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H.R. 2432, PAPERWORK AND REGULATORY IMPROVEMENTS ACT OF 2003

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 2432

TO AMEND THE PAPERWORK REDUCTION ACT AND TITLES 5 AND 31, UNITED STATES CODE, TO REFORM FEDERAL PAPERWORK AND REGULATORY PROCESSES

JULY 22, 2003

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H.R. 2432, PAPERWORK AND REGULATORY IMPROVEMENTS ACT OF 2003

TUESDAY, JULY 22, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, Hon. Tom Davis (chairman of the committee) presiding.

Present: Representatives Tom Davis of Virginia, Ose, Platts, Schrock, Janklow, Blackburn, Waxman, Maloney, Tierney, Watson, Sanchez, and Ruppersberger.

Staff present: Keith Ausbrook, chief counsel; Jim Moore, counsel; David Marin, director of communications; Scott Kopple, deputy director of communications; Drew Crockett, professional staff member; Teresa Austin, chief clerk; Joshua E. Gillespie, deputy clerk; Kristina Boyd and Alexandra Teitz, minority counsels; Earley Green, minority chief clerk; and Jean Gosa, minority assistant clerk.

Mr. OSE [presiding]. Good afternoon. Welcome to today's full committee hearing of the Government Reform Committee. Chairman Davis is working on amendments on the floor, as will I be between now and the 5 p.m. hour. So, we'll probably be going back and forth. The vice chairman of my subcommittee has consented to help us keep in order the bit of business here and by the way we welcome him back from the Mayo Clinic. Mr. Janklow. Just a second. We're going to take care of a little housekeeping here.

Mr. Janklow and Mr. Platts, this is a motion to rise on the floor. I suspect we're going to have a series of such motions every time we have intervening business. What I'd request is that one of you head that way to vote and get back here so you can take the Chair, then I can go vote. But, you've got to hustle. Mr. Platts, you'll take care of that? All right. Then, you can alternate back and forth. How's that? All right.

As I said this is the hearing today of the full committee on Government Reform regarding H.R. 2432, the Paperwork and Regulatory Improvements Act of 2003. We have a number of witnesses with us, two panels in particular. As I move through the panels, you'll notice that we swear in all our witnesses. That's the standard in this committee. And we're going to maintain that standard. We're going to go to opening statements now. First I want to thank Chairman Davis for holding today's hearing on the bipartisan Paperwork and Regulatory Improvements Act that I authored as chairman of the Subcommittee on Energy Policy, Natural Re-

sources and Regulatory Affairs. I am grateful for his becoming an original cosponsor along with my subcommittee's vice chairman, Bill Janklow.

Let me turn to the bill itself. The bill includes legislative changes to one, increase the probability of results and paperwork reduction; two, assist Congress in its review of agency regulatory proposals; and three, improve regulatory accounting. The Office of Management and Budget, which I'm going to refer to as OMB from now on, estimates the Federal paperwork burden on the public of 8.2 billion hours. The IRS accounts for over 80 percent of that total. In 1980, the Congress passed the Paperwork Reduction Act, hereafter referred to as PRA.

In 1995, 1998, 2000 and 2002, Congress enacted additional legislation with the objective of decreasing paperwork burden. Nonetheless, paperwork has increased in each of the last 7 years with the largest increases coming in the last 2 years. And OMB continues to devote less than one full-time equivalent staff position to IRS paperwork reduction. To address this problem, section three of H.R. 2432 requires OMB to devote at least two full-time equivalents to IRS paperwork reduction. Section 4 removes recent unjustified statutory exemptions from various paperwork review and regulatory due process requirements. These include the Administrative Procedure Act's protection for affected parties to have notice and an opportunity to comment on agency regulatory proposals and the PRA's required review and approval by OMB.

Section 5 makes permanent the authorization for the General Accounting Office to respond to requests from Congress for an independent evaluation of selective, economically significant rules proposed or issued by Federal agencies. To assume oversight responsibility for Federal regulations, Congress needs to be armed with an independent evaluation. With this analytic help, Congress will be better equipped to review final agency rules under the Congressional Review Act. More importantly, Congress will be better equipped to submit timely and knowledgeable comments on proposed rules during the public comment period.

Section 6 requires certain changes to improve regulatory accounting. In 1996, Congress required OMB to submit its first regulatory accounting report. In 1998 and 2000, Congress enacted additional legislation to make OMB's regulatory accounting reports more useful. OMB is required to annually estimate the total annual costs and benefits for all Federal rules and paperwork in the aggregate by agency, by agency program and by major rule and to include an associated report on the impacts of Federal rules and paperwork on certain groups. OMB's six regulatory accounting reports have all failed to meet some of the statutorily required content requirements.

Part of the reason for this failure is that OMB has not requested agency estimates for each agency bureau and program, as it does annually for its information collection budget—the paperwork budget—and for the President's budget—the fiscal budget. Section 6(a) of the proposed legislation extends this practice of required agency input for OMB's annual regulatory accounting statements.

Section 6(b) requires OMB's regulatory accounting statement to cover the same 7-year time series as the President's fiscal budget.

Section 6(c) requires integration into the fiscal budget. Currently, the economic impacts of Federal regulation receive much less scrutiny than programs in the fiscal budget. Requiring OMB presentation using the same time series as the fiscal budget and being fully integrated into the fiscal budget documents, Congress will be better able to simultaneously review both the on-budget and off-budget costs associated with each Federal agency imposing regulatory or paperwork burdens on the public.

Last, section 6(d) establishes pilot projects for regulatory budgeting. These tests will determine if agencies can better manage regulatory burdens on the public. Agencies will identify regulatory alternatives and then prioritize them so that the worst societal problems can be addressed first.

Last, I want to explain the overall logic behind this bill. I sought to make incremental improvements in the existing processes governing paperwork and regulations instead of fundamentally changing the role of Congress in its oversight of agency rules to implement laws. I believe that the public expects and deserves paperwork reduction results. In addition, I believe that the public has the right to know if it is getting its money's worth from Federal regulation.

Given the vote situation on the floor, and the likely continuance of that, the other Members will be invited to make opening statements upon their return. This is going to be a little bit of a hobgoblin of a process, but we're going to work our way through it.

[The prepared statement of Hon. Doug Ose and the text of H.R. 2432 follow:]

Chairman Doug Ose
Opening Statement at GRC's Hearing on
The Paperwork and Regulatory Improvements Act (H.R. 2432)
July 22, 2003

First, let me thank Chairman Davis for holding today's hearing on the bi-partisan "Paperwork and Regulatory Improvements Act," that I authored as Chairman of the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs. I am also grateful for his becoming an original co-sponsor along with my Subcommittee's Vice Chairman Bill Janklow.

Now, let me turn to the bill itself. The bill includes legislative changes to: (1) increase the probability of results in paperwork reduction, (2) assist Congress in its review of agency regulatory proposals, and (3) improve regulatory accounting.

OMB estimates the Federal paperwork burden on the public at 8.2 billion hours. The Internal Revenue Service (IRS) accounts for over 80 percent of the total. In 1980, Congress passed the Paperwork Reduction Act (PRA). In 1995, 1998, 2000, and 2002, Congress enacted additional legislation with the objective of decreasing paperwork burden. Nonetheless, paperwork has increased in each of the last seven years, with the largest increases in the last two years. And, OMB continues to devote less than 1 full-time equivalent (FTE) staff to IRS paperwork reduction. To address this problem, **Section 3** of H.R. 2432 requires OMB to devote at least two FTEs to IRS paperwork reduction.

Section 4 removes recent unjustified statutory exemptions from various paperwork review and regulatory due process requirements. These include the Administrative Procedure Act's protections for affected parties to have notice and an opportunity to comment on agency regulatory proposals, and the PRA's required review and approval by OMB.

Section 5 makes permanent the authorization for the General Accounting Office (GAO) to respond to requests from Congress for an independent evaluation of selective economically significant rules proposed or issued by Federal agencies. To date, GAO has not hired staff for this function since the law only authorized a 3-year pilot project. Instead, GAO intended, after the 3-year pilot project received funding (which has not yet occurred), to use contractors to prepare its independent evaluations. To assume oversight responsibility for Federal regulations, Congress needs to be armed with an independent evaluation. With this analytic help, Congress will be better equipped to review final agency rules under the Congressional Review Act. More importantly, Congress will be better equipped to submit timely and knowledgeable comments on proposed rules during the public comment period.

Section 6 requires certain changes to improve regulatory accounting. In 1996, Congress required OMB to submit its first regulatory accounting report. In 1998 and 2000, Congress enacted additional legislation to make OMB's regulatory accounting reports more useful. OMB is required to annually estimate the total annual costs and benefits for all Federal rules and paperwork in the aggregate, by agency, by agency program, and by major rule, and to include an associated report on the impacts of Federal rules and paperwork on certain groups.

OMB's six regulatory accounting reports have all failed to meet some of the statutorily-required content requirements. Part of the reason for this failure is that OMB has not requested agency estimates for each agency bureau and program, as it does annually for its Information Collection Budget (paperwork budget) and for the President's Budget (fiscal budget). **Section 6(a)** extends this practice of required agency input for OMB's annual regulatory accounting statements.

Section 6(b) requires OMB's regulatory accounting statement to cover the same 7-year time series as the President's fiscal Budget. **Section 6(c)** requires integration into the fiscal Budget. Currently, the economic impacts of Federal regulation receive much less scrutiny than programs in the fiscal Budget. Requiring OMB presentation using the same time series as the fiscal Budget and being full integrated into the fiscal Budget documents, Congress will be better able to simultaneously review both the on-budget and off-budget costs associated with each Federal agency imposing regulatory or paperwork burdens on the public.

Lastly, **Section 6(d)** establishes pilot projects for regulatory budgeting. These tests will determine if agencies can better manage regulatory burdens on the public. Agencies will identify regulatory alternatives and then prioritize them so that the worst societal problems can be addressed first.

Lastly, I want to explain the overall logic behind this bill. I sought to make incremental improvements in the existing processes governing paperwork and regulations instead of fundamentally changing the role of Congress in its oversight of agency rules to implement laws. I believe that the public expects and deserves paperwork reduction results. In addition, I believe that the public has the right to know if it is getting its money's worth from Federal regulation.

I

108TH CONGRESS
1ST SESSION

H. R. 2432

To amend the Paperwork Reduction Act and titles 5 and 31, United States Code, to reform Federal paperwork and regulatory processes.

IN THE HOUSE OF REPRESENTATIVES

JUNE 11, 2003

Mr. OSE (for himself, Mr. TANNER, Mr. TOM DAVIS of Virginia, Mr. MOORE, Mr. JANKLOW, Mr. MATHESON, and Mr. RYAN of Wisconsin) introduced the following bill; which was referred to the Committee on Government Reform, and in addition to the Committee on the Budget, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

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A BILL

To amend the Paperwork Reduction Act and titles 5 and 31, United States Code, to reform Federal paperwork and regulatory processes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Paperwork and Regulatory Improvements Act of 2003".

SEC. 2. FINDINGS.

