

June 16, 2004

Dr. John Graham
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Office of Management and Budget
Washington, D.C. 20503

**Re: Peer review comments on 2004 Draft Report on
Costs and Benefits of Federal Regulations.**

Dear Dr. Graham:

As requested in your letter of May 7, please accept my comments on OMB's 2004 *Draft Report on the Costs and Benefits of Federal Regulations* for consideration as part of OMB's peer review process for this document.

As a first matter, I would like to commend you and the staff of the Office of Information and Regulatory Affairs for preparation of this comprehensive report. The task, as prescribed by statute, is a daunting one. This annual publication is a potentially very useful document and a key tool for informing the public and policymakers on the scope and impact of the federal regulatory system. OIRA and its staff are also to be commended for their efforts, described in this draft report, toward strengthening the federal government's regulatory processes over the past year.

That said, there are a number of improvements that should be made to make the report more useful to policymakers and the public, and to ensure that its conclusions are more complete and accurate.

One of the primary purposes of this report, as specified by statute, is the submission of an "accounting statement" on regulation, estimating the total annual costs and benefits of federal regulation 1) in the aggregate, 2) by agency and program, and 3) by major rule.

This is no easy task. Regulatory accounting is still an evolving, and as yet imperfect discipline, making precise and accurate estimates of costs and benefits difficult. Moreover, resource and institutional constraints further limit OIRA's ability to itself analyze and quantify the costs and benefits of regulation.

Problems with accounting statement. In the 2004 draft report, as in previous reports, OIRA's totals were based on regulatory analyses conducted by the agencies promulgating each regulation. While arguably meeting the statutory requirements, the numbers produced are incomplete, and potentially misleading. Among the problems:

- 1. Only major and economically significant rules are included.** The report excludes non-major, non-economically significant rules (essentially those with impacts of less than \$100 million) from consideration. Benefit-cost analyses are typically not performed by agencies for such rules. OIRA states that it believes "that the costs and benefits of major rules capture the vast majority of the total costs and benefits of all rules *subject to OMB review*" (*emphasis added.*) The statute, however, does not limit the accounting statement to rules subject to OMB review. Perhaps, more importantly, there is no factual support for the statement. It may very well be true – but no evidence is provided either way.
- 2. Even among major rules, only a fraction of the costs and benefits are included.** For fiscal 2003, quantified and monetized costs and benefits were available, and thus were included in OIRA's total for only six of 12 major rules reviewed by OIRA. Another two major rules did not undergo OIRA review, and did not have quantified benefits, although costs were quantified.
- 3. The listing of independent agency rules is incomplete.** The draft report states that there were seven major rules issued in fiscal 2003 by independent agencies not subject to OIRA review. Of these only one had monetized benefits. However, this list – based on data maintained by the General Accounting Office pursuant to the Congressional Review Act – is itself incomplete. This is because rules promulgated under authority of the Telecommunications Act of 1996 are, by statute, excluded from the GAO database. As a result, at least two additional major final rules – the Federal Communications Commission's modification of media ownership rules and its revision of local telephone access rules – were excluded in fiscal 2003 alone. Neither costs nor benefits were calculated for either of these rules. Thus, in total, monetized costs and benefits were calculated for only 7 of at least 23 major rules promulgated in fiscal 2003.
- 4. The studies used are inconsistent in their methodologies.** OIRA staff, according the draft report, made minimal changes to the estimates provided by in agency benefit-cost analyses. For the most part, the changes were limited to such things as restating costs and benefits in annualized form, and making adjustments for inflation. However, many other inconsistencies in methodology were not reconciled. For instance, different discount rates were apparently applied in many studies. As the draft report itself states, because of different methodologies used by agencies, and gaps in the available data, the aggregation of numbers may not be "meaningful."
- 5. The regulatory analyses used were not independent.** Aside from being inconsistent with each other, the agency analyses of costs and benefits may

themselves not be reliable. This is for two reasons: first, they were not developed independently – leaving substantial room for institutional bias. Secondly, the analyses were all done before the rules were promulgated, and include no after-the-fact results.

These are serious deficiencies that call into question the usefulness of the aggregated numbers. OIRA is already aware of many of these problems, referring to many of them at various points in the draft report. However, as written, the report seems likely to lead to significant confusion.

