of the NSR reforms. In response to comments on the reforms, EPA stated that no Regulatory Impact Analysis (RIA) was required for the rule because OMB “has determined that the final rule is significant for novel policy reasons but not for economic reasons.”³¹ Similarly, EPA declined to conduct an RIA in response to a commenter’s claim that the NSR program in its unrevised form produced benefits 7-10 times greater than costs.³²

EPA issued a second set of NSR “reforms” in October 2003.³³ Much as with the first set of reforms, OMB designated the second NSR rule as “economically significant” and subject to its review.³⁴ In its brief discussion of Executive Order 12866, however, EPA did not refer to any RIA prepared by EPA for this rule.³⁵ In addition, EPA specifically stated that its second reform of the NSR program was not subject to the requirement of a cost-benefit analysis under the Unfunded Mandates Reform Act of 1995, essentially because its action was deregulatory rather than regulatory.³⁶

In its 2004 Draft Report, OMB explains that it does not include the NSR reforms in its estimate of regulatory costs and benefits because EPA’s second rule was stayed by the D.C. Circuit on December 24, 2003. (Draft Report at p. 3, n. 4.) The D.C. Circuit did not, however, stay EPA’s first set of NSR reforms.³⁷

At the very least, therefore, OMB should include EPA’s first set of NSR reforms in this year’s regulatory calculations. When it does so, of course, OMB will have to explain the awkward fact that it did not require for this rule the kind of cost-benefit analysis it has so assiduously required for regulatory (rather than deregulatory) actions. Moreover, because the New Source Review program limits emissions of the air pollutants whose regulation has produced such astonishingly positive cost-benefit ratios (see 2004 Draft Report at 7), OMB will have to explain why it signed off on a weakening of a program that likely would have produced benefits far in excess of its costs.

Better still, however, OMB should also include EPA’s second set of NSR reforms in its calculations. There is no way to know whether the D.C. Circuit will ultimately

²⁹ EPA, Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NSR): Baseline Emissions Determination, Actual-to-Future-Actual Methodology, Plantwide Applicability Limitations, Clean Units, Pollution Control Projects; Final Rule, 67 FR 80186 (Dec. 31, 2002).

³⁰ *Id.* at 80241.

³¹ EPA, Technical Support Document for the Prevention of Significant Deterioration and Nonattainment Area New Source Review Regulations, at II-7-1 (Nov. 2002), available at http://www.epa.gov/ttn/nsr/rule_dev.html.

³² *Id.* at II-7-2.

³³ 68 Fed. Reg. 61248.

³⁴ *Id.* at 61274.

³⁵ *Id.*

³⁶ *Id.* at 61275-61276.

³⁷ See *New York v. EPA*, 2003 U.S. App. LEXIS 26520 (D.C. Cir. 2003).

uphold these reforms, and an analysis of EPA's second set of reforms would give the public a more balanced idea of EPA's actions in the recent past. In addition, OMB has in the past included in its analysis rules subject to an injunction by a court. (See *Stimulating Smarter Regulation*, at 50, Table 9 (listing costs and benefits of roadless area conservation rule); *id.* at 104 (noting that the implementation of this rule had been enjoined by a federal district court).) Here, too, of course, if and when OMB discusses the costs and benefits of the second wave of NSR reforms, OMB will be faced with the awkwardness of having failed to require of EPA the kind of analysis it routinely requires for regulatory actions.

C. OMB's Arbitrary Exclusion of "Regulations Implementing Federal Budgetary Programs" (i.e., "Agency Transfer Rules") from Cost-Benefit Review

The 2004 Draft Report does not report the costs and benefits of what it now calls "regulations implementing federal budgetary programs," or rules that transfer money from the federal government to private parties. In previous Reports, OMB called such rules "agency transfer rules." (See, e.g., *Final 2004 Report*, at pp. 14-15.) The 2004 Draft Report does not list such rules if they were issued prior to October 1, 2002; it lists such rules only if they were issued subsequent to that date. For the transfer rules issued between October 1, 2002, and September 30, 2003, OMB provides only a brief description of the rules without any estimate whatsoever of their economic costs or benefits. (2004 Draft Report at p. 20, Table 5.) In its 2003 Final Report to Congress, OMB explained in a footnote why it had not analyzed the costs and benefits of transfer rules: "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." (OMB Final 2003 Report, at p. 6 n. 6.)

The transfer rules listed in Table 5 of the 2004 Draft Report include many very expensive government programs. The money spent on these programs is not available for other purposes. The expenditures associated with these programs are therefore opportunity costs in the classic sense; if, for example, the federal government did not spend almost \$1 billion in 2002 to pay peanut farmers to buy out their government quotas (see third item in Table 5, 2004 Draft Report at p. 20; for cost estimate, see <http://www.ewg.org/farm/>), it would presumably have that \$1 billion to spend on something else. In its new guidelines for cost-benefit analysis, OMB makes clear that a basic purpose of conducting cost-benefit analysis is to assess the opportunity costs of federal government programs. (Circular A-4, at pp. 17-19.) In addition, these guidelines explicitly require agencies to analyze the distributional effects of transfer payments. (Circular A-4, at p. 11.) OMB's complete failure to identify, much less analyze, the opportunity costs and distributional consequences of the agency transfer rules in Table 5 flouts OMB's own official policy statements.

Furthermore, OMB has provided no principled definition of what constitutes a transfer rule. Technically speaking, the transfer rules that lie outside the scope of conventional cost-benefit analysis are those rules that do not attempt to change, or have

the effect of changing, the nature or level of economic goods or services provided by private economic actors. They simply transfer money from one entity to another after market actors have chosen the nature and level of goods and services to be provided.

