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# Comments on 2006 Annual Draft Report On Costs and Benefits Of Regulation

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We are writing in response to OMB's April 13, 2006 notice in the *Federal Register*<sup>1</sup> inviting comments on OMB's 2006 annual draft report on the costs and benefits of regulation.<sup>2</sup> I am submitting these comments on behalf of OMB Watch, a nonpartisan, nonprofit research and advocacy center dedicated to promoting an open, accountable government that is responsive to the public's needs. For over 20 years, OMB Watch has advocated for improvements to the regulatory process and against policies that constrain federal action in the public interest.

OMB Watch continues to object to OMB's "regulatory accounting" methodology, which has repeatedly been demonstrated as intellectually bankrupt and useless for public policy. The report continues to perpetuate unsound methodologies and fails to address flaws in the report that have been cited in comments year after year.

Just as OMB has failed to respond to criticism from previous years' reports and has instead chosen to recycle much of its analysis from last year, we are forced to recycle much of our criticism, which has yet to be significantly addressed by OMB. As the guard changes at OMB, we hope that the new administrator will work to usher in greater transparency and responsiveness to the agency's many critics.

Unlike previous years, OMB does not ask for public comment on any particular aspects of the report. Instead, the agency asks for only general comments on the report. OMB Watch's comments make three major points:

1. **OMB's report continues to suffer problems of transparency and responsiveness.** OMB once again fails to seriously consider public input, continuing to make the same blunders year after year and failing to respond to public criticism. OMB needs to improve the transparency of this annual process and must be more responsive to the public's comments.
2. **OMB poses a false and misleading trade-off between corporate interest and protection of the public.** OMB continues to offer weak and unsubstantiated evidence that environmental, health and safety regulation is bad for American business and continues to ignore the rich scholarship that regulation can improve U.S. businesses and overall well-being.
3. **OMB continues to support the flawed methodologies of cost-benefit analysis and net benefits.** While cost-benefit analysis itself is often biased against regulation, OMB's particular use of cost-benefit analysis is even more dubious, often masking highly debatable moral and ethical concerns.

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1. See Notice, 71 Fed. Reg. 19,213 (Apr. 13, 2006).

2. See OFFICE OF INFO. & REG. AFFS., OMB, 2006 DRAFT ANN. REPT. ON COSTS AND BENEFITS OF FED. REGS. (hereinafter "Draft Report").

## I. OMB'S REPORT CONTINUES TO SUFFER PROBLEMS OF TRANSPARENCY AND RESPONSIVENESS.

OMB has not yet made its best efforts to facilitate public participation or be responsive to the public's concerns. When Congress authorized OMB to produce this annual report on the costs and benefits of regulation, it required OMB to make a draft of the report available for public comment and peer review. Although OMB has in the past taken advantage of the public comment process to solicit hit lists of regulatory protections to be weakened or eliminated, it has not yet taken advantage of the public comments process to improve the quality of the report itself. OMB has yet to respond adequately to several errors pointed out by commenters over the years, with the result being that errors from previous reports have reappeared in this year's draft report. OMB could enrich the process and ultimately the annual report itself with a few simple reforms that make it easier for the public to comment on the information contained in this report. If OMB would pay enough attention to those comments, it might make fewer errors in the future.

### A. OMB should facilitate the public's involvement by making the underlying information more transparent.

OMB has improved upon this year's report by adding links to the Regulatory Impact Analysis for some of the rules listed in its cost and benefit estimates. OMB Watch thanks OIRA for making this critical progress towards greater transparency in the report. Unfortunately, though a step in the right direction, the RIAs are not made available for all regulations listed or for other types of economic analysis conducted by the federal agencies. OMB has yet to make all underlying data and cited materials readily available to the general public either through an electronic docket or a reading room.

OMB has thrown up roadblocks that keep the public from holding OMB accountable for its representations in the annual report. In order to track down the information on costs and benefits from previous years, which OMB includes in its 10-year totals, the public must make its way through a maze of past reports:

<i>Major rules from this period...</i>	<i>...must be found in this report:</i>
10/1/93 - 3/31/95	2003 Report, App. A Tbl.18
4/1/95 - 3/1/99	2000 Report, Chapter IV
4/1/99 - 9/30/01	2002 Report, App. E Tbl.19
10/1/01 - 9/30/02	2003 Report, App. A Tbl.19
10/1/02 - 9/30/03	2004 Report, App. A Tbl.12

10/1/03 - 9/30/04	2005 Report, App. A Tbl.A-1
10/1/04 - 9/30/05	2005 Draft Report, App. A Tbl.A-1

Trying to check OMB's work in producing those totals is an even more arduous task. For many major rules covered by the report, OMB avers that it relies on the unadjusted estimates of costs and benefits that the agencies themselves prepared in the course of the rulemaking process. Tracking those estimates down in the 90 days OMB permits for the public comments process is an exercise in futility. All of the regulatory impact analyses and economic impact analyses (which sometimes are separate and distinct documents, meaning that it takes multiple documents to understand the basis of an agency's ultimate conclusions) are available in the agencies' rulemaking dockets, but not all dockets are available online. Even for those dockets that are available online, OMB does not provide docket numbers, which are the essential quanta of information for anyone trying to make his or her way through the universe of government information.

The existence of online agency dockets does not alone solve these concerns. Occasionally, key documents were prepared before the transition to online docket access. In other cases, the dockets are simply inaccessible online, even if they had an online presence at some point. In the case of EPA, which otherwise does an excellent job of maintaining dockets online even after public comment periods have closed, the dockets can be difficult to search: the EPA e-dockets do not readily collapse into lists of documents by type (such as a list only of documents prepared by the agency, excluding public comments, or a list of impact analyses). The pending development of the new e-rulemaking initiative, even if it answered all of these problems, still would not address the larger problem that tracking down the underlying information from which this annual report is generated would require navigating umpteen dockets in umpteen agencies.

The difficulties continue when it comes to information beyond agency docket documents. OMB has cited numerous scholarly articles in this report, most of which are not accessible for free over the Internet. OMB has access to all of this information, which it presumably consults in the preparation of this annual report. OMB could advance the public comment process into the 20th century, at least, by creating an online docket with all of the information upon which OMB relies in the course of preparing its annual report. For those documents which copyright concerns would preclude digitizing on an e-docket, OMB could at a minimum establish a physical docket room.

OMB can only benefit from the improved public comment and peer review made possible by such transparency measures.

**B. OMB has failed to correct mistakes identified by the public.**

The draft report is riddled with errors from previous years that OMB has not corrected, even though commenters have brought them to OMB's attention. When Congress required OMB to submit

a draft of its annual report to the public and peer reviewers for comment, it clearly expected something more than a *pro forma* exercise: it expected that OMB would pay attention to those comments, and that the final report would be enriched by the process. OMB is not, however, taking advantage of the opportunity provided by the public comment process. This year's draft report replicates several mistakes from earlier reports; some of these mistakes have actually been identified multiple times over the years.

OMB should immediately correct the following errors that have returned in this year's draft report:

*Eliminating so-called "transfer rules" from the discussion of total costs and benefits.*

OMB should not need yet another recitation of the problems with its arbitrary and incoherent distinction between social regulations and "transfer rules." There is a prevailing definition of transfer rules as those which "simply transfer money from one entity to another after market actors have chosen the nature and level of goods and services to be provided" and "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."<sup>3</sup> As has been repeatedly pointed out, OMB exempts several regulations from its annual totals of costs and benefits as transfer rules even though they do not fit these criteria. Back in 2003, OMB conceded that there was "merit to the request" that OMB state a principled list of criteria for what constitutes a transfer rule, explain how rules it excludes from annual accounting meet those criteria, and assess the distributive impacts of the rules; OMB actually added that it was "considering the feasibility of providing [better information on transfer rules] in future reports."<sup>4</sup>

OMB has yet to make good on that promise. As it failed to do last year, OMB has again failed to explain adequately its designation of "transfer rules" exempted from its description of costs and benefits. This mistake is not merely academic; it can significantly distort the presentation of the administration's regulatory record.<sup>5</sup>

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3. Lisa Heinzerling & Frank Ackerman, Comments on 2004 Draft Report, at 16.

4. OFFICE OF INFO. & REG. AFFS., OMB, 2003 ANN. REPT. ON COSTS & BENEFITS OF FED. REGS. 17 (hereinafter "2003 Draft Report").

5. For example, one of the "transfer rules" last year is the rule on Automotive Fuel Economy Manufacturing Incentives for Alternative Fueled Vehicles, better known as the "dual fuel" credit. The National Highway Traffic Safety Administration is charged with developing fuel economy standards that reduce the nation's dependence on foreign oil. NHTSA was further empowered by the Alternative Motor Fuels Act of 1988 to encourage use of alternative fuels by granting credits toward average fuel economy requirements to automakers who manufacture "dual fuel" vehicles that can operate on either conventional fuel (gas or diesel) or a domestic alternative fuel such as methanol, ethanol, or natural gas. This incentive is not a tax credit or financial subsidy; it is, instead, a partial exemption from fuel economy standards, the extent of which is calculated in terms of "credits." NHTSA was given the option to end or extend this incentive based on several factors specified in the law. Despite knowing that drivers of vehicles with the dual fuel option inevitably use conventional fuels, because outlets for alternative fuels are few and the fuels can be expensive, the agency decided nonetheless in February 2004 to extend the dual fuel incentive, even though the government's own analysis, confirmed in other studies, estimates that the result of extending the dual fuel incentive will be to *increase* petroleum consumption and emission of greenhouse gases. Projections are that the increase will swallow entirely the oil savings from the administration's recent decision to require a modest hike in fuel economy standards of 1.5 mpg by 2008.

*Failing to account for the benefits lost in deregulation.*

OMB has not yet adequately responded to the charge that it has biased its presentation of costs and benefits by failing to include deregulatory actions. For example, OMB omitted the Bush administration's decision to eliminate two Clinton administration rules that gave miners the same level of protection from harmful diesel emissions that truck and bus drivers enjoy. Among other benefits, the rules combined were expected to prevent 9 to 10 cases of cancer every year. The erasure of these benefits was not recorded in the 2004 accounting of the costs and benefits from the Bush administration's regulatory policies, even though in a proper accounting these lost benefits should have reduced the total level of benefits reported that year. OMB dismissed this concern by noting that the Bush administration rule eliminating these protections was not "major."<sup>6</sup>

Of course, OMB has a great deal to say about which rules are considered "major." One of the criteria for "major" rules covered in this annual report is whether they were brought under the review procedures of E.O. 12,866. That executive order, which OMB uses to grant itself a role in regulatory policy that Congress never authorized, establishes several categories of covered rules. Aside from "significant regulatory action[s]" which have costs or benefits of \$100 million or more, the remaining categories all are overtly subjective and determined at the whim of the White House.<sup>7</sup> OMB has used this provision to insert itself into the regulatory process in all manner of rules, typically to the public's detriment. That OMB itself chose not to determine this rollback fell within the scope of E.O. 12,866 and thus would not be treated as a "major" rule for purposes of this annual report means that OMB has a great deal of control over the universe of costs and benefits it chooses to report. The essence of the charge that OMB excludes deregulatory actions from its accounting is that OMB is manipulating the universe of data in order to selectively present costs and benefits and show the Bush administration in the best light. OMB has yet to answer that charge.