In fact, in the past, OIRA’s disclaimers and explanations of the limitations of the numbers presented in its annual reports have often been lost in public discussions, especially in news reports seeking a “bottom line” conclusion. The Washington Post, for instance, led a story on last year’s report with the statement: “A new White House study concludes that environmental regulations are well worth the costs they impose on industry and consumers...” even though that study, like the present one, merely restated prior agency calculations.¹

Recommendations for improvement. I recognize that there is no easy way to solve all of these problems. Given the resource constraints on OMB, as well as limitations in the art of benefit-cost analyses, many of these problems may be insuperable. However, there are several steps OMB can take to improve the report. Among them:

- 1. Highlight, in the executive summary as well as throughout the report, the limited nature of the statistics.** The report should make absolutely clear, even to casual readers, that the “headline” numbers on regulation are a restatement of prior agency estimates, and do not include the bulk of federal regulations.
- 2. Include information on other credible studies that present alternative estimates of the costs and benefits of individual regulations.** For resource and institutional reasons, it may not be possible for OMB to make new and independent assessments of each regulation for purposes of this report. But, when alternative assessments have been done, and are credible, it would be helpful for them to be referenced as part of this report. This would better inform readers of the possible costs, and other possible ways to quantify them. Such reports could be included if they are deemed credible, without any endorsement of their conclusions by OIRA.
- 3. Require stricter adherence to OMB guidance in the preparation of regulatory analyses.** OIRA has begun to address the problem of inconsistent methodology with the release last fall of new guidelines for regulatory analysis. The new guidelines should now be enforced strictly, and proposed rules not accepted if analyses do not meet adequate standards.

¹ Eric Pianin, “Study Finds Net Gain From Pollution Rules: OMB Overturns Past Findings on Benefits,” The Washington Post, September 27, 2003.

- 4. Provide alternative calculations of benefits and costs, by varying assumptions and other inputs in agency analyses.** I recognize that for institutional reasons it may not be possible – at least in the short run – to require absolutely uniform methodologies in agency analyses. However, even if the headline conclusion in the report is based on calculations performed by agencies, OIRA could calculate and present alternative numbers calculated by using alternative assumptions.

For instance, agencies sometimes use varying discount rates in their analyses. In such cases, OIRA could present total costs and benefits that would result if a standard discount rate were used, as well as those that result under the rates chosen by each agency. Going farther, total under slightly smaller or slightly larger rates could also be included. Similar calculations could be performed for other inputs, such as values of a statistical life.

Such “alternative” calculations would allow OIRA to present the results of more uniform calculations, while avoiding the institutional constraints on overturning or ignoring agency preferences. It also would be of use to readers of the report, helping them to see the robustness of the figures on costs and benefits under a number of scenarios.

- 5. Include all major regulations, not just those in the GAO database.** Specifically, the FCC should be requested to report on all of its major rulemakings, including those stemming from the Telecommunications Act of 1996.
- 6. Include discussion of selected non-major, non-significant rulemakings.** At this time, it is difficult to see any way to include the costs and benefits of *all* rulemaking in the accounting statement. However, many rulemakings that fall beneath the \$100 million threshold *are* important, and can have a significant impact on individual sectors of the economy. To address this, the report should include a qualitative discussion of selected rulemakings of importance that do not meet the \$100 million requirement. This would provide readers at least with a sense of the types and scope of regulations being imposed under the \$100 million radar.
- 7. Provide better support for the assertion that major and significant rulemakings account for “vast majority” of costs and benefits.** This assertion may well be true, but no support for it is given.
- 8. Provide support for assertion that total costs may be a “factor of 10” higher than that provided in report.** The report asserts that total regulatory costs may well be a factor of 10 higher than the ten-year figure of \$34 - \$39 billion ten-year figure provided, implying a total cost of \$340 to \$390 billion. This may be true – although the figures in studies by Mark Crain and Thomas Hopkins suggest the

total cost of regulation is more than twice as large. A fuller justification of the “factor of 10” statement should be included.

- 9. Provide an annual regulatory “scorecard” for each agency.** To help policymakers determine which agencies are conducting high-quality reviews of rules, and which are not yet up to par, OMB should publish a scorecard of each agency’s performance, and publish it with this report.²

This scorecard should include information on the number of major and minor rules proposed or promulgated by each agency, how many were supported by analyses, how many had quantified and/or monetized costs and benefits, and to what extent each adhered to OMB guidelines for analyses. This should be provided in table form, with textual analyses critiquing each agencies efforts.

Other recommended actions. In addition, there are a number of other changes OMB could make to this annual report that would help provide a clearer and more useful picture of the impact of regulation. Among these:

- 1. Require each agency to produce its own report on its regulatory performance.** In addition to OMB analysis of agency efforts, each agency should be asked to submit to OMB – as part of the preparation of this report – a report on its own regulatory efforts. These reports then should be submitted for public comment, along with OMB’s government-wide *Draft Report*.

Such a requirement would provide several benefits. First, it would provide OMB, and the public, with detailed information on the agencies’ regulatory program and analysis. Second, it would provide the agency with an opportunity to articulate its views and the purposes for its actions. Third, and perhaps most important, it would help focus the agency itself on the need to maintain a coherent and rational regulatory program. Improving regulation should be a goal of each agency – rather than solely the responsibility of OMB. Requiring agencies to report on their own efforts could help reinforce that responsibility.