The agency rules OMB includes within the category of transfer rules do not all meet this definition. For example, OMB includes as transfer rules agricultural subsidy programs that clearly affect the nature and level of agricultural goods provided in this country. There can be little doubt, for example, that the agency rules associated with the 2002 farm bill's cotton programs (listed in Table 5, 2004 Draft Report) will affect the production of cotton and thus affect the primary behavior of market actors. Yet OMB provides no explanation as to why these rules are transfer rules" rather than rules that would otherwise be subject to economic analysis. If the federal government chose to affect cotton production through more conventional regulation – such as, for example, the tightening of environmental standards for cotton production – then the costs associated with that regulation would appear in OMB's cost-benefit tables. It is purely arbitrary to characterize rules such as the cotton program rules as transfer rules simply because they affect market actors' behavior through subsidies rather than through government commands.

Indeed, OMB recognizes as much when it singles out NHTSA's rule on the operation of motor vehicles by intoxicated persons for special discussion. Here, OMB acknowledges that the "clear goal" of this transfer rule is to "inspire State-level laws and regulations with public health and safety goals similar to the Federal rules reported in the other sections of this chapter." (2004 Draft Report at 20.) However, OMB does not draw the obvious conclusion from this observation: many of the transfer rules listed in Table 5 have the same effect as the rules for which OMB insists agencies prepare cost-benefit analyses. Yet not only does OMB fail to require cost-benefit analysis for such transfer rules; it does not even bother to tell us the cost of such rules.

Equally fundamental, OMB's decision not to examine the costs and benefits of transfer rules exposes the general poverty of OMB's analytical methodologies. Transfer programs – especially those in which the government takes money from general revenues and gives it to a specific person or entity – are filled with potential for waste and special-interest deal-making. They offer an opportunity, moreover, for the rich to get richer at the taxpayer's expense. In the Peanut Quota Buyout Program, for example, it is estimated that the largest peanut farmers will get the most money from the program. (For information about the program, see <http://www.ewg.org/farm/peanuts>.) Even if this were indeed a true transfer program – one which had no effect on the market behavior of peanut farmers – it should nevertheless be relevant, as a matter of public policy, that money is being transferred from the relatively worse off (consider the average taxpayer) to the relatively better off (the biggest peanut farmers get the most money). OMB's muteness in the face of this transfer reflects the general inability of cost-benefit analysis to take the distributional effects of government programs into account in adjudging their wisdom. Even so, to have OMB wash its hands of review of this kind of program, which in this case is predicted to have cost taxpayers almost \$1 billion in 2002, and to turn its

steely gaze instead on air pollution rules that seem to be the best regulatory bargain of all, reflects a massive failure of OMB to set sensible priorities for its own oversight activities.

Perhaps OMB will respond by suggesting that it has no authority to question the priorities reflected in, for example, agricultural subsidies that go predominantly to the richest farmers. Here, it suffices to observe that OMB has displayed no such reticence when it comes to questioning the priorities embodied in health, safety, and environmental legislation.

At the very least, OMB should provide: (1) a clear definition of what it means by agency transfer rules; (2) an explanation of why the rules listed in Table 5 meet this definition; (3) a listing of the economic costs of the transfer rules it deems inappropriate for cost-benefit analysis, so that the reader of this Report might at least be able to judge the relative expense associated with the transfer rules OMB does not choose to analyze and the social regulations it does; and (4) as required by its own proposed cost-benefit guidance, an analysis of the distributional effects of these transfer rules.

OMB will undoubtedly recognize the foregoing comments. The Center for Progressive Regulation provided the very same comments in response to OMB's 2003 Draft Report. OMB's response was to concede that there was "merit to this request" and to say that it was "considering the feasibility of providing [better information on transfer rules] in future reports." (2003 Final Report, at p. 17.) Yet what has OMB done this year? Merely renamed "transfer rules" as "regulations implementing federal budgetary programs." No one should be fooled by OMB's semantics. The programs discussed at pp. 20-21 of the Draft 2004 Report are transfer rules. OMB should, according to its own guidelines to agencies, analyze the distributional effects of such programs. OMB has, once again, failed to do so. OMB's continued failure to live up to its own rules is inexcusable.

D. OMB's Arbitrary Exclusion of Highly Efficacious Rules from its Estimates of the Costs and Benefits of Federal Regulations

Even where information about a rule's costs and benefits is available, OMB sometimes arbitrarily excludes this information from its estimates of the costs and benefits of federal regulation. These exclusions, though arbitrary, do serve one (illegitimate) purpose: because the rules excluded were highly efficacious, their exclusion from OMB's aggregate estimates of the costs and benefits of federal regulation makes those aggregate estimates look less favorable to regulation than they would with these programs included.

For example: OMB excludes from this year's cost-benefit totals EPA's program to control emissions that cause acid rain. OMB explains that "[t]his rule fell in the time period of 1992 to 1993 and therefore is not included in this year's report totals." (2004 Draft Report at p. 5.) But the rule continues to have substantial effects, imposing both costs and benefits. To exclude such a rule from a table that purports to describe the current "annual benefits and costs of major federal rules" (Table 2) is misleading.

In sum, OMB has arbitrarily excluded rules from its estimates of costs and benefits – and has done so in a manner that paints regulation in a less favorable light than if those rules were included.

The Center for Progressive Regulation has commented on each of OMB's annual Reports since the Center was founded in 2002. Many of the comments we made two years ago, and last year, we make again today. Often OMB has not even seen fit to provide a meaningful response to comments made by parties such as the Center. We hope that OMB will be more responsive in this year's Final Report.

Sincerely,

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