Congress finds the following:

1 (1) In 1980, in the Paperwork Reduction Act,
2 Congress established the Office of Information and
3 Regulatory Affairs (OIRA) in the Office of Manage-
4 ment and Budget. OIRA's principal responsibility is
5 to reduce the paperwork burden on the public that
6 results from the collection of information by or for
7 the Federal Government. In 2002, OIRA estimated
8 that the paperwork burden imposed on the public
9 was 7.7 billion hours, at a cost of $230 billion. The
10 Internal Revenue Service accounted for 83 percent
11 of the paperwork burden.
12 (2) In 1995, Congress amended the Paperwork
13 Reduction Act and established annual government-
14 wide paperwork reduction goals of 10 percent for
15 each of fiscal years 1996 and 1997, and 5 percent
16 for each of fiscal years 1998 through 2001, but the
17 paperwork burden increased, rather than decreased,
18 in each of those fiscal years and fiscal year 2002.
19 Both the Office of Management and Budget and the
20 Internal Revenue Service need to devote additional
21 attention to paperwork reduction.
22 (3) In 2002, the House Report accompanying
23 the Treasury and General Government Appropria-
24 tions Act, 2003 (House Report 107–575) stated,
25 "The Office of Management and Budget has re-

1 ported that paperwork burdens on Americans have
2 increased in each of the last six years. Since the In-
3 ternal Revenue Service imposes over 80 percent of
4 these paperwork burdens, the Committee believes
5 that OMB should work to identify and review pro-
6 posed and existing IRS paperwork.".

7 (4) One key to success in paperwork reduction
8 is the Office of Management and Budget's system-
9 atic review of every new and revised agency paper-
10 work proposal. Recent statutory exemptions from
11 that office's review responsibility, especially those
12 without any stated justification, should be removed.

13 (5) In 2000, researchers Mark Crain of George
14 Mason University and Thomas Hopkins of the Roch-
15 ester Institute of Technology, in their October 2001
16 publication titled "The Impact of Regulatory Costs
17 on Small Firms", estimated that Americans spend
18 $843 billion annually to comply with Federal regula-
19 tions. Congress has a responsibility to review major
20 rules (as defined by section 804 of title 5, United
21 States Code) proposed by agencies, especially regu-
22 latory alternatives and the costs and benefits associ-
23 ated with each of them. In 2000, in the Truth in
24 Regulating Act, Congress established new responsi-

1 bility within the General Accounting Office to assist
2 Congress with this responsibility.
3 (6) In 1996, because of the increasing costs and
4 incompletely estimated benefits of Federal rules and
5 paperwork, Congress required the Office of Manage-
6 ment and Budget for the first time to submit an an-
7 nual report to Congress on the total costs and bene-
8 fits to the public of Federal rules and paperwork re-
9 quirements, including an assessment of the effects of
10 Federal rules on the private sector and State and
11 local governments. In 1998, Congress changed the
12 annual report's due date to coincide with the due
13 date of the President's budget, so that Congress and
14 the public could be given an opportunity to simulta-
15 neously review both the on-budget and off-budget
16 costs associated with the regulatory and paperwork
17 requirements of each Federal agency. In 2000, Con-
18 gress made this a permanent annual reporting re-
19 quirement.
20 (7) The Office of Management and Budget re-
21 quires agencies to submit annual budget and paper-
22 work burden estimates in order to prepare certain
23 required reports for Congress, but it does not re-
24 quire agencies to submit estimates on costs and ben-
25 efits of agency rules and paperwork. The Office of

1 Management and Budget needs to require agencies
2 to submit such estimates on costs and benefits to
3 help prepare the annual accounting statement and
4 associated report required under section 624 of the
5 Treasury and General Government Appropriations
6 Act, 2001.

7 **SEC. 3. REDUCTION OF TAX PAPERWORK.**

8 Section 3504 of title 44, United States Code, is
9 amended by adding at the end the following new sub-
10 section:

11 "(i) In carrying out subsection (c)(3), the Director
12 shall assign, at a minimum, the equivalent of at least 2
13 fulltime staffers to review the Federal information collec-
14 tion burden on the public imposed by the Internal Revenue
15 Service.".

16 **SEC. 4. REPEAL OF EXEMPTIONS FROM PAPERWORK RE-**
17 **DUCTION ACT, ETC.**

18 The following provisions of the Farm Security and
19 Rural Investment Act of 2002 (Public Law 107–171) are
20 repealed:

21 (1) Subparagraphs (A) and (C) of section
22 1601(c)(2).

23 (2) Section 1601(c)(3).

24 (3) Section 2702(b)(1)(A).

25 (4) Section 2702(b)(2)(A).

(5) Section 2702(c).

(6) Subparagraphs (A) and (C) of section 6103(b)(2).

(7) Section 6103(b)(3).

(8) Subparagraphs (A) and (C) of section 10105(d)(2).

(9) Section 10105(d)(3).

SEC. 5. AMENDMENT OF TRUTH IN REGULATING ACT TO MAKE PERMANENT PILOT PROJECT FOR REPORT ON RULES.

The purpose of this section is to make permanent the authority to request the performance of regulatory analysis to enhance Congressional responsibility for regulatory decisions developed under the laws enacted by Congress. The Truth in Regulating Act of 2000 (Public Law 106–312; 5 U.S.C. 801 note) is amended—

(1) in the heading for section 4, by striking "**PILOT PROJECT FOR**";

(2) by striking section 5 and redesignating section 6 as section 5; and

(3) in section 5 (as redesignated by paragraph (2))—

(A) in the heading, by striking "**AND DURATION OF PILOT PROJECT**";

(B) in subsection (a), by striking "(a) EFFECTIVE DATE.—"; and

(C) by striking subsections (b) and (c).

SEC. 6. IMPROVED REGULATORY ACCOUNTING.

(a) REQUIREMENT FOR AGENCIES TO SUBMIT INFORMATION ON REGULATIONS AND PAPERWORK TO OMB.—Section 624 of the Treasury and General Government Appropriations Act, 2001 (as enacted into law by Public Law 106–554; 114 Stat. 2763A–161), is amended—

(1) by redesignating subsections (b), (c), and (d) as subsections (e), (f), and (g), respectively, and

(2) by inserting after subsection (a) the following new subsection:

"(b) AGENCY SUBMISSIONS TO OMB.—To carry out subsection (a), the Director of the Office of Management and Budget shall require each agency annually to submit to the Office of Management and Budget an estimate of the total annual costs and benefits of Federal rules and paperwork—

"(1) for the agency in the aggregate; and

"(2) for each agency program.".

(b) REQUIREMENT FOR OMB ACCOUNTING STATEMENT TO COVER SAME YEARS COVERED BY BUDGET.—Section 624 of the Treasury and General Government Ap-

1 propriations Act, 2001 (as enacted into law by Public Law
2 106–554; 114 Stat. 2763A–161), is further amended by
3 inserting after subsection (b), as added by subsection (a),
4 the following new subsection:

5 "(c) YEARS COVERED BY ACCOUNTING STATE-
6 MENT.—Each accounting statement submitted under this
7 section shall, at a minimum—

8 "(1) cover the fiscal year for which the state-
9 ment is submitted and each of the 4 fiscal years
10 after that fiscal year; and

11 "(2) cover the current fiscal year and the fiscal
12 year prior to the current fiscal year.".

13 (c) INTEGRATION OF OMB ACCOUNTING STATE-
14 MENT AND REPORT INTO PRESIDENT'S BUDGET.—Sec-
15 tion 624 of the Treasury and General Government Appro-
16 priations Act, 2001 (as enacted into law by Public Law
17 106–554; 114 Stat. 2763A–161) is further amended—

18 (1) in subsection (a), by striking "with the
19 budget" and inserting "as part of the budget"; and

20 (2) by inserting after subsection (c), as added
21 by subsection (b), the following new subsection:

22 "(d) FORM OF SUBMISSION.—The accounting state-
23 ment and associated report required by subsection (a)
24 shall be included in the budget documents submitted
25 under section 1105 of title 31, United States Code, in a

1 form that allows direct comparison of the budget for ac-
2 tivities and functions of the Government with the costs
3 and benefits to the public of Federal rules and paperwork
4 associated with those activities and functions.".

5 (d) PILOT PROJECTS FOR REGULATORY BUDG-
6 ETING.—(1) Chapter 11 of title 31, United States Code,
7 is amended by adding at the end the following new section:

8 **"§ 1120 Pilot projects for regulatory budgeting**

9 "(a) The Director of the Office of Management and
10 Budget, after consultation with the head of each agency,
11 shall designate not less than five agencies as pilot projects
12 in regulatory budgeting for fiscal years 2006 and 2007.
13 The designated agencies shall reflect a representative
14 range of Federal regulatory programs, and shall include
15 at least the Department of Labor, the Department of
16 Transportation, and the Environmental Protection Agen-
17 cy.

18 "(b) Pilot projects in the designated agencies shall
19 cover the preparation of regulatory budgets. Such budgets
20 shall present, for one or more of the major regulatory pro-
21 grams of the agency, the varying levels of costs and bene-
22 fits to the public that would result from different budgeted
23 amounts.

24 "(c) The Director of the Office of Management and
25 Budget shall include, as an alternative budget presen-

1 tation in the budget submitted under section 1105 for fis-
2 cal year 2007, the regulatory budgets of the designated
3 agencies for that fiscal year.

4 "(d) No later than the first Monday in February of
5 2009, the Director of the Office of Management and
6 Budget shall transmit to the President and to Congress
7 a report on the regulatory budgeting pilot projects. The
8 report shall—

9 "(1) assess the feasibility and advisability of in-
10 cluding a regulatory budget as part of the annual
11 budget submitted under section 1105;

12 "(2) describe any difficulties encountered by the
13 pilot agencies in preparing a regulatory budget; and

14 "(3) recommend whether legislation requiring
15 regulatory budgets should be proposed and the gen-
16 eral provisions of any legislation.

17 "(e) After receipt of the report required under sub-
18 section (d), Congress may specify that a regulatory budget
19 be submitted as part of the annual budget submitted
20 under section 1105.".

21 (2) The table of sections at the beginning of such
22 chapter is amended by adding at the end the following
23 new item:

"1120. Pilot projects for regulatory budgeting.".

○

Mr. OSE. I apologize for the length of my opening statement. It's frankly uncharacteristic for me to speak that long. But we're trying to build a record here. Now, as I said at the start, we routinely swear in our witnesses on this committee. Our first panel is comprised of Dr. John Graham, who is the Administrator of the Office of Information and Regulatory Affairs at the Office of Management and Budget. And Thomas M. Sullivan, the Chief Counsel for Advocacy at Small Business Administration.

Gentlemen, if you'd please rise.

[Witnesses sworn.]

Mr. OSE. Let the record show that the witnesses answered in the affirmative. Now, we have received your testimony as we have of the witnesses that will follow. I've actually read it. I'm sure the other Members have read most of it, if not all of it. If you could limit your testimony to a 5-minute summary for the purpose of expediting our ability to move through our questions, it would be appreciated. Your entire written statement will be made part of the record and with that, Dr. Graham, I'm pleased to recognize you for 5 minutes.

STATEMENTS OF JOHN D. GRAHAM, ADMINISTRATOR, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, OFFICE OF MANAGEMENT AND BUDGET; AND THOMAS M. SULLIVAN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. GRAHAM. Thank you very much, Chairman Ose. Delighted to be here this afternoon and thank you for the opportunity to testify. Our written statement provides the details of the administration provision on the draft bill. We're basically in a position of having to oppose it in its current form. But we're hoping to work with you to improve it and have something that we can support. I want to take my oral statement just a step back and say some broader things—thank you—to say some broader things, make some broader points about the need for regulatory reform and the various strategies that we might undertake collectively to make progress. The first point I want to make is, there's no magic bullet in this area that's going to be able to solve the problems of regulatory excess and regulatory problems. Instead, what we would like to do is suggest that we have to work multiple angles of this problem and I would like to describe four angles.

One, stronger OMB review; two, sound science and checks on agency power; three, vigorous paperwork reviews; and four, stronger congressional authority and responsibility over regulation. Let me say a few words about each of these. Stronger OMB review. The challenge we face is 4,500 rules a year by Federal agencies. About 500 of them judged significant enough to justify OMB review and about 50 of those that have an economically significant impact on the economy. We collaborate with our partner Tom Sullivan at SBA advocacy and try to get the small business community involved early on. The limits of the OMB review process though, quite frankly, Mr. Chairman, are we are an end-of-the-pipeline check on a process that is often well down the pike before we have an opportunity to review these packages.