*Mischaracterizing the benefits of workplace health and safety protections.*

In a clumsy discussion of the consequences for workers of regulatory protections that improve the health and safety conditions of their workplaces, OMB again mistakenly asserts, "In the occupational health standards case, where the benefits of regulation accrue mostly to workers, workers are likely to be better off if health benefits exceed compliance costs and such costs are not borne primarily by workers."<sup>8</sup> OMB thus failed to recognize an error pointed out two years ago:

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See Public Citizen's comments on the dual fuel rule at <<http://www.citizen.org/autosafety/fuelecon/nhtsaSAFE/articles.cfm?ID=8775>> and comments by the Center for Auto Safety at <<http://www.autosafety.org/article.php?scid=77&did=833>>.

6. See OFFICE OF INFO. & REG. AFFS., OMB, 2004 ANN. REPT. ON COSTS & BENEFITS OF FED. REGS. 29 (hereinafter "2004 Final Report").

7. See E.O. 12,866 § 3(f).

8. Draft Report, *supra* note 2, at 20.

[Workers] 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.” 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.)<sup>9</sup>

OMB should acknowledge this criticism and either correct the sentence or eliminate the section altogether.

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9. Heinzerling & Ackerman, *supra* note 3, at 3 (citation omitted). The commenters added this additional question, which OMB has not answered:

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 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.

*Id.* Given that the agency charged with protecting workers, the Occupational Health and Safety Administration, has essentially abandoned that role, *see* OMB WATCH, THE BUSH REGULATORY RECORD: A PATTERN OF FAILURE (2004), *available at* <<http://www.ombwatch.org/regs/patternoffailure>>, this discussion appears not only incorrect but also moot.



Using absurdly low values to minimize benefits of fuel economy.

OMB continues to use an inexcusably distorted low-ball figure for the cost of gasoline in its cost and benefit calculations. Just as it did the year before, OMB calculates fuel savings benefits using a rate of \$1.10–\$1.30 per gallon. OMB should inform the public where to fuel its cars, because these low prices are nowhere to be found. OMB was informed last year that its cost assumption deviated wildly from the government’s own projections for gas prices and, if history is any guide, from common sense: “In fact, the last time that gasoline retailed for \$1.30 per gallon was April 19, 2002—more than two years ago.”<sup>10</sup> We are now more than *four* years from such a low price, and the government itself projects that we still have some time to go before gas prices will fall to \$1.30: the Department of Energy projects that regular unleaded gas prices will average \$2.65 for 2006 and \$2.61 for 2007.<sup>11</sup> Unless OMB is intentionally trying to forestall arguments that further fuel economy gains would substantially benefit the country while weaning us from dependence on foreign oil, it should update this figure or proffer some principled and credible explanation for its decision to deviate from the best available evidence of soaring gas prices well in excess of OMB’s \$1.30 assumption.

Citing studies that do not meet OMB’s own standards for information quality.

It is puzzling that OMB continues to refer to the discredited Crain study commissioned by the Small Business Administration,<sup>12</sup> given that even John Graham, recent administrator of OMB-OIRA has dismissed it as a hack job that fails to rise to the level of quality that OMB expects government agencies to apply:

The fact that attempts to estimate the aggregate costs of regulations have been made in the past, such as the Crain and Hopkins estimate of \$843 billion mentioned in Finding 5, is not an indication that such estimates are appropriate or accurate enough for regulatory accounting. Although the Crain and Hopkins estimate is the best available for its purpose, it is a rough indicator of regulatory activity, best viewed as an overall measure of the magnitude of the overall impact of regulatory activity on the macro economy. The estimate, which was produced in 2001 under contract for the Office of Advocacy of the Small Business Administration, is based on a previous estimate by Hopkins done in 1995, which itself was based on summary estimates done in 1991 and earlier, as far back as the 1970s. The underlying studies were mainly done by academics using a variety of techniques, some peer reviewed and some not. Most importantly, they were based on data collected ten, twenty, and even thirty years ago.

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10. Robert Verchick, Peer Review Comments on OMB 2004 Draft Report, 4.

11. See Energy Information Admin., Dep’t of Energy, *Energy Use Projections and Prices by Sector* Tbl.4 (June 2006) available at <<http://www.eia.doe.gov/emeu/steo/pub/4tab.html>>.

12. See Draft Report, *supra* note 2, at 18 (guilelessly referring to the Crain study as a “recently sponsored . . . study” proving a disproportionate burden on small businesses).

Much has changed in those years and those estimates may no longer be sufficiently accurate or appropriate for an official accounting statement. Moreover, the cost estimates used in these aggregate estimates combine diverse types of regulations, including financial, communications, and environmental, some of which impose real costs and others that cause mainly transfers of income from one group to another. Information by agency and by program is spotty and benefit information is nonexistent. These estimates might not pass OMB's information quality guidelines.<sup>13</sup>

The Crain report suffers from so systematic a lack of information quality that, as others have pointed out, even Graham's stinging critique may be generous.

Although OMB cites the report this year only to discuss general conclusions and not specific numbers from the Crain report, it is important to stress that the basis for those general conclusions is the aggregation of the numbers that, as John Graham himself has pointed out, are unreliable. Note, for example, that Crain plugs in estimates of the cost of workplace protections by relying on a study by Joseph Johnson.<sup>14</sup> Last year, OMB Watch commented that Johnson's numbers are unreliable.<sup>15</sup> This year, OMB has relied on an updated version of Johnson's report that is not readily publicly available. Again, OMB Watch repeats its criticism that materials used in preparation of the report must be made available to the general public. OMB Watch is unable to discern whether Johnson has corrected the methodological problems from the previous version of his report.

Given the absolute lack of credibility of the entire enterprise of the Crain report, OMB should more thoroughly explain its statement in the 2004 final report that the report is unreliable in its specific calculations but is still somehow "useful as a relative indicator of regulatory activity rather than as an absolute indicator of the overall burden of regulation."<sup>16</sup> The specific conclusions about the "burden" of regulation are utterly unreliable, yet those conclusions are the very basis of the "relative" allocations OMB discusses. If OMB has figured out a way around the "garbage in, garbage out" problem, it should share that secret with the rest of us. Until then, it should assiduously eliminate all references to Crain and leave that study in the waste bin in which it belongs.

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13. *Hearing on H.R. 2432, Paperwork and Regulatory Improvements Act of 2003*, July 22, 2003, Transcript at 21 (statement of John Graham).

14. See W.M. Crain, *The Impact of Regulatory Costs on Small Firms*, 12 (2001) available at <<http://www.sba.gov>> ("The source of our cost estimates on workplace regulations is the 2005 study by Joseph Johnson.") (citing Joseph M. Johnson, *A Review and Synthesis of the Cost of Workplace Regulations*, CROSS-BORDER HUMAN RESOURCES, LABOR AND EMPLOYMENT ISSUES, 433 (Kluwer Law International: Netherlands 2005)).

15. First, he relied entirely on *ex ante* estimates of compliance costs from OSHA's regulatory impact analyses, which use biased samples, fail to anticipate technological innovations that will drive down actual costs, and make other conservative assumptions that routinely overestimate actual compliance costs significantly. Second, Johnson inflated these already inflated cost estimates: he actually *multiplied the estimates by 5.55!*

16. See 2004 Final Report, *supra* note 6, at 102.

## II. OMB POSES A FALSE AND MISLEADING TRADE-OFF BETWEEN CORPORATE COMPETITIVENESS AND PROTECTION OF THE PUBLIC.

Despite the best efforts of commenters who responded to the last two years' draft reports, OMB has decided to repeat in this year's report a misguided and misleading section that suggests we need more of the Bush administration's dismantling of public safeguards in order to shore up the competitiveness of American corporations in the global marketplace. OMB insists that the "strongest evidence of the impact of" what it calls "smart regulation" (by which it means its hostility to protections of the public interest, especially those that act before the public has suffered significant harm) is a comparison of economic growth of countries with "different regulatory systems."<sup>17</sup> Although the United States already has the least restrictive regulation in the world<sup>18</sup> and is third on the list of the world's top ten economies,<sup>19</sup> OMB adds, "Less well known are the significant differences in growth rates . . . seen among economies with *smaller differences* in the degree of government control and regulation."<sup>20</sup> Apparently, OMB hints, it is not enough that American regulatory policy is already the least restrictive in the world; we must continue to dismantle the public's protections and block the development of new ones.

OMB's argument is overly simplistic. Among other things, there are many confounding variables that preclude universal generalizations from mere comparisons of regulatory stringency. For example, the United States has a history of using military and defense line items to subsidize important innovations (primary recent examples being containerization, desktop-sized computers, and the Internet) that are then spun off into private industry, which is primed to seize a competitive advantage in the market that is essentially made possible by that hidden subsidy. Aside from the unaddressed gap between correlation and causation, OMB fails to cite any evidence for its "[l]ess well known" conclusion that small downward adjustments in the strength of regulatory protections can lead to "significant differences in growth rates." The footnote for that conclusion cites an article that provides no support for the thesis but, instead, compares the United States' regulatory protections to the U.S.S.R. on a scale of "dictatorship" and "disorder."<sup>21</sup>

The evidence that OMB cites for its larger discussion of regulation and competitiveness is not at all relevant to the issue as OMB has framed it, much less to the conclusions OMB wants to draw

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17. See Draft Report, *supra* note 2, at 20.

18. *Id.* at 24 text accompanying note 31.

19. *Id.* at 21 text accompanying note 24.

20. *Id.* at 20 to 21 (emphasis added).

21. See Simeon Djankov, Edward L. Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, THE NEW COMPARATIVE ECONOMICS 23-25 (Nat'l Bureau of Econ. Research, Working Paper No. 9608, April 2003), available at <<http://www.nber.org/papers/w9608>>.

about its anti-regulatory (“smarter regulation”) and anti-science (“sound science”) policies. The scholarly studies that would be relevant are noticeably absent, possibly because they simply do not tell the story OMB is so desperate to tell.