- 3. Present key information in more useful format.** While OMB’s draft report provides a wealth of information, much of it is unnecessarily difficult to locate in the report. Improving the way this information is presented would make this report much more useful to policymakers and the public. One possibility would be to provide, perhaps an appendix, summary information on each major or significant regulation adopted over the previous ten years (including those by independent agencies). This could include the date the rule was adopted, a short summary of its purpose, the quantified costs and benefits (if any), a website

² This proposal was also recommended to OMB in prior years by many commenters. See, e.g., “Comments of Mercatus Center on Office of Management and Budget’s Draft Report to Congress on the Costs and Benefits of Federal Regulations” (2001), Robert W. Hahn and Robert E. Litan, AEI-Brookings Joint Center for Regulatory Studies *Regulatory Analysis* 01-01, “An Analysis of the Fourth Government Report On the Costs and Benefits of Federal Regulations” (July 2001).

address for the text of the rule, and for the regulatory impact analysis of the rule. This would increase the transparency of the information and analysis in the report, while making it easier to compare and assess various regulatory actions and trends.

- 4. Provide more contextual information.** In addition to the raw numbers, additional efforts to put this information in context would be useful to policymakers. Historical information, for instance tables showing year-to-year incremental changes in the number and cost of major regulations, would be particularly helpful. Other information, comparing the cost of rules to such things as Gross Domestic Product, federal budget levels, tax revenues, and the like (and changes over time in the ratios) would also be helpful in conveying the scope and impact of regulation.
- 5. Include other measures of regulation.** Although the Regulatory Right-to-Know Act only requires OMB to provide information on the costs and benefits of regulation, there are also a number of other statistical measures that provide information on regulatory trends. While each of these is imperfect, they can be useful to filling in the regulatory picture. These statistics include total number of final rules and proposed rules by year, total number of major final and proposed rules, the portion of each that decrease - rather than increase - regulatory burdens, the total number of rules in the Unified Agenda pipeline, economically significant rules in the pipeline, total budgets of regulatory agencies, total staffing of regulatory agencies, and more.

This information could be readily compiled by OMB, and included in each year's report, along with tables showing year-by-year changes in these figures, in the aggregate and broken down by agency.

- 6. Provide better follow-up on recommendations for reform made in prior years.** OIRA typically includes in its reports a request for recommendations from the public on regulations that should be considered for reform. It is not always clear, however, what happens to these recommendations. Recommendations made pursuant to a request in the 2002 draft report, for instance, were listed in the 2002 final report, and their status was not mentioned again until the 2003 final report. This year's draft report does not mention them at all, although it includes a request for further recommendations. While it is understandable that agencies cannot act immediately on all recommendations, the lack of accounting - at the very least - discourages members of the public from putting time and effort into identifying reforms. Each draft and final report should contain a status report on each recommendation made in prior years, until that recommendation is definitively acted upon or rejected by the agency involved. Perhaps even more important, OIRA should maintain a comprehensive list of recommendations on its website, easily accessible to the public.

Impact of regulation. Your letter also asks for suggestions regarding the discussions in the draft report on the impact of regulation on economic growth, and on the impact of regulation on manufacturing. I do not have a detailed critique of these sections. Overall, they appear to be a reasonable summary of the effects of regulation.

I recognize, of course that summarizing the effects of regulation is no easy – and perhaps an impossible – task. There may be no way to determine the exact effect of regulation, if for no other reason than the vast differences in the types of rules. There may be little similarity, for example, in the economic effects overtime rules, price regulations for telecommunications networks, and fuel economy standards. All may have substantial costs, but the kind of costs varies tremendously – from increased labor costs to stunted investment to increased fatalities. An expanded discussion of these variations in the effects of regulation could be helpful in the final report.

The draft report nevertheless provides a reasonable survey of the overall effect of regulation. Its general conclusion - that the burden of regulation is on the whole inversely related to economic growth - seems well supported.

Similarly the discussion of regulation and manufacturing provides a good survey of the field. I would suggest a rephrasing, however, of the language on p. 51 regarding regulatory costs. The draft report states flatly that “these new rules added a total of \$95 billion in regulatory cost burden...” Two paragraphs later, the draft – as it should – discusses the substantial uncertainty surrounding this figure. This uncertainty should be reflected from the start, perhaps by restating the earlier sentence to read “The costs that have been quantified by agencies in their own reviews of these new rules total \$95 billion.”

Although not manufacturing-specific, I would also like to call attention to a recent study of the costs and benefits of regulation in health care by Christopher J. Conover of Duke University. As summarized in testimony last month before the Joint Economic Committee, Conover found the net cost of regulation of health care alone to be \$128 billion.³

³ Testimony of Christopher J. Conover, Ph.D., Before the Joint Economic Committee, United States Congress, Hearing on *Health Care Costs and the Uninsured*, May 13, 2004.

Conclusion. Thank you for the opportunity to provide these comments.
Please contact me if you have any questions, or need any further information.

Sincerely,

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