And second, as the OIRA staffing is at a situation now, compared to 1980 of substantial reduction in overall staffing while we've had increases in statutory responsibilities. So we are not in an easy position to take on substantial additional responsibilities.

Second point I would like to make is the strategy of trying to induce more sound science as a check on regulatory power. We have a new information quality law that we've been working quite diligently to implement with all the agencies. It provides the public an opportunity to request corrections of erroneous information that regulators are disseminating to the public. We're also trying to encourage independent external peer review. The problems here are the practices of the agencies are very uneven with regard to the peer review of their information, and there's limited options for the public when an agency shirks its responsibility to seek independent peer review of its work.

The third basic strategy is vigorous paperwork reviews. This is the vision of the Paperwork Reduction Act, and although it was once the principle mission of OIRA to do paperwork reviews, it is now one of the five basic functions described in my testimony. This involves line-by-line review of forms and surveys by Federal agencies. There are 3,000 of these information collection requests every year submitted to OMB. We do our best to review them. The limits of this strategy are that these paperwork burdens are often mandated by law, or by regulations that are outside the purview of OMB. It's also very labor intensive. Beyond OMB, the current staffing level is unable—by a substantial margin—to do highly intensive reviews of every one of these paperwork requests.

Mr. OSE. Dr. Graham, I'm getting boxed on time here. I'm going to have to call a temporary recess here of the committee. I have to get over to vote. Apparently there's another such vote immediately stacked behind this. Like I said, we're going to be running.

Mr. GRAHAM. You had forewarned us, Mr. Chairman.

Mr. OSE. So we're recessed for a period of probably no less than 5 minutes, but probably no more than 10.

[Recess.]

Mr. JANKLOW [presiding]. If we could, we'll go ahead and get started. Apparently, we're going to have a series of votes. I don't know exactly when they'll be. So let's just try and go ahead and recognize one unfortunate circumstance dealing with these witnesses and others who come a great distance and prepare, so we'll try and go ahead and just get started. Mr. Graham, they told me that Mr. Sullivan had completed his opening testimony. Excuse me. I'm sorry. Mr. Graham, you were in the middle of your testimony and so let's just go ahead and pick it up from there if we can.

Mr. GRAHAM. I will do so. And the fourth strategy I was discussing to a regulatory reform was stronger congressional accountability in this area of regulation. This form of accountability can come in many ways. It could involve simplifying the Tax Code, which is one of the major sources of the large volume of paperwork that we heard about from the chairman this morning. It could involve passing the President's Clear Skies legislation, replacing the morass of existing regulatory programs with one comprehensive market-based cap and trade program. It might also involve new institu-

tional capacity in the Congress to analyze regulations such as GAO or the Congress and the Budget Office.

We fully support the idea of Congress looking harder at ways that it can assert its authority over the regulatory process and generate a more constructive approach to passing legislation in the first place and participating in regulatory evaluations as the implementation process unfolds. We did submit detailed written comments on H.R. 2432.

As I mentioned in my opening remarks, we would have to oppose this particular bill in it's current form, but we're hoping to work with the committee to make improvements to the point where it's something we could support. And the written testimony does make rather detailed suggestions in a variety of areas.

Let me conclude just by saying that we feel the most innovative feature of this bill is in the area of pilot tests of regulatory budgeting. We think that State and local governments as well as foreign governments are going to be watching very closely the U.S. experience if this provision is adopted. And I think in the long run, with—if we're looking at anything in this bill that could potentially have a major long-run influence in the area of regulatory reform, I believe it's the provision on regulatory budgets. We have suggested that provision be scaled back a little bit, be made to look more modest so that we at OMB can make sure that we can accurately oversee the implementation of this provision, but we do think it is a very constructive and innovative step in the right direction. Thank you very much.

[The prepared statement of Mr. Graham follows:]

STATEMENT OF JOHN D. GRAHAM, PH.D.
ADMINISTRATOR
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
OFFICE OF MANAGEMENT AND BUDGET
EXECUTIVE OFFICE OF THE PRESIDENT OF THE UNITED STATES

BEFORE THE
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

July 22, 2003

Good morning, Mr. Chairman, and Members of this Committee. I am John D. Graham, Ph.D., Administrator, Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget. Thank you providing me with this opportunity to share our views on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." This bill has stimulated a significant amount of thought and discussion within OIRA about interests we obviously share with this Committee. We endorse the bill's underlying goal of reducing the burdens that the Federal government imposes on the regulated public. While we have a number of concerns with the bill that prevent us from supporting it in its current form, I am hopeful that together we can use it as a starting point for improving regulatory policy.

While I would like to devote the bulk of my remarks to the bill's provisions on regulatory accounting and OIRA staffing, I would first like to address briefly the other two major provisions. Section 4 would repeal the exemptions contained in the Farm Security and Rural Investment Act of 2002 from various paperwork review and regulatory due process requirements. OIRA strongly supports this provision. We would simply recommend that the Section 4 make this repeal effective six months after enactment, so that the Department of Agriculture has sufficient time to comply with paperwork and regulatory requirements. Section 5 would make permanent the authorization for the General Accounting Office (GAO) to respond to congressional requests for independent evaluations of selective economically significant rules proposed or issued by Federal agencies. Since this provision concerns internal Legislative Branch operations, OIRA chooses not to take a position. We would urge the Committee, however, to consider whether GAO or the Congressional Budget Office is the most appropriate entity to be given this responsibility.

Improving Regulatory Accounting

Section 6 of HR 2432 has four provisions aimed at improving OMB's annual regulatory accounting statement. Although we support improvements in regulatory accounting, we have concerns about these four provisions as well as some suggestions.

1. Should All Federal Rules and Paperwork Requirements Be Analyzed?

The provision in Section 6(a) would require that OMB require each agency to submit to OMB an estimate of the "total annual costs and benefits of Federal rules and paperwork...for the agency in the aggregate; and...for each agency program." This requirement is apparently based on Finding (7) that OMB "does not require agencies to submit estimates on costs and benefits of agency rules and paperwork" which OMB "needs ... to help prepare the annual accounting statement" under section 624 of the Treasury and General Government Appropriations Act, 2001, also known as the Regulatory Right to Know Act. This finding is not entirely accurate. Beginning in 1981, Executive Order 12291 and in 1993 E.O. 12866 have required agencies to submit to OMB estimates of the costs and benefits of their major regulatory actions, defined generally as rules with impacts on the economy of $100 million or more. OMB has used these data to prepare its annual accounting of the costs and benefits of Federal regulations since 1997.

If Section 6(a) is intended to require an estimation of the costs and benefits of all existing rules and paperwork requirements, this provision is not workable. It would require OMB and agencies to estimate *every year* the costs and benefits of *all* Federal rules, including those adopted 10, 40 and 100 years ago that are still in effect today. (From 1980 and 2003 alone, over 113,000 final regulations were issued by Federal agencies.) Although it is feasible for OMB and agencies to assemble cost and benefit information for major rules adopted over the last ten years, it is not feasible to estimate reliably the costs and benefits of non-major rules—which were not subjected to such analysis when adopted—and major rules adopted more than ten years ago, since the pre-regulation estimates are no longer valid. Our 2003 draft report provided estimates of the costs and benefits of regulations in the aggregate, by program, and for major rules over the period October 1, 1992 to September 30, 2002. Each year in the future, OIRA plans to provide cost-benefit data for the preceding ten years.

Agencies do not generally submit estimates of costs and benefits of non-major rules nor do independent agencies submit such data to OMB. If this provision is intended to require executive branch agencies to produce cost-benefit information for non-major rules and independent agencies to begin to provide this information for all their rules, then OMB could not support such a requirement. Requiring benefits and costs of all rules and all paperwork to be quantified every year would be a massive, unjustified paperwork requirement. This could compel agencies to collect massive amounts of new information from regulated entities to support these new estimates, inadvertently creating one of the larger new paperwork burdens in recent history.

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. 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. In particular, many of the studies they relied upon for these aggregate estimates are not sufficiently transparent about the data and methods to facilitate the reproducibility of the information by qualified third parties. That is why we have opted in the most recent Reports to Congress to report just the costs and benefits of major regulations prepared by agencies and reviewed by OMB over the last ten years.

Finally, even if the hundreds of agency analysts could generate the aggregate estimates of the costs and benefits of the over 113,000 final rules that have been issued since 1980, OIRA would be unable to read and evaluate them, given our current staffing level. Our concern about Section 6(a) would be greatly reduced if it were amended to say that agencies would provide the data "to the extent feasible," to reflect the instruction to OMB in Section 624(a)(1) of P.L. 106-554.

2. Should a Seven-Year Time Series Be Specified?

Section 6(b) would require that the accounting statement cover the same seven-year period covered by the Budget. We question the utility of providing this information over the seven-year budget cycle. All future costs and benefits must be presented and seven years is usually not a long enough time horizon. This points out a major difference as to how budgetary information is presented compared to benefit-cost information. Reducing the utility of benefit-cost information by forcing it into this budgetary framework is not the solution. OMB believes this provision would be improved if it were amended to say that OMB's preparation of the statement be done "consistent with the information-quality law" and "to the extent feasible." The cost-benefit information should be presented in annualized terms, with an indication of the appropriate time horizon.

3. Should the Accounting Statement Be "Part of the Budget?"

Section 6(c) would require the integration of OMB's accounting statement and report into the President's Budget. OMB believes that the accounting statement and report should continue to be transmitted "with" the President's Budget, not "as part of the budget" (as would be required by Section 6(c)). If the accounting statement and report

are to be submitted as part of the budget, such a change would significantly increase the workload burden of preparing the President's Budget documents without necessarily improving the quality of the report. Moreover, given that (1) OMB is currently required to provide for peer review and public comment on a *draft* accounting statement and (2) OMB does not believe it would be appropriate to submit a draft accounting statement and report with the President's Budget, OMB would have to submit cost-benefit data for the past fiscal year, not the fiscal year for which the President's Budget is submitted.

OMB believes it could be feasible to issue a separate volume with the budget that contains the final regulatory accounting report and perhaps some related budget information for comparison purposes. A separate volume might also permit adequate presentation of intangible costs and benefits. Intangible values such as fairness, ecology, privacy, and civil rights are not easily measured. These considerations might receive less attention than the reported quantitative information about costs and benefits, if the information is in summary form for a long list of programs packed in multiple budget documents.

4. Should We Undertake Pilot Tests of Regulatory Budgeting?

Section 6(d) contains the proposed pilot tests of regulatory budgeting. This is an innovative provision that, with proper refinement, could prove to be a helpful step forward in regulatory policy. We suggest the following refinements or clarifications. First, the pilot projects should be smaller, covering only NHTSA within DOT and the air office within EPA, because, in OMB's judgment, these are the only regulatory entities in the Federal government that are prepared—based on institutional and technical capacity—to tackle this ambitious project. As currently written, the agencies covered (Labor, Transportation and EPA) account for a large proportion of the total rulemaking activity of the Federal government. That is far too ambitious for a pilot effort. Moreover, OMB does not have adequate staffing to accomplish effective oversight of more than two modest pilots. Second, the provision should clarify that the alternative regulatory budget levels to be set by OMB (a) are for non-budgetary costs and (b) are hypothetical and informational in nature and thus do not have legally binding impact. The language should clarify that agencies are permitted to exceed the alternative "budget levels" if the agency head determines it is appropriate to do so or if statutory or other legal requirements for rulemaking compel the regulatory budget levels to be exceeded. Although we could be supportive of these pilot projects, we caution the Committee that overly ambitious language could lead to failure of these projects, which in turn might give the concept of "regulatory budgeting" a bad name. If the projects are successful, showing ways to achieve more health and safety protection at less overall cost, then the pilots may pave the way for more widespread use of regulatory budgeting throughout the Federal government. The project is so innovative that we believe it will be closely watched by other Federal agencies, State and local governments, and foreign governments interested in regulatory reform.