· As pointed out by commenters to previous regulatory accounting reports, OMB’s simplistic conclusions ignore other means of market interventions used by wealthy countries in place of direct regulation, such as elaborate and heavy taxes on industrial practices disfavored by the government.<sup>22</sup> OMB also assumes that the benefits of “economic freedom” will continue to accrue equally at every level of deregulation.<sup>23</sup> This conclusion is particularly unsuited for policy in the United States which, according to an OECD study that OMB cites, is already the second least regulated country and one that already follows the World Bank’s major recommendations by guaranteeing property rights, protecting consistency in its treatment of business, and enforcing contracts. OMB provides no support for its conclusion that rolling back health, safety and environmental protections will achieve continued benefits in economic growth.<sup>24</sup>

Moreover, as discussed below, OMB’s simplistic and strained analysis fails to capture the true impact of the regulations reviewed in the Draft Report. OMB bases its analysis of the impact of regulations on studies that look solely at economic regulations, while the report itself focuses on social regulations. OMB then further confuses the matter by limiting its definition of well being to economic growth and ignores other indicators of well being. At the same time, OMB ignores the rich scholarship that shows that regulation may actually increase U.S. competitiveness.

OMB should finally acknowledge that its section on regulatory protections and competitiveness lacks any relevant support for OMB’s arguments.

**A. OMB’s conclusions are not supported by the World Bank and OECD studies that OMB cites.**

OMB recognizes the inherent differences between economic and social regulation in its section on the impact of regulations on wages and yet conflates this difference when considering the impact of regulations on economic growth and macroeconomics. The Draft Report reaches inaccurate and incomplete conclusions on the economic effects of social regulation by relying on studies that look solely at economic regulatory factors to reach their conclusions and by failing to include research on the impact of environmental, health and safety regulations on economic prosperity. OMB should revise its report to account for the fact that social regulation operates differently than economic regulation and may have a different effect on economic productivity and growth.

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22. Countries such as Denmark, praised in OMB’s report, and Norway and Sweden use such an approach. *See* Verchick, *supra* note 10, at 6.

23. *Id.* at 6-7.

24. *See* Heinzerling & Ackerman, *supra* note 3, at 5.

Of the regulations listed in OMB's table of the Summary of Agency Estimates for Final Rules,

- 17 are environmental, health or safety regulations;
- One other, a Housing and Urban Development regulation to provide low income housing, is a social regulation;
- Only three are non-social regulations;
- Only one of the regulations listed by OMB deals with trade; and,
- None of them relates to price controls, business practices, international trade and investment or public ownership.

OMB's macroeconomic comparison of economic growth and regulatory indicators, however, cites studies by the World Bank, OECD and research based on OECD data, which use only economic regulatory variables. Reviewing the research ranking countries by economic freedom and comparing their performances, OMB cites *Doing Business in 2004*, as well as the subsequent 2005 and 2006 volumes, and the *Understanding Regulation* studies by the World Bank that conclude heavier regulation is bad for business and that poor countries face larger regulatory burdens than rich countries.<sup>25</sup> The World Bank study also connects greater regulation with greater inefficiency and less labor productivity and concludes that better performance and a greater ease of doing business is associated with more jobs.<sup>26</sup> OMB includes the World Bank's five common elements that unite well-performing countries, number one being a simplified and deregulated competitive market.<sup>27</sup>

The regulatory indicators used in the World Bank studies do not include social regulatory variables, such as the control of pollution emissions, food and drug inspection, or workplace health and safety standards. Instead, the indicators used by the World Bank study to measure a country's regulatory stringency are regulations related to starting a business, dealing with licenses, hiring and firing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business. In fact, the World Bank assumes, in comparing regulations affecting market entry, for example, a business that "(1) 'is not using heavily polluting production processes,' (2) is not subject to industry-specific regulations (such as many environmental regulations), and that (3) is operating in the country's most populous city."<sup>28</sup> As Profs. Heinzerling and Ackerman point out, "obviously... many of the rules reviewed by the OMB pertain to heavily polluting industries which are subject to industry-specific regulations and which are not operating in New York City."<sup>29</sup> The study then draws conclusions that countries with the greatest ease of doing business and the least economic regulations are the ones with the greatest degrees of economic growth.

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25. See Draft Report, *supra* 2, at 22.

26. See *id.* at 22.

27. See *id.* at 22.

28. Verchick, *supra* note 10, at 7.

29. Heinzerling & Ackerman, *supra* note 3, at 4.

OMB also cites the Organization for Economic Cooperation and Development (OECD) 2001 regulatory measurement database.<sup>30</sup> OECD reports that strong relationship between excess regulation and economic performance persists in a survey of 30 high-income democracies.<sup>31</sup> OECD concludes that the least regulated countries show the greatest improvement in their rates of multifactor productivity and show the largest increases in the number of new small and medium sized firms and the rate of investment, indicating productivity and per capita income growth.<sup>32</sup>

OECD's database may use objective measures; however, the factors used in their measurement are again limited to economic regulations and market structural factors. OECD's regulatory indicators include state control barriers to entrepreneurship, barriers to international trade and investment, public ownership, tariff and non-tariff barriers, constraints to business operation, and price controls.<sup>33</sup> The variables used to compose OECD's database of regulatory restrictiveness do not specifically include social regulatory variables. While some environmental, health, and safety regulations may be included in these factors—especially constraints to business operations and barriers to entrepreneurship—the subcategory of regulations that target environmental, health and safety concerns is not independently explored by OECD. Thus, the research cannot be applied to the regulations specifically addressed by OMB in the Draft Report.

Perhaps in effort to lend greater to credibly to their slim evidence, OMB cites a study by Guiseppe Nicoletti and Frederic L. Pryor as more evidence of regulation's effect on economic growth.<sup>34</sup> While OMB brags that the studies use different indicators and types of regulation to reach similar conclusions, a closer look at the scholarship reveals the Nicoletti study relies on the same OECD market indicators to judge regulatory effects in their cross-country comparisons.<sup>35</sup> Research by Norman V. Loayza, Ana Maria Oviedo and Juis Serven is also included in OMB's macroeconomic analysis, which "provides additional support to the supposition that excess regulation tends to reduce growth."<sup>36</sup> Like the other studies relied upon, these use variables like fiscal burdens, trade barriers, financial markets and contract enforcement to evaluate regulatory intensity across countries.<sup>37</sup>

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30. See Draft Report, *supra* note 2, at 23.

31. See *id.* at 23.

32. See *id.* at 24.

33. OECD, *Special Issue on Regulatory Reform*, OECD ECONOMIC STUDIES NO.32 (2001), available at <[http://www.oecd.org/document/57/0,2340,en\\_2649\\_34323\\_2392761\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/57/0,2340,en_2649_34323_2392761_1_1_1_1,00.html)>.

34. Draft Report, *supra* note 2, at 24.

35. Guiseppe Nicoletti & Frederic Pryor, *Subjective and Objective Measures of the Extent of Government Regulation*, J. ECON. BEHAVIOR AND ORGANIZATION (2001), available at <<http://www.aei-brookings.org/admin/authorpdfs/page.php?id=424>>.

36. Draft Report, *supra* note 2, at 24.

37. See Norman V. Loayza, Ana Maria Oviedo, & Juis Serven, *The Impact of Regulation on Growth and Informality: Cross-Country Evidence*, AEI-Brookings Joint Center (2005), available at, <[http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/06/06/000012009\\_20050606113300/Rendered/PDF/wps36230rev.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/06/06/000012009_20050606113300/Rendered/PDF/wps36230rev.pdf)>.

Conclusions cannot be drawn about social regulations and their economic implications from sources that do not measure their indicators. OMB should acknowledge that economic regulations do not have the same impact on a country's economic growth as socially protective measures and their argument that "these findings likely hold for social as well as economic regulation" lacks relevant support.<sup>38</sup>

**B. OMB has chosen to ignore the rich scholarship disproving the regulation-competitiveness trade-off.**

OMB continues to ignore evidence of the real relationship between regulation and competitiveness. OMB appears to be using inapposite evidence in order to avoid scholarly evidence that militates for a contrary conclusion. That OMB would maintain this section in the report despite the paltriness of the evidence is perplexing, at least until the actual scholarly debate on regulation and competitiveness comes into clearer focus. That debate, as outlined below, trends toward a completely different conclusion. In fact, given the scholarly evidence below, it would appear that competitiveness concerns should drive us in the opposite direction of this administration's hostility to public protections; we should, instead, embrace them, for the world of good they do for us in terms of public health, safety, civil rights, environment, and now the economy as well.

**1. Economic indicators fail to show an environment/competitiveness tradeoff.**

Economists look at several economic indicators to determine the impact of regulation on competitiveness, such as plant location, industry imports and exports, and foreign direct investment (FDI). The argument that regulation harms U.S. competitiveness is based primarily on the theory that pollution-intensive industries will move to areas with more lax environmental regulations ("pollution havens") in order to avoid the costs of compliance with more stringent environmental protections. If the pollution haven theory holds, then firms will choose to open new plant locations in areas with less regulation. Similarly, if regulation impacts competitiveness, then there should be a positive correlation between regulation and net imports of an industry: as regulation increases, countries with more lax regulations will gain a great share of the import market. Further, if the pollution haven theory is to hold, then stringent regulation in the United States will induce high polluting firms to disproportionately invest overseas.

Though some economists have found a pollution haven effect, many economists have discovered that regulation has no negative impact on competitiveness, and some have even argued that regulation may increase competitiveness, a fact OMB fails to mention in its analysis. Even in studies that have found that regulation hampers competitiveness, the effect tends to be insignificant or, at most, significant but relatively minor. OMB neglects to mention, for instance, a 1995 survey of economic studies by Jaffe et al., which concludes that "overall, there is relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on

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<sup>38</sup> See Draft Report, *supra* note 2, at 25.

competitiveness, however that elusive term is defined.”<sup>39</sup> Eban Goodstein not only corroborated Jaffe’s conclusions but has also found that, between 1979-1989, the industries that spent more on regulation compliance actually exhibited superior performance compared to imports from developed and developing countries.<sup>40</sup> OMB systemically ignores the divergent economic opinion on regulation and competitiveness and instead focuses only on inapposite evidence mischaracterized as corroborating a deregulatory agenda.

Regulation does not negatively impact plant location decisions.

The Jaffe et al. study looked at all three indicators of competitiveness and found on all accounts that regulation was not a major factor in competitiveness. In the case of plant location decisions, Jaffe et al. found that there is little evidence to support the conclusion that stringent regulation is a major determinant in plant location decisions. This finding is corroborated by a host of other economists. Timothy J. Batrik studied the impacts of state government environmental regulation expenditures on plant location decisions and found that such expenditures had an insignificant effect on plant locations.<sup>41</sup> Kevin Gallagher found that plants moving to Mexico are not the ones with highest pollution abatement costs; overseas movement of industries is affected more by labor costs than by regulation.<sup>42</sup> A look at plant location within India found that increased government spending on environmental regulation not only did not deter plant location but actually had a positive impact.<sup>43</sup>

Clark, Marchese, and Zarrilli examined industry decisions to conduct offshore assembly in developing companies. Consistent with the findings on plant location, the authors found that pollution intensive industries were less likely to conduct offshore assembly. They argued that the U.S. has a comparative advantage in highly polluting industries, while developing countries have a comparative advantage in simple assembly industries. At the same time, “the cost of pollution control and abatement are too small to influence the competitive performance of location decision of these activities.”<sup>44</sup>

Regulation does not increase dependence on imports.

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39. Jaffe et al., *Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?*, 33 J. ECON. LIT. 132, 157 (1995).

40. See Eban Goodstein, *A New Look at Environmental Protection and Competitiveness*, Briefing Paper for the Economic Policy Institute, Washington, DC (1997).

41. See Timothy J. Batrik, *The Effects of Environmental Regulation on Business Location in the United States*, 19 GROWTH CHANGE 22 (1988).

42. See Kevin Gallagher, *Trade Liberalization and Industrial Pollution in Mexico: Lessons for the FTAA*, Working Paper for Global Development and Environment Institute (October 2000).

43. See Muthukumara Mani, Sheoli Pargal & Mainul Huq, *Does Environmental Regulation Matter? Determinants of the Location of New Manufacturing Plants in India in 1994*, World Bank Working Paper, at 1-26.

44. Don P. Clark, Serafino Marchese & Simonetta Zarrilli, *Do Dirty Industries Conduct Offshore Assembly in Developing Countries?*, 14 INT’L ECON. J. 75, 86 (2000).



Further, several economic studies have found that stringent regulations have not led to increases in imports. Jaffe et al. examined a number of studies on the impact of regulation on imports and exports and concluded once again that regulation has no significant impact. Grossman and Krueger, for instance, looked at the impacts of NAFTA on net imports and found greater imports in industries with the lowers pollution costs. Moreover, they found that “traditional determinants of trade and investment patterns” have a significant impact on net imports while environmental costs have a minor and insignificant impact.<sup>45</sup>

A 1997 briefing paper by Eban Goodstein confirmed the findings of Jaffe et al. Moreover, Goodstein’s study also found that “over the 1979-89 period, *industries that spend more money complying with environmental regulations actually demonstrated superior performance against imports from developed countries.*”<sup>46</sup> Goodstein found the same relationship “for imports from developing countries, but the relationship was not as strong.”<sup>47</sup> Goodstein expanded on existing research on the effect of regulation on net imports by exploiting the large dataset made available by the National Bureau of Economic Research (NBER). Again, he concluded from the data that environmental regulation does not harm U.S. competitiveness. A look at the top 20 industries that experienced growth of import share by less-developed countries (LDC) from 1973-79 and 1979-89 shows that industries with high environmental costs were not the industries experiencing growth in net imports. In fact, “only three of the top 20 in the early period were industries with higher-than-average environmental costs; only one in the latter. It seems, then that low-wage industries, not ‘dirty’ ones, dominate the list of LDC import leaders.”<sup>48</sup>

Regulation does not send foreign investment abroad.

Despite predictions to the contrary, several economic studies have found foreign direct investment to increase with environmental stringency, implying that environmental regulation does not deter foreign investors. In a recently published article for the *International Trade Journal*, Elizabeth T. Cole and Prescott C. Ensign have found that U.S. FDI into Mexico is moving toward low polluting industries.<sup>49</sup> In fact, air pollution decreased in the United States at a time when foreign direct investment was increasing.<sup>50</sup>

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45. See Gene M. Grossman & Alan B. Krueger, *Environmental Impacts of a North American Free Trade Agreement*, in THE US-MEXICO FREE TRADE AGREEMENT 13 (Peter Garber ed. 1993).

46. Goodstein, *supra* note 40, at 2.

47. *Id.*

48. *Id.* at 6

49. See Elizabeth T. Cole & Prescott C. Ensign, *An Examination of U.S. FDI into Mexico and its Relation to NAFTA: Understanding the Effects of Environmental Regulation and the Factor Endowments that Affect Location Decision*, 19 INT’L TRADE J. 1 (2005).

50. See David Wheeler, RACING TO THE BOTTOM? FOREIGN INVESTMENT AND AIR POLLUTION IN DEVELOPING COUNTRIES (Development Research Group, World Bank, 2001), *available at* <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=632594](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632594)>. Wheeler’s study shows a correlation and not

Thus, the bulk of the economic literature contradicts OMB's claim that regulation seriously hampers U.S. competitiveness. As Jaffe et al. conclude, "studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location decisions have produced estimates that are either small, statistically insignificant, or not robust to tests of model specification."<sup>51</sup> Other economic factors, such as labor costs, play a much more significant role in the movement of industries. Concludes Goodstein, "Highly polluting industries are relocating to poor countries; but the reason, overwhelmingly, is low wages."<sup>52</sup>

Despite OMB's characterizations, economic opinion on the existence of a pollution haven effect is by no means conclusive. Economic studies deviate broadly on the subject. According to one literature review, "much of the empirical literature that has attempted to test this assumption has arrived at differing conclusions, ranging from a modest deterrent effect of environmental regulatory stringency on economic activity to a counterintuitive modest attract effect."<sup>53</sup> Even in the most damning characterizations, regulation still is only said to have a modest impact on U.S. competitiveness.<sup>54</sup>

Even if *some* evidence does point to a pollution haven effect, one cannot dismiss the wide range of divergent economic opinion on the subject. As Tim Jeppensen, John List and Henk Folmer conclude in a 2002 article for the *Journal of Regional Science*, "casual perusal of the literature [on regulation and competitiveness] indicates that construction of a consensus point is akin to finding a needle in a haystack."<sup>55</sup>

## 2. Regulation does not cost jobs.

Economists have also refuted the claim that increased regulation decreases jobs. Economist

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causation.

51. Jaffe et al., *supra* note 39, at 157-158.

52. EBAN GOODSTEIN, JOBS AND THE ENVIRONMENT: THE MYTH OF A NATIONAL TRADE-OFF 19 (1994).

53. Smita B. Brunnermeier & Arik Levinson, *Examining the Evidence on Environmental Regulations and Industry Location*, 13 J. ENV'T. & DEVEL. 6 (2004).

54. See Keller & Levinson, *Pollution Abatement Costs and Foreign Direct Investment Inflows to U.S. States*, 84 REV. ECON. & STATS. 691 (2002), in which they found that environmental regulation does have significant negative impact on FDI into the United States, but the magnitude is economically small. See also Arik Levinson, *Environmental Regulation and Manufacturers' Location Choices: Evidence from the Census of Manufacturers*, 62 J. PUB. ECON. 5 (1996), in which Levinson found that the manufacturing sector is sensitive to environmental regulation, but again the impact is small in magnitude. Though the sector was sensitive to regulation, "the degree of aversion to stringent states does not seem to increase for pollution-intensive industries."

55. Tim Jeppesen, John A. List, & Henk Folmer, *Environmental Regulations and New Plant Location Decisions: Evidence from a Meta-Analysis*, 42 J. REGIONAL SCI. 19, 36 (2002).

Eban Goodstein at the Economic Policy Institute has written substantially on the relationship of jobs and the environment. According to Goodstein, the jobs-environment trade-off is largely a myth. Goodstein's book *Jobs and the Environment: The Myth of a National Trade-Off* finds a small positive effect of environmental regulation on overall employment, especially in the area of manufacturing workers.<sup>56</sup> Goodstein also finds that environmental regulation does not lead to manufacturing plant shutdowns.

Regulation leads to job creation and innovation of new technologies that can then expand the economy. Government spending on environmental regulation includes "investments in pollution control equipment and personnel, scientific studies to test pesticides and chemicals, the clean-up of hazardous wastes at Superfund sites, and the bill paid to your local garbage collector."<sup>57</sup> All of these costs *create jobs*. Moreover, these jobs are overwhelmingly blue collar and, by nature, domestic.<sup>58</sup> According to Goodstein, "the one comprehensive estimate available suggests that, in 1992, just under 4 million jobs were directly or indirectly related to pollution abatement and environmental protection the United States."<sup>59</sup>

Even the more equivocal work of Richard D. Morgenstern, William A. Pizer, and Jhih-Shyang Shih cannot avoid the job-creating potential of environmental protection: they conclude that environmental regulation is *just as likely* to create jobs as to cause job losses. "While environmental spending clearly has consequences for business and labor, the hypothesis that such spending significantly reduces employment in heavily polluting industries is not supported by the data," they write.<sup>60</sup> Morgenstern et al. examined the pulp and paper, plastics, petroleum and steel sectors and found "that a million dollars of additional environmental expenditure is associated with an insignificant change in employment."<sup>61</sup>

They explain: "Most importantly, there are strong positive employment effects in industries where environmental activities are relatively labor intensive and where demand is relatively inelastic, such as plastics and petroleum. In others, where labor already represents a large share of production costs and where demand is more elasticity, such as steel and pulp and paper, there is little evidence of a significant employment consequence either way."<sup>62</sup>

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56. See generally Goodstein, *supra* note 52.

57. Eban Goodstein, *Jobs or the Environment? No Trade-Off*, 38 CHALLENGE 41, 46 (1995).

58. See Frank Ackerman & Rachel Massey, *Prospering with Precaution: Employment, Economics, and the Precautionary Principle* (Precautionary Principle Project, Aug. 2002), available at <<http://www.healthytomorrow.org/pdf/prosper.pdf>>.

59. Goodstein, *supra* note 57, at 42.

60. RICHARD D. MORGENSTERN, WILLIAM A. PIZER, & JHIH-SHYANG SHIH, JOBS VERSUS THE ENVIRONMENT: AN INDUSTRY-LEVEL PERSPECTIVE 25 (Resources for the Future Discussion Paper No. 99-01-REV, 2000).

61. *Id.* at 24.

62. *Id.*

Berman and Bui also found that regulation had no impact on labor demands. The authors examined the impact on labor demands of increased air pollution abatement in the Los Angeles area. In looking at data from 1979 through 1992, a period that saw sharp increases in environmental regulation, they found that increased regulation had no effect on employment in refineries.<sup>63</sup>

### 3. Regulation can improve efficiency.

Those positing an anti-regulatory agenda are forced to dismiss entirely the Porter “hypothesis” that regulation can actually increase productivity by increasing the efficiency of operations. Porter’s theory was developed in response to real-world observations, such as OSHA’s Cotton Dust Rule, in which regulations to protect the public had indirect benefits of inducing technological innovations and improved efficiencies in business operations. Since Porter elaborated his argument, the real world examples have continued to multiply. His “hypothesis” is now backed by a robust body of empirical evidence:

Though regulation certainly does result in some cost to industry, it can also spur economic growth and increased efficiency. Jaffe points to a 1990 Barbera and McConnell study that “found that lower production costs in the nonferrous metals industry were brought about by new environmental regulations that led to the introduction of new, low-polluting production practices that were also more efficient.”<sup>64</sup> EPA itself has in fact argued that environmental regulations generate “more cost-effective processes that both reduce emissions and the overall cost of doing business.”<sup>65</sup>

A study of the impacts on food manufacturing of trade liberalization between Mexico and the U.S. found that free trade would benefit Mexican producers because of resulting productivity growth, not because of the country’s more lax environmental regulation. In fact, increased environmental regulation actually stimulated greater productivity in Mexican food manufacturing. “Pollution abatement efforts encouraged by the Mexican Government’s inspection program manifestly have stimulated improvements in food processing efficiency as well as in environmental quality.”<sup>66</sup> The enhanced productivity offset any consequence for the profitability of Mexican food manufacturing in the aftermath of the new pollution controls. At the same time, the authors found “U.S. pollution regulations have had no impact on the profitability or productivity of U.S. food manufacturing.”<sup>67</sup>

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63. See Eli Berman & Linda T. M. Bui, *Environmental Regulation and Labor Demand: Evidence from the South Coast Air Basin*, 79 J. PUB. ECON. 265 (2001).