On regulatory budgeting, I would like to conclude with a few observations about why the Committee should be cautious about fostering direct comparisons between budgetary

outlays and non-budgetary, regulatory costs and benefits. First, unlike the fiscal budget, an audit to determine whether regulatory costs or benefits are accurate is not feasible. It is sometimes feasible to perform *ex post* evaluations of the costs and benefits of rules, and compare these *ex post* amounts to the pre-regulation estimates, but even these studies will typically provide only rough estimates. For this reason, regulatory costs and benefits are inherently more speculative than budgetary outlays. Second, some advocates of regulatory budgeting confuse the notion of accounting costs (e.g., audited budgetary expenditures) with social opportunity costs and hedonic costs, which are the foundation of regulatory costs. Social opportunity costs include consumer and producer surpluses as well as actual expenditures (price times quantity), and are therefore conceptually different from budgetary outlays or expenditures. Moreover, hedonic costs (e.g., the economic value of extra travel time, increased safety, and higher quality products) are measured and expressed in dollar units but they are not "expenditures" in a way that is directly comparable to budgetary expenditures. Third, while there is no such thing as an "intangible" or unquantifiable budgetary expenditure, some of the most important regulatory costs and benefits are intangible or very difficult to quantify (e.g., privacy, civil rights and some ecological amenities). Fourth, while the notion of regulatory "benefit" is well defined and often quantifiable, the budgetary process does not produce information on "benefits" for budgeted activities. Performance measurement in budgeting is on the rise but many performance measures are not economic in the same way that regulatory benefits are economic in nature. For these reasons and others, the Committee should be careful about suggesting that budgetary outlays and regulatory costs and benefits can be directly compared. Instead, regulatory cost-benefit information should be considered another piece of performance information that the budgetary process might consider. Valid benefit-cost information is an important consideration in budgeting for regulatory programs and this use of such information is certainly consistent with OMB's implementation of the Government Performance and Results Act (GPRA).

We also have concerns about two of the subsections that Section 6(d) would add to Chapter 11 of Title 31 of the U.S. Code. The new Subsection 1120(c) would require OMB to "include, as an alternative budget presentation in the budget submitted under section 1105 for fiscal year 2007, the regulatory budgets of the designated agencies for that fiscal year." The new Subsection 1120(d)(3) would require OMB to submit a report on the pilot projects to the President and to Congress that would "recommend whether legislation requiring regulatory budgets should be proposed and the general provisions of any legislation." Our view is that these provisions are inconsistent with the Recommendations Clause of the Constitution, which gives the President the authority to submit for the consideration of Congress such measures as the President judges necessary or appropriate. We therefore recommend that these two provisions be amended to require the submission of recommendations to Congress only "to the extent the President judges necessary or appropriate."

We are very pleased that the committee is interested in regulatory accounting and budgeting, and we believe that we can work with you to make significant advances in this area. Specifically, I would propose that the committee give strong consideration to the following three issues, which I believe are central to meeting the challenge of improving

the accounting and budgeting of regulatory costs and benefits. First, we must explore ways to measure those costs and benefits that are most difficult to quantify. Second, given the uncertainty of some agency estimates, agencies should be encouraged to base their cost-benefit analyses on valid scientific data and principles. Finally, I would urge the committee to consider the impact of more rigorous regulatory accounting and budgeting on the analytic resources in the agencies and OMB.

Requirement that OMB Devote Two Full-Time Staff to Tax Paperwork Reduction

Before discussing Section 3 of H.R. 2432, I would like to respond to Finding 1 in Section 2, which asserts that "OIRA's principal responsibility is to reduce the paperwork burden on the public that results from the collection of information by or for the Federal government." When OIRA was created in 1980, it was accurate to say that OIRA's principal responsibility was paperwork review. However, OIRA has changed dramatically since 1980 as we have assumed additional responsibilities, such as regulatory review, information technology, information-quality oversight and statistical policy. During the same period, the number of full-time equivalent staff at OIRA declined steadily from a peak of 90 in 1980 to 47 in 2000, with a modest increase to 55 in 2003. Moreover, although reduction of paperwork burden is one of the primary objectives of the Paperwork Reduction Act of 1995 (PRA), another priority of the Act is to "ensure the greatest possible public benefit from and maximize the utility of" information collected by government in support of vital government functions. Both objectives of the PRA are important and they should not be considered in isolation of each other. Thus, we respectfully suggest that Finding 1 in Section 2 be revised to provide an up-to-date description of OIRA.

The requirement in Section 3 that OIRA devote at least two full-time staff to reducing tax-related paperwork burden is based on this finding in Section 2. It is also based on a perception that, since approximately 80 percent of overall paperwork burden by Federal agencies is imposed by the Internal Revenue Service (IRS), OIRA should have a substantial staff investment in review of IRS paperwork. While the 80 percent figure is roughly accurate, we believe this figure does not necessarily justify an increase in OIRA staff investment in IRS paperwork reviews. There are good reasons why OIRA does not make substantial staff investments in IRS paperwork review:

1. OIRA's staffing allocations reflect both the full range of OIRA's agency oversight responsibilities and OMB's historical deference to Treasury on tax policy and regulatory matters.
2. Most of the IRS paperwork burden is rooted in the Tax Code, and therefore beyond IRS' discretion to control.
3. There have been continued successes in the IRS-initiated efforts to reduce unnecessary paperwork burdens and IRS has perhaps the largest and most proficient paperwork-review office in the Federal government. Thus IRS has seldom been found to be in violation of the PRA.

4. Where OIRA has been effective in assisting IRS is in improved measurement of paperwork burden, an important analytical step toward performance measurement under the PRA and the GPRA.

I would like to elaborate on each of these four points.

1. Rationale for OIRA's Staffing Allocation to IRS

With our limited number of personnel (55 FTEs), OIRA must make staffing allocations that cover all agencies of the Federal government in five functional areas: regulatory review, paperwork review, information technology, information quality and statistical policy. Two of OIRA's four branches, comprised of 22 full-time analysts, are primarily responsible for the regulatory and paperwork reviews of all Federal agencies—including HHS, Labor, EPA, Transportation, Interior, Agriculture, as well as the new Department of Homeland Security and Treasury. The President expects thorough OMB oversight of *all* of these agencies, so these 22 full-time analysts are spread across dozens of large and small Federal agencies. In addition, these analysts devote their time to many other activities, including the annual development of the report to Congress on the costs and benefits of regulation, the report to Congress on the Unfunded Mandates Reform Act, and the Information Collection Budget.

Since some studies indicate that regulation is vastly more costly to the public than paperwork requirements per se—and a significant amount of paperwork not imposed by legislation is imposed by regulation—the allocation of these 22 full-time analysts is weighted toward regulatory review. (Keep in mind that good regulatory review also reduces paperwork burden, an activity that we undertake in close collaboration with the Advocacy Office of the Small Business Administration.) Congress recognized the importance of Federal regulation in the Regulatory Right to Know Act, which is the foundation of OIRA's annual report to Congress on the costs and benefits of Federal regulation. In the President's March 2002 call for public nominations of reforms to rules, guidance documents and paperwork, the vast majority of public interest—including small business interest—was in reform of rules and guidance documents. When paperwork burdens were nominated for scrutiny, they tended to be paperwork burdens created by regulation.

When I assumed the leadership of OIRA two years ago, there was one "desk officer" devoted to IRS. I understand that this staffing level for IRS paperwork has remained relatively constant since the Paperwork Reduction Act was first enacted in 1980. During the last year, in response to congressional interest, we increased senior-level support to that desk officer to better determine whether more OIRA staffing could produce less paperwork burden on small businesses and the general public. I must say that I have not been convinced that an increase in the number of IRS desk officers at OMB is a cost-effective use of scarce OIRA resources.

First, IRS and OMB have acquired over 20 years of experience under the PRA. Many of the more burdensome IRS information collections (e.g., high-volume tax forms

that are based on statutory requirements) have been reviewed by IRS and OMB on a recurring basis and the issues concerning them have been resolved in previous reviews. When Congress changes the Tax Code, the paperwork burdens change but in most cases the discretion at IRS and OIRA to influence that burden is limited.

Second, there has been a historical agreement between OMB and Treasury that provides Treasury a high degree of autonomy on tax and revenue regulatory matters. Under every President since Jimmy Carter, OMB has not, as a routine matter, reviewed IRS interpretive regulations. After President Reagan issued EO 12291 in February 1981, Treasury and OMB entered into a "Memorandum of Agreement" that exempted from OIRA review all IRS interpretative regulations. After President Clinton issued EO 12866 on September 30, 1993, the OIRA Administrator informed Treasury that "simply stated, we are continuing the Treasury Department's current exemptions from regulatory review..." This Administration considered early on whether to change this relationship and a decision was made—above my pay grade and for good reasons—to retain the historical OMB-Treasury relationship.

It is important to understand the historical rationale for OMB deference to Treasury. First, OMB's predecessor, the Bureau of the Budget, was once part of Treasury. When President Roosevelt moved the Bureau out of Treasury in 1939 and placed it in the Executive Office of the President, the staff expertise on tax policy and paperwork review remained with Treasury, where it continues to vastly exceed that of OMB. Considering specialization of labor, OMB staff investment in tax expertise is not very sensible. Second, the Watergate years taught us the dangers of politicizing the process of tax administration. By deferring to Treasury, each Administration since Jimmy Carter's has insulated itself from the charge that it was using White House review of the IRS for political purposes.

Taking all of this into consideration, I believe that any rational OIRA Administrator would not be inclined to make review of IRS paperwork a more significant staffing priority. An understanding of how Congress creates paperwork burden through the Tax Code further underscores this conclusion.

2. The Tax Code and IRS Burden

In evaluating IRS's record on burden reduction, it is important to note the challenge IRS faces in administering the Tax Code. To a greater extent than for other agencies and programs, IRS paperwork burden is driven by a statute (the Tax Code), and in particular the complexities of the Code. To ensure taxpayer compliance with our tax laws, IRS must collect a tremendous amount of information. This task is complicated by a massive, complex Tax Code that is subject to continuous revision. In the 15 years following the 1986 overhaul of the Code, Congress passed 84 tax laws. These laws required IRS to create and/or revise reporting and recordkeeping requirements, which in turn increased taxpayer burden. The Internal Revenue Service also had to make several changes to the 1040 schedules to implement the Economic Growth and Tax Relief Reconciliation Act of 2001. These statutorily driven revisions increased the burden on

taxpayers by 47 million hours. Moreover, there are other factors totally outside the control of IRS—most notably increases in the number of tax filings due to economic and population growth over the years—that increase the aggregate IRS burden hours but not—and this is important—the average burden on individual taxpayers.

Sometimes it is mandated *reductions* in tax liability that result in more paperwork burden. Consider, for example, the recently enacted tax benefit that allows teachers to subtract up to $250 from their taxable income for the purchase of classroom supplies. To implement this tax benefit, the IRS had to provide significant explanation on the Form 1040 about eligibility requirements to claim the tax benefit. Eligible taxpayers must fill out a separate worksheet to compute the amount, up to $250, that they may claim. This burden is necessary for IRS to determine if a taxpayer is claiming the benefit correctly. We reviewed IRS' work and did not find any unnecessary burden.

While we must ensure that paperwork burden is not unnecessarily increased in order to implement tax changes, it remains the case that taxpayers probably consider it a good trade-off to incur some additional paperwork burden in return for their taxes going down. OMB is committed to continued efforts to reduce paperwork burden responsibly—form by form, regulatory requirement by regulatory requirement. However, setting arbitrary staffing goals that have no analytic basis does not make sense.