64. Jaffe et al., *supra* note 39, at 155.

65. Office of Air and Radiation, Environmental Protection Agency, *The Clean Air Marketplace: New Business Opportunities Created by the Clean Air Act Amendments—Summary of Conference Proceedings* (July 24, 1992).

66. Ebru Alpay, Steven Buccola, & Joe Kervilet, *Productivity Growth and Environmental Regulation in Mexican and U.S. Food Manufacturing*, 84 AMER. J. AGR. ECON. 887, 894 (2002).

67. *Id.* at 887.

Berman and Bui also found that in meeting more stringent environmental standards, oil refineries in the Los Angeles Air Basin actually increased their productivity and efficiency. Interviews with “plant managers and environmental engineers suggested that productivity increases were not accidental. They resulted from a careful redesign of production processes induced by the need to comply with environmental regulation.”<sup>68</sup>

Stephen Meyer compared regulation across states in the United States found that environmental regulation did impact economic prosperity. In fact, “states with stronger environmental regulations tended to have higher growth in the gross domestic products.”<sup>69</sup> Though the correlation does not suggest causation, it does indicate that environmental regulation does not hinder state’s economies. The correlation held true even during times of recession. In an update focusing on the 1990-91 recession, Meyer found states with stronger environmental regulation were not more likely to face economic decline during a period of recession than states with weaker environmental standards.<sup>70</sup>

After completely mischaracterizing Porter’s insights in the 2004 regulatory accounting report,<sup>71</sup> OMB has opted this year to ignore the matter altogether. Clinging to disproven and unsupported theories tendentiously applied to support its anti-regulatory hostility, OMB is missing out on an opportunity to stimulate truly smarter regulation by paying attention to Porter’s theory and the evidence that backs it up.

### III. OMB CONTINUES TO SUPPORT THE FLAWED METHODOLOGIES OF COST-BENEFIT ANALYSIS AND “NET BENEFITS.”

#### A. OMB’s use of cost-benefit analysis is biased against public protection.

OMB continues to believe that cost-benefit analysis, especially in OMB’s application of it, is deeply flawed and a limited tool for determining public policy priorities. For a detailed analysis of the limitations of cost-benefit analysis, please see Lisa Heinzerling and Frank Ackerman’s excellent work, *Pricing the Priceless*.<sup>72</sup> (Please also note our analysis disputing the continued need of cost-benefit analysis in Appendix B.)

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68. Eli Berman & Linda T. M. Bui, *Environmental Regulation and Productivity: Evidence from Oil Refineries*, 83 REV. ECON. & STATS. 498, 508 (2001).

69. Stephen Meyer, *Environmentalism and Economic Prosperity: An Update* (Department of Political Science, Massachusetts Institute of Technology, Feb. 1993), at 2.

70. *See id.* at 9.

71. *See* Heinzerling & Ackerman, *supra* note 3, at 9.

72. Frank Ackerman & Lisa Heinzerling, *Pricing the Priceless: Cost-Benefit Analysis of Environmental Protection*, 150 U. PA. L. REV. 1553, 1554 (2002).

**B. OMB continues to support the misguided use of net benefits.**

Encouragingly, the net benefits section has been scaled down in the 2006 Draft Report. OMB still refers to net benefits, however, as a high-quality measurement tool and as a “theoretically superior measure of the overall value of regulation.”<sup>73</sup> The much protested net benefits chart from the 2005 report was left out of the 2006 Draft Report; however, a bar graph with the cost and benefits of major rules juxtaposed remains.<sup>74</sup> OMB encourages readers to compare the difference between cost and benefits to find the net benefits of rules from 1992 to September 2005.<sup>75</sup> As thoroughly explained in the OMB Watch 2005 comments and summarized here, we suggest removing all mentions and calculations of net benefits; the net benefits approach is misleading and an inappropriate regulatory measurement.<sup>76</sup>

“Net benefits” is a simplified approach, forcing all cost and benefits to be reduced to monetary valuations, or else disregarded. The simplicity—the reduction of the overall costs and benefits to society to one number—is the central problem for the measure’s usefulness. In order to create this one number, costs and benefits must all be reduced to monetary valuations; everything that is not or can not be monetized is disregarded. As a result, the many problems of cost-benefit analysis, the strong tendencies to minimize benefits, overestimate costs to industry, and leave many key and controversial assumptions ignored entirely or relegated to footnotes, are thus greatly aggravated. In his peer review of the 2005 Draft Report, Richard W. Parker, a professor at the University of Connecticut School of Law, also noted the problems that arise when costs and benefits are reduced to monetary valuations.<sup>77</sup> He explained that the analysis lacks any indication of which benefits are monetized or which key assumptions are adopted. Furthermore, he restated the problem that arises when a variable is impossible to quantify and the net benefits approach omits it: benefit estimates are skewed.<sup>78</sup> Parker suggests identifying non-quantified and non-monetized benefits and their level of significance in the 2005 report, however his suggestion was ignored.

Not only does the approach lead to over-simplified results, but a net benefits analysis raises ethical and moral considerations. Net benefits are not the same as *benefits created* and as a result aggregate benefits are ignored. When the only benefits that matter are those that outweigh costs, economic efficiency becomes the sole objective, disregarding necessary health, safety and environmental protections. A net benefits approach possesses the same problematic assumptions as a

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73. Draft Report, *supra* note 2, at 26.

74. *See id.* at 29.

75. *See id.*

76. *See* J. Robert Shull, Comments on the 2005 Draft Report to Congress, 22, 23-24 (OMB Watch 2005) *available at* <[http://www.whitehouse.gov/omb/inforeg/2005\\_cb/K\\_OMBWatch.pdf](http://www.whitehouse.gov/omb/inforeg/2005_cb/K_OMBWatch.pdf)>.

77. *See* Richard W. Parker, Comments on the 2005 Draft Report to Congress, at 2 (2005) *available at* <[http://www.whitehouse.gov/omb/inforeg/2005\\_cb/5\\_Parker.pdf](http://www.whitehouse.gov/omb/inforeg/2005_cb/5_Parker.pdf)>.

78. *See id.*

cost-benefit analysis, but to a more extreme degree because only benefits that outweigh costs are considered worthwhile. Cost-benefit comparisons are often inaccurate or impossible to assess because many benefits and values are difficult to quantify. Furthermore, the ethically-blind tool of cost-benefit analysis often produces policy assessments that do not comport with our intuition (e.g. : assessing the monetary value of a child's life, evaluating costs to society based on a victim's age, or subsidizing a dangerous habit that will save the state money). The assumption that humans are rational *homo economicus*, that we all are "rational" wealth-maximizing consumers in all of our behavior, often goes against human nature, and therefore results from cost-benefit analyses are often ethically and morally suspect.

Presenting net benefit analysis as a superior measurement tool masks the political nature of the approach. The ultimate regulatory reduction goals of the Bush II administration are emphasized in the Draft Report, under figure 2-2, noting that in no year were costs significantly greater than benefits.<sup>79</sup> The footnote below adds: "In 1993 and 1995, costs exceeded benefits by about \$400 million in each year."<sup>80</sup> The politics of the net benefits approach is revealed when the report compares the net benefits from this administration to the net benefits from the previous administration. Thomas McGarity and Amy Sinden from the Center for Progressive Reform noted the politically driven anti-regulatory bias in the 2005 report: "OMB's specious attempts to draw a connection between high levels of regulation and slow economic growth and its related attempts to congratulate the Bush II administration for reducing levels of environmental, health, and safety regulation display a pervasive and politically driven anti-regulatory bias."<sup>81</sup>

Extensive methodological and logical weaknesses make the net benefits measure a misguided waste of public resources with no real usefulness to policymakers for assessing the health, safety, and environmental goals of our country. The net benefits measure aggravates the problematic and questionable assumptions of cost-benefit analysis in general, and it amounts to little more than a biased and easily manipulated political scorecard which should be removed from the 2006 Draft Report.

#### IV. CONCLUSIONS AND RECOMMENDATIONS

As OMB finalizes the 2006 report, we hope that it takes the opportunity to address its critics and fix the methodological problems point out year after year. In particular, OMB Watch makes the following suggestions.

**OMB should solve problems of transparency and responsiveness.**

- OMB should make the underlying information in the report more transparent to the public by making regulatory impact analyses, economic impact analyses, and scholarly articles more accessible, via an accurate online docket.

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79. Draft Report, *supra* note 2, at 29.

80. *See id.*

81. Thomas O. McGarity & Amy Sinden, Comments on the 2005 Draft Report, 9 (Center for Progressive Reform 2005) *available at* <[http://www.whitehouse.gov/omb/inforeg/2005\\_cb/B\\_CPR.pdf](http://www.whitehouse.gov/omb/inforeg/2005_cb/B_CPR.pdf)>.

- OMB should increase transparency of the report by making it possible for the public to compare report assertions with the material at large and verify OMB's information. This can be accomplished by providing source and page numbers of data, documenting changes or conversions to agency estimates, and including electronic spreadsheets and data sets used to reach conclusions.
- OMB should correct the errors noted in comments and peer reviews in previous years, including the following:
  - Eliminating “transfer rules” from the discussion of total costs and benefits,
  - Accounting for benefits lost in deregulation,
  - Correcting the characterization of benefits of workplace health and safety protections,
  - Using correct values in the fuel economic discussion, and
  - Removing the widely disregarded Crain study from the literature.

**OMB should revise its overly simplistic argument that regulatory stringency reduces American competitiveness in the global marketplace.**

- OMB should remove economic regulatory evidence from World Bank and OECD studies cited in the social regulation and competitiveness argument; they are irrelevant to the social anti-regulatory conclusions.
- OMB should acknowledge factors besides economic growth that account for well-being and the connection between social regulation and such indicators.
- OMB should review their assumptions that the benefits of “economic freedom” will continue to accrue equally at every level of deregulation and their conclusions that that reducing health, safety and environmental protections will achieve continued benefits in economic growth.
- OMB should include literature that discounts a regulation-competitiveness trade-off, including research on economic indicators such as plant location, industry imports and exports, and foreign direct investment and numerous studies which argue against the pollution haven effect.
- OMB should include research surrounding the Porter “hypothesis” that regulation can actually increase productivity by increasing the efficiency of operations.