3. Recent Efforts to Reduce IRS Paperwork Burden

Despite the challenges it faces in administering the Tax Code, IRS is making progress. As we reported in the recently released Information Collection Budget, in FY 2002 the Treasury Department achieved a net program change reduction due to agency actions of 9.51 million hours, largely as a result of actions within the control of IRS (i.e., changes in paperwork not due to new statutory requirements or violations of the PRA). After years of reporting increases, we are encouraged by this result and fully intend to build on this important accomplishment by achieving further reductions in the future. Several notable examples of such IRS actions include:

- Revisions made to Form 6251 – This form is used to implement the requirements of the Alternative Minimum Tax for individuals. IRS eliminated several lines and made other simplifying changes that resulted in a change in taxpayer burden of 5.5 million hours.

- Changes to Form 1040-EZ – This form is used by individuals who are single or joint filers with no dependents. IRS reduced taxpayer burden by 4.3 million hours by deleting several worksheets and a number of lines to this form.

- Changes made to Schedule D of Form 1040 – This form is used by individual taxpayers to report taxable income and calculate their correct tax liability. It was revised and simplified to make it easier for taxpayers to compute their capital gains and losses, resulting in a reduction of 2.9 million burden hours.

Treasury and IRS do a much better job than most agencies of carrying out their responsibilities under the Paperwork Reduction Act. IRS does not commit PRA violations and it has initiatives for reviewing its collections to identify opportunities for burden reduction. Few other agencies can say the same with equal strength. Because Treasury and IRS dedicate significant resources to paperwork review, and can demonstrate accomplishments in this area, OIRA does not have to dedicate additional resources to reviewing IRS paperwork to ensure that a careful PRA review is conducted.

4. Measuring IRS Burden

In recognizing that the Tax Code hinders IRS's ability to reduce taxpayer reporting burden, OMB has worked with IRS and Treasury to replace its current burden estimation methodology with a new measure of compliance burden. This revised measure will provide policymakers with a tool to assess the effects of legislative proposals to create and revise statutory provisions on the taxpayer burden *before* they are enacted. The specific goals of the new methodology include:

- measuring compliance burden more comprehensively and accurately by, for example, accounting for electronic filing methods;
- providing a tool to reduce compliance burden during the development and analysis of legislative and administrative proposals; and
- providing a tool to explain current levels of taxpayer burdens and the changes in those burdens due to administrative or statutory changes.

We believe that the capability of the new model to predict changes in burden due to changes in tax law—as well as changes in IRS tax administration—will allow OMB, Treasury, IRS, and Congress to work together to achieve tax policy objectives in a manner that minimizes taxpayer burden, consistent with the effective and fair collection of needed tax revenue.

In summary, OIRA has decided that its overall performance would not improve if OIRA reassigned its staff from other responsibilities to reviewing IRS paperwork. Admittedly, this is a judgment call. However, this is a judgment call that I as a manager must make in deciding how OIRA can best serve the President and carry out our numerous statutory responsibilities. The bottom line is that OIRA needs the "freedom to manage" and the mandated staffing in Section 3 represents an unprecedented and unwarranted intrusion on the ability of the President to manage his office.

In conclusion, the Administration recommends against enactment of this bill in its current form, but we would be prepared to work with you to fashion paperwork and regulatory improvement legislation that we could all support. That concludes my prepared testimony. If you have any questions, I would be happy to answer them.

Mr. JANKLOW. Thank you very much. And I—at this time, I'll defer to Mr. Platts if he has any questions. I'll reserve my right to ask questions for a few minutes. Do you have any? OK. Mr. Graham, if I could, let's go to Mr. Sullivan at this point in time.

Mr. Sullivan, if you would, would you please give us your testimony.

Mr. SULLIVAN. Thank you, Congressman Janklow and members of the committee. Good afternoon. Thank you for the opportunity to appear before you this afternoon. The Office of Advocacy is an independent office within SBA, and therefore the comments expressed here do not necessarily reflect the position of the administration or the SBA. Before addressing advocacy-specific comments on H.R. 2342, I must give credit to John Graham's office. My office works with Dr. Graham and his desk officers every day, and I believe that small business has a great friend in that office. Despite a small staff, OIRA manages to do a difficult job very well and as their responsibilities grow, I would hope that they receive the tools that they need to get the job done.

Now, to H.R. 2432. The Office of Advocacy supports the Paperwork and Regulatory Improvements Act of 2003. Increased attention to reducing the tax compliance burden makes sense. According to a study paid for by my office, the Crain-Hopkins Report, small business is disproportionately burdened by complying with Federal regulation. The study points out that small firms with fewer than 20 employees spend twice as much on figuring out and complying with the Tax Code than do their larger counterparts of over 500 employees. Advocacy strongly supports section 4 of your legislation, which repeals exemptions from notice and comment rulemaking procedures.

And Advocacy strongly supports H.R. 2432's strengthening of regulatory accounting found in sections 5 and 6. In addition to paperwork, small businesses tell us that they often encounter regulations written with no apparent awareness of the costs that must be borne by the affected businesses. This happens despite laws requiring agencies to account for the cost and benefits of new rules. Unfortunately, Advocacy's and OMB's efforts have too often been hampered by incomplete agency estimates of the cost and benefits of regulations. The Office of Advocacy recommends that rules without identified and substantiated costs and benefits and a breakdown of impact on small entities should be returned to those agencies by OMB.

So what happens when the Federal Government doesn't proceed with the benefit of small business input or the public allows a rule to proceed without gaining insight from small business impact analysis? The U.S. Environmental Protection Agency's treatment of small business in its requirement for reporting lead usage under Toxic Release Inventory [TRI] is a good example of well-intended policies gone bad. EPA recently started requiring small businesses that handle small amounts of lead to report their yearly use of the metal under TRI. EPA estimated that this requirement would take the average first-time TRI filer about 1 week. That's small business hours, 50 hours 1 week to prepare the report.

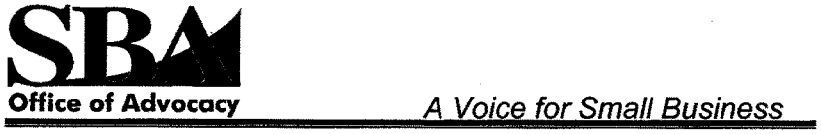
In return for spending a week entirely devoted to filling out a new form, last month, EPA learned that close to half of the first

time filers had no discharges of lead to the environment. The majority of the remaining filers reported very low amounts.

Had EPA considered the impact on small business and allowed the public the luxury of a thorough cost and impact analysis, then resources by small business owners may have been better directed toward workplace safety or environmental precautions and not in filling out a form that small business speculated years ago would show no, or minimal, discharges, and more importantly, provide no environmental benefit. Advocacy believes that improved regulatory accounting will benefit small business by making the agency rulemaking process more considered, rational, and transparent. Such accounting will enable better review of rules by the public and Congress. Thank you for allowing me to present these views and I'd be happy to answer any questions.

Mr. JANKLOW. Thank you very much.

[The prepared statement of Mr. Sullivan follows:]



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Testimony of
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U.S. House of Representatives
Committee on Government Reform

Date:	July 22, 2003
Time:	2:00 P.M.
Location:	Room 2154 Rayburn House Office Building Washington, D.C.
Topic:	H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003"

Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. The Chief Counsel for Advocacy, who is appointed by the President and confirmed by the U.S. Senate, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Issues are identified through economic research, policy analyses, and small business outreach. The Chief Counsel's efforts are supported by offices in Washington, D.C., and by Regional Advocates. For more information about the Office of Advocacy, visit ***http://www.sba.gov/advo****, or call (202) 205-6533.*

Chairman Davis and Members of the Committee, good afternoon and thank you for giving me the opportunity to appear before you today. My name is Thomas M. Sullivan and I am the Chief Counsel for Advocacy at the U.S. Small Business Administration (SBA). Congress established the Office of Advocacy to represent the views of small entities before Federal agencies and Congress. The Office of Advocacy is an independent office within the SBA, and therefore the comments expressed in this statement do not necessarily reflect the position of the Administration or the SBA.

The Committee asked that I testify regarding the Office of Advocacy's opinion on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." We support the bill and believe that it would improve agency accountability in ways that would benefit small business.

Before addressing Advocacy's specific comments on H.R. 2432, I must give credit to our colleagues in the Office of Information and Regulatory Affairs (OIRA) of the Office of Management and Budget (OMB). My office works with Dr. Graham and the desk officers at OIRA every day, and I believe that small business has a great friend in Dr. Graham. Despite a small staff, OIRA manages to do a difficult job very well. As their responsibilities grow, I would hope that they receive the tools that they need to get the job done.

Paperwork and Regulatory Burdens on Small Entities.

Based on frequent comments from small businesses, the Office of Advocacy is concerned about the large – and growing – Federal paperwork burden on small businesses. Despite the passage of laws designed to relieve the paperwork burdens

imposed by the Federal government on such entities – such as the Paperwork Reduction Act, and, most recently, the Small Business Paperwork Relief Act of 2002 – the Federal paperwork burden continues to be cited by small businesses as one of their most significant problems. Most recently, this was communicated to Advocacy during a March 4, 2003 meeting we held with small business representatives to discuss implementation of the Small Business Paperwork Relief Act.[1]

In addition to paperwork, small businesses tell us that they often encounter regulations written with no apparent awareness of the costs that must be borne by the affected businesses. This happens despite laws requiring agencies to account for the costs and benefits of new rules. Section 624 of the FY 2001 Treasury and General Government Appropriations Act, which was enacted as part of Pub. L.106-554, for example, directs OMB to quantify annually the costs and benefits of Federal regulations. Likewise, the Regulatory Flexibility Act, as amended, Pub. L. 104-121, Executive Order 12866, and Executive Order 13272, further require agencies to consider the costs and benefits of rules before they can take effect. Unfortunately, Advocacy's and OMB's efforts have too often been hampered by incomplete agency estimates of the costs and benefits of regulations. While Advocacy and OMB work to improve agency rulemakings, small businesses are obliged to comply with rules that may have significant costs and negligible societal benefits. As well documented by Advocacy's Crain-Hopkins report, small business continues to pay a *disproportionately large* share of the total Federal regulatory burden, which was estimated to total $843 billion in 2000.[2] For firms

[1] For additional information about the Small Business Paperwork Relief Act of 2002, Pub. L. 107-198 go to www.sba.gov/advo.
[2] See *The Impact of Regulatory Costs on Small Firms*, an Advocacy-funded study by W. Mark Crain and Thomas D. Hopkins (October 2001).

employing fewer than 20 employees, the annual regulatory burden in 2000 was estimated to be $6,975 per employees – nearly 60% higher than the $4,463 estimated for firms with more than 500 employees.[3]

How Would the "Paperwork and Regulatory Improvements Act of 2003" Benefit Small Business?

We believe that the proposed legislation would help to alleviate the burdens imposed on small businesses, small nonprofit enterprises, and small state and local entities in several ways.

Reduction of Tax Paperwork. Section 3 of the legislation requires OMB to assign a minimum of two full-time staff to review the Federal information collection burden on the public imposed by the Internal Revenue Service (IRS). As this Committee knows, the IRS generates the vast majority of the Federal paperwork burden on businesses. It is no wonder that small businesses consistently report that tax requirements are the most challenging regulatory requirements.[4] Advocacy agrees that additional attention must be given to tax paperwork burden relief; small businesses would benefit enormously from tax paperwork relief. If dedicated OMB personnel can conduct a more thorough evaluation of IRS Information Collection Requests (ICRs), opportunities may be identified for paperwork simplification and the elimination of redundant information collections.