**OMB should fix flawed methodologies of cost-benefit analysis and net benefits.**

- OMB should acknowledge the limitations of cost-benefit analysis as a tool for determining public policy priorities.
- OMB should remove the references to net benefits as a superior method of analysis and discontinue the use of this oversimplified, unethical and political measurement tool.



### Appendix A: Another Look at Look-Back Studies

In an attempt to analyze and validate pre-regulation estimates of benefits and costs, OMB's 2005 Report contained sections on "Validation of Estimates" and "Brief Summaries of Ex-post Evaluations of Regulations." The public interest community was hopeful that OMB's focus on look-back studies would serve as an acknowledgement of complaints that agencies' *ex ante* estimates of industry compliance costs are consistently overestimated in agency analysis. Unfortunately, OMB's analysis used a skewed assortment of look-back studies, excluded most of the rich literature on this subject, and included studies of dubious merit. OMB did not utilize the full range of available research and tended to use only look-back studies that concentrated on NHTSA rule-making.

#### Biased studies remained in the final OMB report.

Besides including a greater range of research, we recommended the removal of two studies from the list: one by the industry-friendly AEI-Brookings<sup>82</sup> and the Thompson/Graham article.<sup>83</sup> OMB not only failed to take our suggestion for the removal of these reports but also failed to respond to our criticism of their merit. The AEI-Brookings piece drastically overestimates the cost of the regulation by failing to distinguish between overestimates due to lack of compliance by employers and that due to overestimation by the agency and by using a skewed sample, while the Thompson/Graham article fails to accurately estimate the benefits of the regulation of air bags.<sup>84</sup>

Other peer reviewers also commented on the bias of the look-back studies included in the 2005 Draft Report. Joan Claybrook from Public Citizen noted that the look-back studies are unbalanced and biased and recommended that the flawed studies from AEI-Brookings and Thompson/Graham evaluation be excluded.<sup>85</sup> Thomas McGarity and Amy Sinden from the Center for Progressive Reform also reviewed the 2005 draft and found look-back literature composed of biased studies, used to paint an inaccurate picture of the academic debate.<sup>86</sup>

#### OMB failed to include studies suggested by public interest commenters.

This year the validation section was removed from the report. While omitting the section on

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82. See SI KYUNG SEONG & JOHN MENDELOFF, *ASSESSING THE ACCURACY OF OSHA'S PROJECTIONS OF THE BENEFITS OF NEW SAFETY STANDARDS* (AEI-Brookings Jt. Ctr. for Reg. Studs. Regulatory Analysis No. 03-8, July 2003), available at <<http://aei-brookings.org/admin/authorpdfs/page.php?id=277>>.

83. See Kimberly M. Thompson, Maria Segui-Gomez, & John D. Graham, *Validating Benefit and Cost Estimates: The Case of Airbag Regulation*, 22 RISK ANAL. 803 (2002)

84. For the full criticism of both the AEI-Brookings and Thompson/Graham articles, see Shull, *supra* note 76, at 36-38.

85. See Joan Claybrook, Public Citizen, Comments on the 2005 Draft Report, 11-12 (2005) available at <[http://www.whitehouse.gov/omb/inforeg/2005\\_cb/O\\_PublicCitizen.pdf](http://www.whitehouse.gov/omb/inforeg/2005_cb/O_PublicCitizen.pdf)>.

86. See Thomas O. McGarity & Amy Sinden, *supra* note 81, at 12.

look-back studies removed some bias from the 2006 Draft Report, OMB's faulty conclusions still circulate unanswered. *Ex ante* cost estimates tend to be higher than *ex post* results, resulting in skewed cost-benefit analyses that support a reduction in regulation. OMB should acknowledge this problem in their cost-benefit report.

In our 2005 comments, OMB Watch suggested a list of studies that should have been incorporated into OMB's mini-bibliography of look-back studies. Studies suggested by OMB Watch that were absent from the final 2005 report:

- Nicholas A. Ashford & Charles C. Caldart, *Technology, Law, and the Working Environment* (Island Press, 1996).
- Eban Goodstein, "Polluted Data," *American Prospect*, Nov.-Dec. 1997, at 64, available at <<http://www.prospect.org/web/page.wv?section=root&name=ViewPrint&articleId=4757>>.
- Eban Goodstein, *The Trade-Off Myth: Fact and Fiction About Jobs and the Environment* (Island Press, 1999).
- General Accounting Office, *Environmental Protection: Assessing the Impacts of EPA's Regulations Through Retrospective Studies* (Rep. No. GAO/RCED-99250, 1999), available at <<http://www.gao.gov/archive/1999/rc99250.pdf>>.
- Thomas O. McGarity & Ruth Rutenberg, "Counting the Cost of Health, Safety, and Environmental Regulation," 80 *Texas L. Rev.* 1197 (2002).
- Office of Tech. Assessment, U.S. Cong., *Gauging Control Technology and Regulatory Impacts in Occupational Safety and Health: An Appraisal of OSHA's Analytical Approach* (Rep. No. OTA-ENV-635, Sep. 1995), available at <[http://www.wws.princeton.edu/~ota/disk1/1995/9531\\_n.html](http://www.wws.princeton.edu/~ota/disk1/1995/9531_n.html)>.
- Ruth Rutenberg & Assocs., *Not Too Costly, After All: An Examination of the Inflated Cost-Estimates of Health, Safety, and Environmental Protections* (Public Citizen, Feb. 2004), available at <<http://www.citizen.org/documents/ACF187.pdf>>.

The suggestions from OMB Watch's comments, as well as the other peer reviewers on the subject of look-back literature, were not used by OMB in the 2005 report, or the draft that followed this year. OMB should also acknowledge the methodological faults of its look-back review approach.

### New Research on Look Backs

OMB should also consider a new meta-study by economist Frank Ackerman, which questions fears of large regulatory costs through an examination of various validation studies. *The Unbearable Lightness of Regulatory Costs*, examines both conservative and more expansive estimates of regulatory cost, finding that "[t]he costs of environmental protection are much more often overestimated, rather than underestimated, in advance."<sup>87</sup> Ackerman studies the biases in *ex ante* estimates of regulatory costs by introducing literature and research on patterns of overestimation.

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87. Frank Ackerman, *The Unbearable Lightness of Regulatory Costs* (hereinafter "Ackerman"), Global Development and Environment Institute Working Paper No. 06-02 (2006), available at <<http://www.ase.tufts.edu/gdae/pubs/wp/06-02unbearablelightnessreg.pdf>>.

Ackerman's study includes OSHA workplace safety cost estimates which were found in *ex post* studies to overestimate the costs of reducing vinyl chloride exposure. Ackerman also includes a study by Hart Hodges, which found environmental regulatory compliance costs were overestimated in 11 of 12 cases examined. Ackerman also relies on an article by Winston Harrington, which found that cost estimates were 25 percent too high in 14 of 28 cases examined and 25 percent too low in only 3.<sup>88</sup> Drawing together this robust evidence, Ackerman is able to show that *ex ante* cost estimates of regulatory protections tend to be inflated across the board.

Ackerman also responds to OMB's Office of Information and Regulatory Affairs' conclusions to the contrary. In the 2005 draft report OMB cited only three studies to reach their conclusion that *ex ante* cost estimates are routinely underestimated. A closer examination of the underlying studies, however, reveals that the authors claim that regulatory costs are large, not that the estimates are *underestimated*.<sup>89</sup> Furthermore, Ackerman notes that the "details of these claims are not impressive."<sup>90</sup> The first study uses OMB data and allows OMB to cite itself in support of its claims, while the second study multiplies findings by 5.5.<sup>91</sup> The third study used by OMB to justify its conclusions is based on a far different period of environmental law and pollution control spending.<sup>92</sup>

Ackerman also reviews the conclusions by OMB in its final 2005 report, which include 47 rules in which pre-regulation estimates of benefits and costs were made by federal agencies. Ackerman finds OMB's conclusions that cost estimates were too low to be "fundamentally unpersuasive" because OMB's conclusions are based on skewed data from only a few sources that reviewed multiple rules, finding a pattern that is not statistically significant.<sup>93</sup> The evidence provided in the 2005 report boils down to only 13 OSHA rules, 9 of which were adopted before 1992.<sup>94</sup> In response to OMB's

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88. See Ackerman, *supra* note 87, at 10. See also U.S. CONG., OFFICE OF TECHNOLOGY ASSESSMENT, GAUGING CONTROL TECHNOLOGY AND REGULATORY IMPACTS IN OCCUPATIONAL SAFETY AND HEALTH: AN APPRAISAL OF OSHA'S ANALYTIC APPROACH (1995), available at <[http://www.dau.mil/educdept/mm\\_dept\\_resources/reports/OTA-Gauging-controltech-and-impact-on-OSHA.pdf](http://www.dau.mil/educdept/mm_dept_resources/reports/OTA-Gauging-controltech-and-impact-on-OSHA.pdf)>.

See also Hart Hodges, *Falling Prices: Cost of Complying with Environmental Regulations Almost Always Less Than Advertised* (Economic Policy Institute 1997), available at <<http://www.epinet.org/briefingpapers/bp69.pdf>>.

See also Winston Harrington et al., *On the Accuracy of Regulatory Cost Estimates*, 19 J. POL. ANALYSIS & MNGMT. 297 (2000), available at <<http://www.agecon.lsu.edu/WebClasses/AGEC7603/Literature/RFF-DP-99-18.pdf>>.

89. See Ackerman, *supra* note 87, at 11.

90. See *id.*

91. See *id.* See also *supra* note 15.

92. See Ackerman, *supra* note 87, at 11.

93. See *id.* at 12.

94. See *id.* at 13.

suggestion that costs are systematically underestimated while benefit overestimated, Ackerman concludes: “The grounds for this contrary conclusion include citation of a limited number of unconvincing studies, and manipulation of a regulatory data set which does not show a statistically significant tendency toward overestimates of benefit-cost ratios.”<sup>95</sup>

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95. *See id.* at 18.

## Appendix B: Is Cost Benefit Analysis Needed?

OMB seems wedded to using the deeply flawed methodology of cost-benefit analysis. OMB continually fails to reasonably respond to critics of cost-benefit analysis. Cost-benefit analysis is just one tool used by policymakers in developing public policy. OMB seems to blindly assume that cost-benefit analysis is the best or only way to make decisions about federal policy. Especially when considering policies with non-monetary benefits, such as those regarding the environment, health, safety or civil rights, cost-benefit analysis consistently fails to capture the real impacts of a particular regulation. Moreover, while cost-benefit analysis (CBA) is often touted by the administration as a neutral tool in policymaking, recent studies by legal scholars show that CBA is inherently political and may even advise against what we consider our most immutable public protections.