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[3] *Id.*

[4] *See, e.g.*, National Federation of Independent Business National Small Business Poll, *Coping with Regulation* (2001), 64 (largest percentage of small businesses stating that tax-related regulations "create the greatest difficulty").

I would urge this Committee to work with Appropriators to ensure that this staffing requirement translates into two **additional** staff, and does not merely reassign existing OIRA team members who are stretched thin ensuring that agencies do not impose unfair regulatory mandates.

Repeal of Exemptions from the Paperwork Reduction Act and Other Requirements. Section 4 of the bill repeals certain exemptions from the Paperwork Reduction Act and notice and comment rulemaking procedures that are currently contained within the Farm Security and Rural Investment Act of 2002, Pub. L. 107-171. The Office of Advocacy strongly opposes any blanket exemptions from notice and comment rulemaking. Besides diminishing the transparency of the agency decision process, these exemptions also deprive small entities of the protections afforded by the Regulatory Flexibility Act, as amended by the Small Business Regulatory Enforcement Fairness Act. In Advocacy's view, the exemptions currently available to agencies under the Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.* are sufficient. Likewise, we believe that blanket exemptions from the Paperwork Reduction Act are unwise, and may needlessly add to the paperwork burdens borne by small entities.

Permanent Provision for Regulatory Analyses in the Truth in Regulating Act of 2000. Section 5 of this bill makes permanent the authority for regulatory analyses under the Truth in Regulating Act of 2000, Pub. L. 106-312. The Office of Advocacy supports such regulatory analyses as a means to yield better agency decision making, as discussed in greater detail below.

Improved Regulatory Accounting. Section 6 of the legislation amends Section 624 of the Treasury and General Government Appropriations Act of 2001 (sometimes

referred to as the "Regulatory Right-to-Know Act"), which was enacted as part of Public Law 106-554. The bill would require agencies to submit annual estimates to OMB of the costs and benefits of their regulations and paperwork requirements, for OMB in turn to develop regulatory accounting statements, and for five agencies to undertake pilot projects to conduct regulatory budgeting. Advocacy recommends that the bill also require agency submissions to OMB (and OMB's corresponding accounting statements) to identify and analyze regulatory impacts on small entities, consistent with the impact analysis required under the current regulatory accounting law.

The Office of Advocacy welcomes more robust regulatory accounting by Federal agencies. We note that, since 1997, OMB has done its best to quantify the costs and benefits of Federal regulations. Regrettably, OMB's efforts have been hampered by its dependence on agency estimates of regulatory costs and benefits that are incomplete or insufficiently detailed. Despite the challenges facing OMB, Advocacy has found each Report to Congress to include useful information. Specifically, the "recommendations for reform," including OMB's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements, could produce better consideration of small entity impacts if followed by the agencies. In addition, OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulation (OMB Draft Report) re-affirms Advocacy's own experience that too often agencies publish a rulemaking without a firm knowledge of costs and benefits of the proposed regulation.

To address this shortcoming, Advocacy recommends that rules without identified and substantiated costs and benefits and a breakdown of impacts on small entities should be returned by OMB. Agencies should determine whether there is sufficient information

to pursue a regulation. The agency may choose to delay the rulemaking until it has performed sufficient outreach to the potentially regulated community and gathered the data it needs to perform the appropriate analyses. The agency should also be certain that it has the necessary resources to develop a well-conceived, well-supported regulation. Stated in other words, the agency needs to consider the complexity of a rule and the magnitude of the costs and benefits of the rule when allocating its analytic resources for rulemakings.

Regulatory Accounting Focusing on the Impacts on Small Entities.

Current regulatory accounting requirements direct OMB to include an "analysis of impacts of Federal regulations on . . . small business" in its Report to Congress. To date, OMB's reports have only addressed the impact of Federal regulations on small businesses in concept. The lack of agencies' analysis of their rules' impacts on small business impacts has prevented OMB from providing the more quantitative and meaningful analysis required by the law. Unless agencies are required to break out and analyze regulatory impacts on small entities, OMB's Report to Congress (and the agencies' analyses the Report is based upon) will remain deficient.

Advocacy therefore recommends that H.R. 2432 and OMB's directives on cost-benefit analysis and regulatory accounting instruct Federal agencies to analyze the impacts of their regulations on small businesses and state and local governments. This would help identify whether the costs imposed on small firms by the rule and whether the benefits of regulating small firms justify those costs. Regulatory requirements are often

extended to small businesses that impose large compliance costs with little or no corresponding benefit.

For example, the Environmental Protection Agency (EPA) recently started requiring small businesses that handle small amounts of lead to report their yearly discharges of the metal under EPA's Toxic Release Inventory (TRI) program. EPA estimated that this requirement could take first-time TRI filers up to ***110 hours*** to comply with; the average first-year filer could expect to spend ***50 hours*** complying with the reporting requirement.[5] Many of the first-year filers were small businesses, so EPA essentially directed these businesses to spend more than *a week* of their precious time to prepare the report or, alternatively, to pay for a consultant to prepare the report. In return for this substantial investment of small business resources, EPA learned that 41% of the first-time filers had ***no discharges*** of lead to the environment. The majority of the remaining filers reported very low discharges. EPA forced small businesses to spend several millions of dollars of time and effort, which they can hardly afford, to comply with a regulatory requirement that conferred little or no benefit to society.

Generally, this sort of outcome happens because the agency failed to isolate the small and large firm impacts in its regulatory analysis, or failed to identify regulatory alternatives that vary the scope of the rule's coverage. We believe that focusing on the composition of the impacted classes, and regulating accordingly, yields an outcome that is more efficient than uniform regulations. When the cost and benefit estimates are required for small entities on the accounting statements, small business considerations will figure more prominently in agencies' regulatory calculus.

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[5] *See* 66 Fed. Reg. 4500, 4538 (January 17, 2001).

OMB Return Letters.

Advocacy further recommends that OMB issue return letters on a rule-by-rule basis to enforce agency compliance with the OMB Circular and Bulletins. We note that OMB Director Mitch Daniels advised this Committee on March 24, 2001 that OMB would issue return letters to enforce agency compliance with the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4. We look forward to the continuation of that policy under OMB's current leadership and for return letters to be issued to agencies that do not follow OMB's Circular and Bulletin(s) on accounting for regulatory impacts imposed on small entities.

Conclusion.

Advocacy believes that improved regulatory accounting will benefit small business by making the agency rulemaking process more considered, rational, and transparent. Such accounting will enable better review of rules by the public and the Congress.

Thank you for allowing me to present these views. I would be happy to answer any questions.

Mr. JANKLOW. As I lead in the questions, I'd just like to make a comment. The information that was provided to me prior to the hearing by the chairman and Mr. Schrock indicates that in 1942, we passed laws dealing with paperwork. In 1980, we passed laws dealing with paperwork. In 1995 we passed laws dealing with paperwork. In 1998, in 2000, in 2002. This reminds me of the—back in my early days in the 60's when I was a legal aid lawyer I was involved in the war on poverty. By the late 70's we decided poverty had lost the war. And this is the war on paperwork. The reality is this is a mess.

Mr. Graham, when we had testimony before, when you came before our committee discussing stuff, and again, you testified before a subcommittee, I made notes: You had no answer on how to make agencies pay a price for noncompliance. I mean, you were asked about that. And generally, you really didn't have an answer. You said we needed to build units within agencies to address problems. You said you had no good answer as to how business can self-identify to use OMB software to gain information. You said you really didn't have an answer on efforts to consolidate agency requirements to provide one-stop-shopping for business. How do you train agency points of contact? We didn't have an answer for that.

The reality of the situation is our government is so large, the paperwork is so immense, our culture is such, what is it really going to take, Dr. Graham, to move this forward? Laws aren't going to really do it. We just pass laws and everybody half applies them or they ignore them. They claim all kinds of impediments on how they can't accomplish anything. What is it going to take, sir, to really move forward? Let's cut through all the bunk. If you were running it and desired, what would you do to really reduce paperwork?

Mr. GRAHAM. Well, let me start by saying that we at OMB don't pretend that we have all the answers to those questions that you just recited.

Mr. JANKLOW. Do you have any?

Mr. GRAHAM. We may have lots of opinions, but I'm not sure we have actually that many definitive answers. But I think one of the key things that we have to keep in mind is the documented growth in paperwork burden that you're describing is partly a function of the growing appetite of the U.S. Government, both its Congress and its executive branch, to pass laws and to adopt regulations.

So I think the answer to your question lies in the four categories that I described to you in my oral statement. We have to do a better job at OMB. We have to have more science and peer review check from the outside community on the power at agencies, we need to more vigorously enforce the Paperwork Reduction Act both within the agency and at OMB. And the fourth area, which I'd like to remind you of, we need greater congressional responsibility for how they handle themselves in the area of regulation.

And all three of these have a role to play.

Mr. JANKLOW. Let's take them in reverse order. Let's start with Congress.

Mr. GRAHAM. OK.

Mr. JANKLOW. Do you, as a matter of practice every time Congress is in the process of passing laws, lay out before the Congress exactly how much more paperwork you perceive is going to be re-

quired from the legislation? As a matter of practice, OMB doesn't do that.

Mr. GRAHAM. I think it sounds in some ways like a very sensible idea. But to be quite candid with you, we have to scramble together to even get a qualitative, you know, set of sentences together to evaluate each of the various bills that Congress considers. This is a very busy Congress, and OMB does our best to get agencies together and formulate reviews, but I think you're asking something that's considerably beyond where we're currently capable of making a contribution.

Mr. JANKLOW. OK. But sir, you're the point man for the administration on this; correct?

Mr. GRAHAM. Right.

Mr. JANKLOW. And you have—it's not like OMB's sitting out there in a world all by itself. You have allies. They're called the Department of Transportation, the Department of Commerce, the Department of Energy. I don't need to go through the whole list. But they have legions of people out there that also monitor every single moment, every piece of Federal legislation that's being proposed or discussed. Why is it that we can't put in place something to remind Congress of its responsibility in this area, one, and two, why is it that we can't—where do we point to successes? Where have you had success, sir? How long has OMB been doing this?

Mr. GRAHAM. OMB has been active for—1980 was when we were created.

Mr. JANKLOW. OK. So if my math is correct, that's about 23 years ago; is that correct?

Mr. GRAHAM. Yes.

Mr. JANKLOW. So in 23 years, what have we gotten done?

Mr. GRAHAM. Well, I think it sounds very depressing the way you frame the question. But I think a fair evaluation——

Mr. JANKLOW. Why don't you frame the question for me?

Mr. GRAHAM. Right. I think the fair evaluation would be what would have been the growth in paperwork and regulatory—what would it have been in the absence of OMB review, and I think you might want to ask some of the independent witnesses in this hearing.

Mr. JANKLOW. They couldn't answer that. That would be a subjective speculation and guess, and I think you know if we were playing lawyer, no court would allow that into evidence. All right? What would it be. I'm dealing with what it is, OK? And I'm handicapped, sir, because I was an administrator for many years at the executive level at State governments, and if you knew how much people hate the government, if you really knew how much the people hate the government because of the paperwork and the penalties involved with it, are you capable of fixing it? Do you, sir, feel that you're capable of fixing it?

Mr. GRAHAM. Single-handedly, we are not capable of fixing it.

Mr. JANKLOW. Are you capable of being—providing the leadership to bring about the solutions?

Mr. GRAHAM. We're part of the leadership, but it will take more than OMB leadership to solve the problem.

Mr. JANKLOW. No, I mean you. Are you the right person in the right job?

Mr. GRAHAM. Absolutely, sir.

Mr. JANKLOW. OK. If you're the right person in the right job, who do you need on the allied council with you to get this done? I'd like to get something done. I'm cosponsoring this legislation, but the reality is, sir, we can pass all the laws we want, but until we've captured the hearts and minds of people to make a difference, we won't make a difference. And we shouldn't have to pass any more legislation to make a difference. My time's up, but—I didn't know Mr. Ose was back here. I'm sorry, sir. Go ahead.