In relying on CBA, OMB seems to believe that regulators are irrational in their policy decisions and that CBA is necessary in developing regulations because it acts as a neutral, rational tool, evenly weighing all considerations, but many public interest advocates have argued that cost-benefit analysis unfairly targets environmental, health, safety and other social regulation and will always favor lowering costs rather than creating more stringent protections. If cost-benefit analysis really is a neutral tool, then it must be equally capable of siding with more stringent regulation as it does weaker regulation. Three recent articles examine the neutrality of CBA both in theory and in practice and analyze the arguments of CBA's greatest proponents. Lisa Heinzerling, Frank Ackerman and Rachel Massey's "Applying Cost Benefit Analysis to Past Decisions: Was Environmental Protection Ever a Good Idea?,"<sup>96</sup> David Driesen's "Is Cost-Benefit Analysis Neutral?,"<sup>97</sup> and Richard Parker's "Is Government Regulation Irrational? A Reply to Morall and Hahn"<sup>98</sup> all find that neither in theory nor in application is cost-benefit analysis a neutral tool. Moreover, this "simplistic scorecard" fails to embody our national regulatory priorities.

### The "Simplistic Scorecard"

Advocates of cost-benefit analysis claim that regulation is irrational and that cost-benefit analysis is necessary to rein in costly, burdensome measures. Yet as Richard Parker points out in "Is Cost Benefit Analysis Irrational?," the arguments of CBA's biggest supporters are themselves irrational, relying on fuzzy numbers and misguided assumptions to prove the case for this weak policy tool.

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96. See Frank Ackerman, Lisa Heinzerling & Rachel Massey, *Applying Cost-Benefit to Past Decisions: Was Environmental Protection Ever a Good Idea?* (Georgetown University Law Center, Public Law & Legal Theory Working Paper Series, Research Paper No. 576161, 2004), available at <<http://ssrn.com/abstract=576161>>.

97. See David M. Dreisen, *Is Cost-Benefit Analyst Neutral?*, (Syracuse University College of Law 2005) available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=663602](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=663602)>.

98. See Richard W. Parker, *Is Government Regulation Irrational?: A Reply to Morall and Hahn* (University of Connecticut School of Law 2004) available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=588881](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=588881)>.

Some of the most widely-cited cases for the necessity of cost-benefit analysis is necessary in policy-making have come from John Morrall, an economist at the Office of Management and Budget (OMB), and Robert Hahn, of AEI-Brookings Joint Center for Regulatory Studies. Both have argued, after applying cost-benefit analysis to the totality of government regulation, that the costs of federal regulation far outweigh the benefits, proving, they assert, that government regulation is fundamentally irrational and overzealous. They point to what appear to be egregious examples of overly-cautious regulations, citing cases in which regulation costs up to \$72 billion for every life saved. Yet, as Parker easily points out, their arguments are based on shaky assumptions that fail to take into account the full range of considerations necessary for an agency to make a rational policy decision.<sup>99</sup>

### Unreproducible Results

For all the lip service on hard numbers, both Morrall and Hahn's data contained many undisclosed assumptions, and calculations and methodologies were often not revealed. Parker observes that Hahn's gaps are particularly noteworthy: "Hahn's original studies do not so much as *list* the rules in his database."<sup>100</sup> Hahn also offers no documentation of his calculations. After soliciting Hahn, Parker finally received Hahn's data, but his Excel spreadsheet only gave a tally of costs and benefits and his final calculation, without indicating any of the assumptions Hahn made to arrive at numbers he used.<sup>101</sup>

Even without being able to reproduce the results, it is clear that Morrall and Hahn make assumptions that are biased against regulation. In fact, as Parker points out, the data set that Morrall chooses to work with focuses on some of the most extreme cases of costly regulation.<sup>102</sup> Morrall chooses an arbitrary set of 16 highly costly regulations in order to make his claim that regulators make irrational choices. Most of these regulations have to do with just a handful of pollutants, which have, as Parker notes, "generated some of the most heated and heavily litigated controversies in all of environmental law."<sup>103</sup> Clearly Morrall's case examples do not represent a neutral dataset.

### Shaky Numbers

Morrall and Hahn also choose to use a very high discount rate, which discounts the future costs and benefits of a regulation using a constant exponential rate. Though many scholars disagree on the practice of discounting benefits at all, there is little consensus on a discount rate higher than three percent.<sup>104</sup> Yet Morrall chooses a discount rate of 10 percent and Hahn uses discount rates at three,

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99. See John F. Morrall, *Saving Lives: A Review of the Record*, 27 J. RISK & UNCERTAINTY 221 (2003); see also Robert W. Hahn, *Regulatory Reform: Assessing the Government's Numbers*, in REVIVING REGULATORY REFORM: A GLOBAL PERSPECTIVE 32 (2000).

100. See Parker, *supra* 98, at 14.

101. See *id.* at 15.

102. See *id.* at 3.

103. See *id.*

104. See Richard L. Revesz, *Environmental Regulation, Cost-Benefit Analysis, and the Discounting of Human Lives*, 99 COLUM. L. REV. 941, 980-981 (1999); see also Murray Weitzman, *Gamma Discounting*, 91 AM. ECON. REV. 260 (2001).

five and seven percent.<sup>105</sup> Such rates can dramatically reduce the potential benefit of a regulation. As Parker points out, “discounting a constant stream of benefits over 25 years will reduce its present value by 30 percent at a three percent discount rate, or 50 percent at a seven percent discount rate.”<sup>106</sup>

Morrall and Hahn also assume a latency period in the calculation of certain benefits. For risks such as cancer which may not manifest themselves for a number of years, they add in a latency period to their calculation of benefits, which greatly reduces the present benefit of avoiding a future harm. As Parker points out, if one assumes “that the stream of cancer risk reduction benefits (which dominate many of the health and environmental rule benefit numbers) only begins to accrue after a latency period of some 15-35 years, the impact of discounting can become truly enormous. Discounting a constant dollar annual benefit accruing over 25 years -- beginning 35 years out -- will effectively shrink benefits by a factor of four at a three percent discount rate, and a factor of twenty at . . . [a] seven percent rate.”<sup>107</sup> This assumption distorts their calculation of benefits, and once again, the distortion favors the regulated community.

Morrall also arbitrarily chooses to reduce benefits. Rather than relying on agency calculations to calculate benefits, Morrall chooses numbers from published studies that significantly reduce benefits.<sup>108</sup> When agencies present a range of possible benefits, he arbitrarily chooses from the bottom of the range, without explaining his methodology. Morrall adjusts agency numbers on health effects, risk assessments, and effectiveness, in each case swaying the balance in favor of less regulation.<sup>109</sup> That Morrall should do independent analysis of factors is not the issue, but Morrall’s choice to manipulate the equation without an explanation or rationale leaves observers guessing as to how the numbers were attained.

#### Ignoring Unquantified or Non-Life-Saving Benefits

Morrall and Hahn also choose to ignore benefits that agencies did not quantify or benefits that can be quantified but not given a dollar value. For instance, Morrall gives OSHA’s formaldehyde rule a price tag of \$72 billion per life saved.<sup>110</sup> Though the formaldehyde rule may only save one life a year, it has many other significant benefits that are not included in Morrall’s calculation, including, according to Parker, “reduced or avoided burning eyes or noses, sore or burning throats, asthma attacks, chronic bronchitis, allergic reactions, dermatitis and skin sensitization. OSHA notes that over 500,000 American workers are regularly exposed to formaldehyde at concentrations that have been found to cause one or more of these illnesses or discomforts.”<sup>111</sup> By focusing only on lives saved,

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105. See Parker, *supra* 98, at 8.

106. See *id.*

107. See *id.* at 9.

108. See *id.* at 4.

109. See *id.* at 4-8.

110. See *id.* at 10.

111. See *id.* at 11.

Morrall's calculations miss the harm that a regulation is actually averting, one that resists his simplistic calculations.

Hahn ascribes "a zero value to any benefit which the government's regulatory impact assessment did not quantify and monetize."<sup>112</sup> Hahn also ignores benefits that were quantified and monetized by agencies "but which failed to fit within his Procrustean categories of recognized benefit - reduction of cancer, heart disease, lead poisoning and accidents, and benefits of reduction a handful of air pollutants -- even as he insisted that he was using the government's numbers."<sup>113</sup> Hahn wrongly asserts that leaving out these "non-standard" benefits will have no impact on his calculations.

Parker gives the example of EPA's *Great Lakes Water Quality Guidance*, which reduces "the discharge of persistent, toxic and bio-accumulative pollutants" in the Great Lakes.<sup>114</sup> The compounds reduced by the regulation are associated with very serious risks, including "neurotoxicity, fetotoxicity, endocrine disruption, hematological impairment, reproductive dysfunction, sensory and equilibrium disturbances," among others.<sup>115</sup> Despite the clear benefits of such regulation, this measure fails cost-benefit analysis because a great many of its benefits cannot be monetized. These non-cancerous risks are difficult to quantify:

Unlike cancer, which is widely assumed to have a linear dose-response down to a zero exposure level (making the calculation of population risk from aggregate exposure data relatively simple), non-cancer endpoints generally have non-linear risk thresholds -- which means that, to calculate a population risk from any given discharge, you have to know not only the exposure of the population to the pollutants issuing from the sources targeted by the particular regulation. You also have to know the cumulative exposure to individuals in the population to these and other interacting pollutants from other sources.<sup>116</sup>

According to Hahn, the only benefit from this regulation is the reduction of fatal cancer to sports anglers and Native American subsistence fisherman.<sup>117</sup>

Looking just at the cost-benefit analysis, the cost of the regulation would seem to far outweigh the benefit. An entirely different picture emerges with knowledge of the health effects of the hazards the guidance addresses. Fortunately, EPA's consideration of the rule was not limited to quantified benefits.

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112. *See id.* at 16-17.

113. *See id.* at 17.

114. *See id.* at 19.

115. *See id.*

116. *See id.* at 19-20.

117. *See id.* at 20.



Accounting for such benefits requires a more in-depth dynamic analysis, which cost-benefit analysis cannot capture, leading Parker to refer to the methodologies of CBA's greatest proponents as a "simplistic scorecard."<sup>118</sup>

### Not a Neutral Tool

Even given the many uncertainties of cost-benefit analysis, proponents still argue that it acts as a neutral tool. Yet, as David Driesen points out, "if CBA only makes regulation weaker, and never strengthens overly weak regulation, it cannot improve priority setting and consistency in the manner its proponents envision."<sup>119</sup> Driesen lays to rest the argument of CBA's neutrality by dissecting the use of CBA both in practice and theory. Driesen finds that both in OMB's implementation of cost-benefit analysis as well as in the assumptions of the cost-benefit analysis itself, CBA is weighted in favor of the regulated industry and against health, safety and environmental protections.

### In Practice

Driesen focuses his look at cost-benefit analysis particularly on the role of OMB in implementing Executive Order 12,866. According to a Government Accountability Office (GAO) report, between June 2001 and July 2002, OMB "significantly affected 25" environmental, health and safety regulations.<sup>120</sup> If cost-benefit analysis is in practice a neutral tool, then OIRA's use of cost-benefit analysis to review regulation would sometimes strengthen protections and sometimes weaken them. Driesen found that none of OIRA's changes made environmental, health or safety protections more stringent, and 24 out of the 25 weakened protections.<sup>121</sup> Even if cost-benefit analysis is theoretically a neutral tool, in the hands of this administration, it is certainly biased against strong public protections.

Further evidence comes from the records of agencies whose statutes demand the use of cost-benefit analysis. Courts have interpreted the Toxic Substance Control Act (TSCA) and the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) to require CBA. The result has been a nearly complete halt on regulatory activity.<sup>122</sup> According to Driesen, "EPA has not banned a single chemical under TSCA since the United States Court of appeals for the Fifth Circuit interpreted the statute as requiring that bans pass a cost-benefit test."<sup>123</sup> FIFRA has suffered much the same fate. Cost-benefit analysis has put the breaks on needed regulatory protections.

For other statutes governing EPA, including the Clean Air Act and the Resources Conservation and Recovery Act, cost-benefit analysis is used in an "indeterminate position," meaning it is considered

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118. *See id.* at 22.

119. *See* Driesen, *supra* 97, at 3.

120. *See* United States General Accounting Office, RULEMAKING: OMB'S ROLE IN REVIEWS OF AGENCIES' DRAFT RULES AND THE TRANSPARENCY OF THOSE REVIEWS 5 (2003).

121. *See* Driesen, *supra* 97, at 33.

122. *See id.* at 14.

123. *See id.* at 13.

when forming regulation but does not serve as a specified criterion.<sup>124</sup> For regulations promulgated under these statutes, OMB historically has applied cost-benefit analysis unevenly, providing lengthy analysis when considering a new regulation but quickly approving deregulatory actions.<sup>125</sup> Driesen uses the example of regulating particulate matter. For example, notes Driesen, “OMB engaged in protracted argument with EPA in the early 1980s over whether EPA must prepare a CBA of a possible tightening of the particulate matter National Ambient Air Quality Standard (NAAQS), but it cleared EPA revocation of the hydrocarbon NAAQS in two days with no formal CBA.”<sup>126</sup>

Though overall OMB generally approves agency rules without changes, when it comes to reviewing EPA rules, “OMB often significantly changes between 45 and 75 percent of the rules it reviews.”<sup>127</sup> This high rate shows that at least in practice OMB is hostile to environmental protections.

Driesen was able to find only one case in which cost-benefit analysis has led to increased regulation: the reduction of lead in gasoline. Yet in this case, the initial implementation of the regulation occurred without performing cost-benefit analysis. CBA was only applied after the regulation had been in place for a number of years in order to support a more stringent standard.<sup>128</sup> Heinzerling, Ackerman and Massey have shown that if the regulation had not already been in place, the empirical evidence would not have existed to justify the further reduction of lead in gasoline.

### In Theory

Cost-benefit analysis can be used in a variety of ways by regulators. Some agencies use cost-benefit analysis in what Driesen calls an “indeterminate position,” meaning the agency considers cost-benefit analysis but does not use it as a criterion for determining regulation.<sup>129</sup> OMB tends to see cost-benefit analysis as a criterion under which the cost of implementing a regulation can never exceed the benefit.<sup>130</sup> Another option is that cost-benefit analysis is used as a criterion under which cost must always equal benefit, optimizing the efficiency of the regulation.<sup>131</sup> Driesen shows that in each case cost-benefit is not a neutral tool and will always favor the regulated community over the health, safety and environmental regulation.

*The Indeterminate Position:* Even if cost-benefit analysis is used in an “indeterminate position,” weighed equally with other factors, it will still side against health, safety and the environment because cost-benefit analysis requires a greater expenditure of government resources and a delay in

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124. *See id.*

125. *See id.* at 15.

126. *See id.*

127. *See id.* at 16.

128. *See id.* at 32.

129. *See id.* at 55.

130. *See id.* at 58.

131. *See id.* at 59.

implementation of important safeguards. In lieu of cost-benefit analysis, agencies consider regulation based on the technological feasibility of implementing a regulation (including the cost of compliance) or an assessment of the health effects of a given regulation. “Cost benefit analysis combines all of the difficulties of both of these forms of analysis and creates an additional complication -- it requires quantification of benefits and, whenever possible, the assignment of monetary values to each of those benefits,”<sup>132</sup> according to Driesen. This method is inevitably more costly and time-consuming for the agencies and delays enforcement.

Delays in regulation are not neutral. They always benefit the regulated community at the expense of those exposed to the potential hazards by increasing the amount of time individuals are exposed to adverse conditions while giving the regulated community a longer time to avoid compliance.

*Benefit Cannot Outweigh Cost Criterion:* The criterion that benefit cannot outweigh cost is inherently not neutral. It acts as a one way ratchet, reducing benefit when cost is too great but never demanding an increase in benefit. If cost falls below benefit, this criterion does not require a more stringent standard. But if cost outweighs benefit, agencies are forced to weaken their standard in order to comply. This understanding of cost benefit is the one generally employed by OMB and the administration.

*Cost Equals Benefit Criterion:* If benefits are optimized, then cost should always equal benefit. CBA using this criterion at first appears to be a neutral tool. It could create either more or less stringent standards based on the conditions. If marginal benefit is greater than the marginal cost, it could recommend a stronger, more costly standard. Optimizing benefit may be more neutral overall, but it is not neutral compared to existing standards. Key provisions in the law require full protection of public health and the environment. In comparison to this standard, optimizing benefit is not a neutral theory because, as Driesen says, “this optimization criterion would not make regulation that already fully protects human health and the environment more stringent, but it would sometimes make it less stringent, so it is certainly not neutral relative to a health-protective standard.”<sup>133</sup> By maximizing efficiency, this criterion could also allow for the death of innocent life or allow harms to go unabated.

Even if cost-benefit analysis is applied in a relatively neutral way, the underlying methodology involves value choices that cannot be neutral. A cost-benefit analysis requires choosing a specific methodology to make a comparison of benefits and costs. Various ways of calculating benefits can have drastically different outcomes. Driesen explains:

For example, CBA proponents do not ask how much would a company have to pay a victim to get her to agree to die of cancer contracted after breathing in the fumes from the company’s plant. Rather, they have asked how much would a potential victim pay the factory to avoid a risk.<sup>134</sup>

Choosing a methodology involves a non-neutral value judgment.

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132. *See id.* at 57.

133. *See id.* at 60.

134. *See id.* at 65-66.

### Misguiding Our Priorities

Not only is cost-benefit analysis not a neutral tool; it fundamentally gets it wrong. Cost-benefit analysis does not reflect our country's values or priorities. In Lisa Heinzerling, Frank Ackerman and Rachel Massey's "Applying Cost-Benefit Analysis to Past Decisions," the authors seek to show what would have happened if cost-benefit analysis had been applied to some of our landmark environmental, health and safety regulations. They investigate the reduction of lead in gasoline, a proposed regulation that would have allowed damming in the Grand Canyon, and the regulation of occupational exposure to vinyl chloride, a chemical used in producing PVC. Their conclusion in all three cases is that cost-benefit analysis would have gotten it wrong, depriving us of some of our most important health, safety and environmental protections.

One of their most compelling examples is that of vinyl chloride. Vinyl chloride is a known carcinogen used in making PVC. In 1974, when OSHA sought to regulate vinyl chloride, substantial evidence existed about vinyl chlorides toxicity, especially its link to a rare form of liver cancer, angiosarcoma, but little was known about the safe level of exposure or how many people had or would die from angiosarcoma through exposure to vinyl chloride. At the time, there were only 13 known cases of angiosarcoma deaths from vinyl chloride exposure.<sup>135</sup> Still, OSHA chose to take a precautionary stance and sought to lower the allowable exposure level to 1 ppm over an eight-hour period. Previously, industry had allowed an exposure of 200 ppm "time-weighted average" with a maximum allowable exposure of 500 ppm.<sup>136</sup>

By statute, OSHA does not perform cost-benefit analysis and must enforce the most stringent policy "feasible." If it had performed CBA when determining an exposure limit for vinyl chloride with the knowledge they had at the time, CBA would have come out in favor of a much weaker standard.<sup>137</sup> Heinzerling, Ackerman and Massey compared the estimated cost of compliance at the time with the estimated value of a life in order to determine how many lives OSHA would have needed to think it was saving to justify the stringent regulatory standard.<sup>138</sup>

The estimated cost of compliance with the vinyl chloride regulation was thought to be \$200 million per year (though it turned out to be much lower).<sup>139</sup> For the value of a human life, the authors used two different estimates: the highest value of a life based on current EPA calculations and adjusted for inflation, which is \$1.81 million, and the much lower value of life used in the Ford Pinto controversy that occurred around the same time, which estimated the value of a statistical life at \$200,000.<sup>140</sup>

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135. *See id.* at 47.

136. *OSHA Standards for Vinyl Chloride Plants Upheld*, 5 ENVTL. L. REP. 10042 (1975).

137. *See Ackerman, Heinzerling & Massey, supra* 96, at 52.

138. *See id.* at 50-53.

139. *See id.* at 52.

140. *See id.* at 52-53.

Only 7,000 people worked in the vinyl chloride industry.<sup>141</sup> Using the Ford Pinto value, one out of every seven workers would have had to die to justify the stringent standard. That means that 1,000 people would have had to die each year to justify OSHA's regulation. If you take into account discount rates, the picture becomes even more dismal. At a 3 percent discount rate, 200 people using the high estimate for life value or 2,000 people using the lower estimate would have had to die each year for OSHA to justify the costs. At a 10 percent discount rate, 700 people would have had to die using the former estimate and 7,000 using the lower. Thus they conclude, "using a 10 percent discount rate and the value of life estimated in the 1970s, it would be necessary to show that every worker in the industry, every year, would have died in the absence of the standard, in order to justify the regulation in cost-benefit terms."<sup>142</sup>

This dramatic example adds to the overwhelming evidence that cost-benefit analysis is not only a weak tool for determining public protections, but its "impartial" calculations can have severe and damaging impacts. In no way is it a blind arbitrator, equally weighing both sides of an issue. Rather it is a political tool, weighted to favor the regulated community that does not adequately address our regulatory priorities.

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141. *See id.* at 53.

142. *See id.* at 54.