Mr. OSE. Mr. Chairman, I was enjoying—I'll yield my time to you. You were on a roll. Proceed.

Mr. JANKLOW. Well, if I could, Mr. Graham, and I don't want to single you out, but——

Mr. GRAHAM. Go right ahead.

Mr. JANKLOW. OK. But the key thing is, if you were sitting where I'm sitting, what would you ask? Tell me the first question you would ask.

Mr. GRAHAM. Well, I probably would ask what is the most appropriate way for the Congress to get itself organized more effectively to know what it's doing regulationwise and paperworkwise when it passes laws. So I would look carefully at some of the provisions in the bill you have. I would ask questions like, is GAO the best equipped body to play the role that you're describing in that bill? Are there alternatives that could do that job more effectively? And those are the kinds of questions you're asking.

Mr. JANKLOW. But isn't that process—what you're discussing is process. I'd like to switch over to the substantive side for a moment. One time years ago, back in the 1970's, as a candidate for office, I went and got all the forms required to be filled out by people applying for welfare in my State. And I got another list of all the forms from the State revenue department. I Scotch-taped them together and it was high drama as I rolled them down the Capitol steps, which were about as high as our U.S. Capitol and across the driveway and over through the grass, over and they went, one of them went all the way to the flags, the United States and the State flag.

And it was—it graphically portrayed what a little old State like South Dakota had for paperwork. Why don't we do that with any agency that you pick? And see if it doesn't go from here to maybe Baltimore and back. You know, I'm serious, because people—until you get to the individuals in the agency, you can't train people to do paperwork reduction. That's nonsense. I mean, that really is nonsense. You just put out more rules that they're supposed to read and regulations about how to reduce paperwork. The reality is that isn't the way to do it. Why can't you pick one pilot agency? Why doesn't OMB go out and pick on some little Federal obscure agency and clean up the paperwork and then move forward? You know, Lord forbid, we won't start with the IRS, because you'd make headway. What's your objection to that?

Mr. GRAHAM. I'm happy to work with you. If you identify the one where there's unnecessary paperwork——

Mr. JANKLOW. Excuse me, sir. I don't have your job. Your job is to identify them, not mine.

Mr. GRAHAM. Right. Well our role is to review, as those agencies, all of them submit information collection requests.

Mr. JANKLOW. Who's the worst performer since you've been in the position?

Mr. GRAHAM. Well, in one of the previous hearings you may remember we actually rank ordered the various agencies on how many violations of the Paperwork Reduction Act there had been, and also what progress we've been making in reducing violations of the Paperwork Reduction Act, and I recall off the top of my head, the Department of Housing and Urban Development and the Veterans Administration were among those, and the U.S. Department of Agriculture, as I recall, were in that group.

Mr. JANKLOW. Of violators?

Mr. GRAHAM. Yes.

Mr. JANKLOW. What have you done about it? Do you have access to anybody in this government with power?

Mr. GRAHAM. I'd like to have more, sir.

Mr. JANKLOW. What are you missing for access to people to solve the problem at the VA, at Agriculture and at Labor?

Mr. GRAHAM. Well, one of the things that has been done by the subcommittee is they have actually called some of the people from those agencies before the subcommittee, and quite frankly, that has helped me do my job at reinforcing the need for them to devote the staffing resources to eliminating the violations of paperwork.

Mr. JANKLOW. OK. I just want to make sure I understand this. You're the point person for the administration and the paperwork reduction; is that correct?

Mr. GRAHAM. Correct.

Mr. JANKLOW. And people within the administration are not cooperating with you to the extent you think is necessary to do paperwork reduction?

Mr. GRAHAM. It's a very complicated town, sir.

Mr. JANKLOW. OK. And then you've had to get the assistance of another agency of the government, another leg, the executive branch, to call witnesses. That's been helpful to you to put witnesses that work in the administrative side with you in the executive branch on the spot to get things done?

Mr. GRAHAM. Oftentimes, we're looking for allies within the administration to assist us on these issues. Mr. Sullivan, to my left, though an independent officer of the Federal Government, is often extremely helpful.

Mr. JANKLOW. Sir, I don't want to argue. My time is really up now.

Mr. GRAHAM. Sure you do.

Mr. JANKLOW. But this is what drives me nuts. You reference an outside independent advocate for paperwork reduction, I'll just say advocacy for small business when the problem is within the executive branch, you folks don't have the ability to get it done. Is it leadership? Is it structure? Or is it ignorance? Or give me a fourth category.

Mr. GRAHAM. At least all of the above and the four items I mentioned actually in my oral statement.

Mr. JANKLOW. And do you think legislation will fix those three plus what you mentioned in your statement.

Mr. GRAHAM. I think it's one modest piece of the solution.

Mr. JANKLOW. Last question, sir. What authority do you think you need to enforce that you don't have?

Mr. GRAHAM. Authority? I have actually said if you have noticed in a number of my speeches that legal authority is actually not the primary barrier we have at the present time. Resources to do the job that Congress envisioned for us is a substantial problem that we have. And of course, that's why we're quite sensitive to the resource prescriptions that are in the draft legislation we're discussing.

Mr. JANKLOW. Thank you. Mr. Ose.

Mr. OSE. Mr. Chairman, I note on the clock on the floor, I have about 6 minutes, which means I have 2 minutes to ask questions.

Mr. JANKLOW. Mr. Chairman, I'm not going to go over to those votes. I don't have the ability to run back and forth.

Mr. OSE. I have asked Congresswoman Blackburn to go over and vote and come back and Mr. Schrock has joined us. I need to go vote and I'll be back. If you'd be kind enough to provide me time when I get here, that'll be great.

Mr. JANKLOW. Sure. You own the Chair. Can I just go ahead? Mr. Sullivan, if you would, sir, how long have you been in your position?

Mr. SULLIVAN. About a year-and-a-half, sir.

Mr. JANKLOW. Forget the legislation for a moment. What does it take to really begin to fix the problem of paperwork? Or is it something we can't fix so it's kind of like emphysema, we just want to hold it in check.

Mr. SULLIVAN. No, I think that we can fix it. I don't think that there's a silver bullet approach. I agree with Dr. Graham in the opening part of his oral statement when he said there isn't a magical one-part solution. But I think a lot of the burden reduction can be fixed. I think that it can be done. One way that it can be done differently is by examining what's working now, what can be done better. I think that the stick-and-carrot approach is something that can work. Dr. Graham mentioned the stick or the hammer or whatever you want to call it. And that is certainly the responsibility that the administration has to be responsive to the oversight committees in Congress. And there is, actually, benefit when subcommittees and full committees do call heads of agencies and say, "Dr. Graham's trying to get you to reduce paperwork. The committee's trying to get you to reduce paperwork. The folks who are paying your salaries, the small business men and women around the country are trying to get you to reduce paperwork."

Mr. JANKLOW. But the problem with that is sometimes you have to needlessly embarrass people and you know, there's no—I don't want to embarrass anybody and I don't think most people do. Put them on the spot, fingerpoint. But this is almost like an incurable disease.

Mr. SULLIVAN. Well, actually, I think that's where we leap to the second part of it, and that is the carrot. And that actually has a tremendous benefit toward reducing regulatory burden. Dr. Graham, didn't mention some of the success stories that have been accomplished over the last few years. Maybe it's because there simply aren't enough of those examples. But one of those examples is

reducing the paperwork requirement for small local gas stations to report to their local fire station that they have gas on the premises. This was a rule under the Emergency Planning and Community Right to Know Act that, with the leadership of the folks in charge, finally got taken off the books.

Now, how do we, as a government, hold up that example and say we want to reward the public servants that actually come up with more ideas on reducing unnecessary paperwork? And that's from the carrot approach, I think where we get past the point of needlessly calling up individuals and embarrassing them.

Mr. JANKLOW. Sir, would it make any sense if we had a—what if we were to put in place a system that—an agency like yours could assemble these types of things? Because the bureaucracy system ends. But an agency like yours could assemble them from let's say just small business and then lay them up on a platter and then, within a period of time, they cease to exist unless they are reimplemented. Why wouldn't a system like that work?

Mr. SULLIVAN. Actually, Mr. Chairman, a system like that would work. There's another part of what Dr. Graham's office has been doing in addition to accounting for the costs and benefits of rules. Also hidden in those reports are recommendations for reform. In that component of Dr. Graham's offices, annual reports are the identification of specific rules on the books that can be reformed or sometimes, Mr. Chairman, eliminated and I think that, in that component, the flow-through between the government offices right now where you see the most likely chance of success in turning this around.

Mr. JANKLOW. Well, why don't they just implement it. If they're rules, why don't they just implement it?

Mr. GRAHAM. This is the initiative that Mr. Sullivan's referring to. We asked, with the President's assistance, for nominations from anyone of the public, including small businesses, what existing regulations or paperwork requirements should be modified, eliminated, or, in some cases, strengthened? And we received over 300 nominations which, quite frankly, was very encouraging in the sense of the level of interest out there and is consistent with your understanding of the level of concern about this issue, but is overwhelming to us as a relatively small unit within OMB. We're now in the process of trying to persuade each of the Federal agencies that they should take up the ideas in here which make sense.

Mr. JANKLOW. But what I don't understand, sir, is there's one elected official that runs the executive branch; is that correct?

Mr. GRAHAM. Indeed.

Mr. JANKLOW. Everybody else works for him. If the word came down from high that you're going to do what Dr. Graham suggests, or you can appeal it to someone, let's say the OMB Director, what prevents—I mean, I don't understand how you can come to Congress and say the VA isn't doing this. The Agriculture Department isn't helping. The Labor Department isn't helping. I mean, these folks don't operate in a vacuum out there. Is it that there's not really a will to do it or is it more than that?

Mr. GRAHAM. Oh, I don't think there's any President who's been more committed to this effort than this President. I think you also know that it is a much more complicated problem than that.

Mr. JANKLOW. Well, what if they were to tell the Agriculture Department if you don't want to comply with what's being suggested by Dr. Graham, then you'll have to appeal to our office, you know, to Andy Card or the Vice President or someone. My guess is they wouldn't hear from the Ag Secretary very often on the issue.

Mr. GRAHAM. Well, and then each one of these nominations involves a discussion with agencies and then they may formulate a position. They appeal it to their higher ups in their agency and then you have basically the problem of government working again. So I think it's clear that to try to reform, amend or rescind 300 Federal regulations, which is a very small fraction of the total, is itself a very substantial enterprise.

Mr. SULLIVAN. With the chairman's permission, could I actually give an example of Presidential leadership that's actually led to the potential of paperwork reduction that John Graham has been involved in, and certainly involved with my office and home builders and other construction officials? There—right after the President announced the small business plan, he—before a women entrepreneurial conference in March 2002—said that he is committed to removing regulatory barriers that stifle job growth. At that point under his, the President's direction, John and I sat down and looked over a number of rules, one of which the Environmental Protection Agency was looking at for controlling stormwater run-off from new home construction. And when small businesses came in, small home builders, and said to Dr. Graham and to me, "Look, we already fill out a local or State permit that takes care of this exact situation that the Federal EPA is trying to regulate and create a new paperwork form for," with the President's leadership Governor Whitman, who was at that time the head of EPA, did in fact take the President's lead and reconsider and then say, "maybe we don't need this new paperwork form that accomplishes the same thing that a State form already requires." So that one example should be held out as a carrot for other agencies to follow. But it did start most certainly with the executive direction from the President.

Mr. JANKLOW. Thank you.

Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman. I'm sorry I came in late. They were having a series of strange votes on the floor. I don't quite understand it, so we're probably going to be doing this well into the night. This is deja vu all over again. You know, I think somehow we've had these discussions in the last couple of days, and I wanted to see who the people were over in the Office of Advocacy, and I went over there yesterday and there are some really great people over there trying to fix things. And we've just got to help them fix it.

The President signed the bill, but he is certainly not going to go stop in at all these agencies. Ed Schrock might. Ed Schrock is threatening to go visit these agencies and say, "I want to see who your person is that does this sort of thing." They're not going to like it very well, but I don't like the fact that they haven't done it. Poor John Graham has taken over almost an impossible task. But the fact is, we've got to hold these people's feet to the fire.

If when I was in the Navy they didn't do it, I gave them a bad fitness report and got them out of there. That was the way we took

care of that. And if these people's feet can't be held to the fire, then we need to do something about it. I don't know where that big list of 71 phone numbers is today, but I'll bet you Ed Schrock, in 3 working days, could get every number and every person, a person to go along with that or maybe a series of people that are doing it.

It just seems like if somebody really sat down and talked to the agencies, I'll bet if I called Secretary Mineta, for instance, I'll bet you he could find somebody for me in a heartbeat. He wouldn't like it that I called him. He'd probably wonder why his people didn't do it. But folks, this should be a very simple thing to do. But as we sit up here and argue this back and forth, as you heard Governor Janklow say, the businesspeople in the district I represent are dying down there because the regs keep flowing in and they keep having to fill out all this useless stuff.

As we said the other day, you know, when I got the census report, my God, what was it, 27 pages long or something like that. They wanted to know what kind of peanut butter I ate. That's nonsense, you know, and that's what these poor people are doing. And then some agencies have to fill out a series of paperwork just to see if they have to fill out another series of paperwork. Meanwhile, that takes hours away from creating more jobs or doing the business themselves. And when a business owner has to call Washington and gets shuttled from here to there on different phone calls. I think one person who testified, Andrew Langer, testified that he did a test case and this took him 2 hours to get to the person he needed to talk to. Now what if a businessperson had to do that? That's a lot of money out of their pocket, folks. We've got to solve this.

And Mr. Graham, if you want me to come down there with you, I'll come down there. I would love to go with you to some of these agencies just to get this stuff fixed. We've got to get this stuff fixed. I wasn't privileged to hear what y'all said earlier, but this is just gnawing at me big time. And it's just big government at its worst. And it's—I don't know. It seems simple to me. I think what I heard Governor Janklow say was it doesn't seem like a hard thing to do. Am I correct in what I heard you say?

Mr. JANKLOW. It's not hard.

Mr. SCHROCK. No, I don't think it's hard either. I mean we've just got to get this fixed. I don't know whether—you know, there are so many questions I could ask, but I think we've already asked them all. But at what point do we put people's feet to the fire and make them perform? Please help me understand that. That was a question.

Mr. GRAHAM. I was about to take you up on your offer to join me at some of these agencies.

Mr. SCHROCK. Well, I—honest to goodness. Now, my staff won't like this very well. But I would like to do that. You know, I gave the story the other day and if you didn't hear it, I'm going to tell it again. I'm privileged to represent all the military in the Virginia Beach/Norfolk area. The commander-in-chief of the Atlantic fleet, Admiral Bob Natter, once a week when his aide and his driver pick him up in the morning, he'll say, "OK guys, what ship are we going

to this morning?" This is 6 a.m., 0600, and he pops in on a ship once a week and asks all kinds of questions.

And take my word for it, those ships are ready, they have the answers and they're doing what they're supposed to be doing, and I think if we did that, I think that's part of our oversight role. We should be doing that, and I'd like to use that example and just pop in on some of these guys some day. I'm just mean enough to do it, and I think we have to do it to make these people accountable to the people they're supposed to be serving. These people are the servants of the people who are out there. But it seems like it's the other way around and that we've got to get over that mentality and we've got to get over it quick. And yes, if you want me to go with you, I'll get my schedule and get your schedule, and you and I will be the best friends in the world for about 2 or 3 months. I would do that. I honestly would do that. And I think there are other Members who have told me, "When you go, let me know, I'd like to go with you. I really will."

Mr. GRAHAM. You've got a deal.

Mr. SCHROCK. I yield back.

Mr. JANKLOW. The Chair recognizes the gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you, Governor Janklow and I have been here a number of sessions and every year we vote on a Paperwork Reduction Act. Every year. It's always on the floor. Paperwork Reduction Act. But it never seems like the paperwork gets less. I sometimes have nightmares that I'm drowning in paperwork. Anyway, exactly what is a regulatory budget? Could you explain it to me? You're going to analyze, if the regulation costs more than the benefit? How exactly does it work? What is a regulatory budget?

Mr. GRAHAM. Well, the analogy would be to the appropriations. We currently have for the on-budgets appropriation every year a limit that a Federal agency is allowed to spend.

Mrs. MALONEY. Yes.

Mr. GRAHAM. We have no such limit on what a Federal agency is required to compel the private sector to spend. So the question would be, why would we have limits on taxpayers spending but not limits on regulations that impose on consumers or workers or businesses spending of money? So the basic idea is, let's track both kinds of expenditures. I think it's a pretty sensible idea.

Mrs. MALONEY. Is there any work now tracking what the private sector spends on regulation?

Mr. GRAHAM. Yes. And we report to the Congress each year the best available information we have in this particular document.

Mrs. MALONEY. OK. And do we have the document today before us?

Mr. GRAHAM. I can get it for you.

Mrs. MALONEY. I'd like to see it. And does the administration support this bill? Is this an administration bill?

Mr. GRAHAM. As I mentioned in my opening remarks, in the current form we would have to oppose the bill but we're hoping to work with the committee to find a way that we can support it.

Mrs. MALONEY. And who would set the regulatory budgets? Would it come out of OMB or out of the various areas or who would set the regulatory budgets?

Mr. GRAHAM. Well in the academic literature where people have written about the concept of regulatory budget, in some models the Congress would set the regulatory budget. In some models, OMB would set the regulatory budget. And as I read the current draft of this bill, OMB would set several possible budget levels and see what the impact would be in terms of how much benefit we could get from regulation if we had different budget levels.

Mrs. MALONEY. In your research, which agency has the most regulatory provisions on the private sector, would you say?

Mr. GRAHAM. I think if you look at the total volume of regulations, certainly the big regulators in town are the Department of Labor, the Environmental Protection Agency, the U.S. Department of Agriculture, the Department of Transportation. Those four are certainly among the big ones.

Mrs. MALONEY. Which one do you think puts the most regulations, would you say? OK. Mr. Schrock said EPA, so we'll use that as an example. I think he threw quite a challenge at you and I think he's a former—what is he, an admiral, a captain. He was—he's important in the Navy. Trained killer. OK.

Mr. SCHROCK. You've seen nothing yet. Believe me.

Mrs. MALONEY. OK. Well, I'm from New York, so EPA is not that active in New York. So tell me, so EPA would come up with a regulation that then makes a demand on the private sector and there's no control over what that demand means to the private sector. When these regulations come forward, do they not come from Congress? Where do they come from?

Mr. GRAHAM. The general authority to adopt those regulations would typically come from Congress.

Mrs. MALONEY. The authority interpreted——

Mr. GRAHAM. Generally.

Mrs. MALONEY [continuing]. Interpreted by the agency?

Mr. GRAHAM. Correct.

Mrs. MALONEY. And so, have any States gone forward with this model that you're talking about where you have a regulatory budget? See, to me, it's an interesting idea. But I don't know how you would quantify or analyze the exact costs. Do you see what I am saying, of what it means to the private sector. Obviously, when you have a lot of paperwork you have to respond to, it takes your time and your energy to respond to it. But actually, a lot of complaints I hear sometimes people can't even figure out what it is—they want to do what the government wants them to do, but they can't even figure out what it is.

So, how would you come up with it? How in the world would you determine what the regulation costs the private sector? Because a lot of it is sort of almost out there in either, you know, we want you to be a good citizen and not pollute the air. So how in the world do you make sure that my apartment building is not polluting the air? Do you understand what I'm saying? How would you quantify it? It seems like a very difficult thing to do.

Mr. GRAHAM. On the cost side of the ledger?

Mrs. MALONEY. Yes.

Mr. GRAHAM. Right. Well, usually you would look at both the amount of labor, the extra employees that have to go in to either filling out paperwork or monitoring the operation of pollution con-

trol equipment or the capital resources, the extra equipment or technology that would be purchased in order to comply with the requirement.

Mrs. MALONEY. And then who would do this? Would this come out of OMB, it would come out with the regulation deal, or would it come out of the agency?

Mr. GRAHAM. Actually out of the agency.

Mrs. MALONEY. It would come out of the agency?

Mr. GRAHAM. Right.

Mrs. MALONEY. Well, how do the agencies feel about this? They like their regulations, so they're not going to want—do you understand what I'm saying?

Mr. GRAHAM. Right.

Mrs. MALONEY. They write their regulations so they're going to want to implement their regulations. So if you call upon them to monitor their regulations—you understand what I'm saying?

Mr. GRAHAM. Right, the analogy that's worth thinking about is if we gave the agencies power to set their own budgets, they might like that idea a lot. We don't allow that to happen. We have both an OMB and an appropriations process that places limits every year on how much of the taxpayer dollar they're allowed to spend. We have no such limit on what they're allowed to impose on small businesses, big businesses, anybody in the private sector, from spending. So the idea of the regulatory budget is, let's control the imposed unfunded mandates as well as those appropriations.

Mrs. MALONEY. Well, it's an interesting idea. Thank you.

Mr. JANKLOW. Thank you, ma'am. The Chair recognizes the chairman, Mr. Ose.

Mr. OSE. Thank you. I've caught my breath now. A couple of questions, if I may. Dr. Graham, half of your written statement that I read addresses your opposition to increasing OMB's staffing devoted to reducing tax paperwork. And you laid out three or four pages about that. One of them—one of the quotes were many of the more burdensome IRS information collections have been reviewed by IRS and OMB on a recurring basis, and the issues concerning them have been resolved in previous reviews.

Now, in previous hearings, in response to written questions, I think according to the information I have, that my staff has put together, is that, in response to a question on a hearing stemming from April 24 you were asked about improving results at the IRS, your response was at the subcommittee's April 24 hearing. IRS Commissioner Rossotti testified that, "The potential for greater paperwork and burden reduction is enormous. The IRS has barely scratched the surface." Now, that's the guy on the spot, or at least was on the spot, at IRS. And yet, your testimony submitted here today is that you're very resistant to the idea of additional full-time equivalents being assigned to the IRS tax burden.

Now, over here in front of Congresswoman Blackburn, there are three binders. Two binders include current tax forms required of small businesses, and one includes similar forms for individuals. My question is, I would surmise that within those three binders there are some information collection requests that are not necessary. But if we don't have adequate staff committed to reviewing that, how do we ever determine that?

Mr. GRAHAM. We don't.

Mr. OSE. So we just walk away?

Mr. GRAHAM. No. I thought you said if we don't have adequate staff. What I understand the legislation to be without regard to what our overall staffing is at OMB, we will have at least two IRS desk officers. That is what I interpret the legislation to say. And we regard that as an obstruction of the ability of the President to manage the Executive Office of President.

Mr. OSE. And yet the testimony in the past has been that 80 percent of paperwork burden stems from the IRS information collections.

Mr. GRAHAM. Fair. But that 80 percent figure includes all of the paperwork imposed by the Tax Code, which we can't change, all of the paperwork imposed by IRS interpretive regulations, which, as I explain in our testimony, we can't change. And IRS's paperwork office itself is probably larger than the whole OMB operation on paperwork. It's not at all obvious that allocating an extra one or two desk officers to IRS is a very good use of OMB's resources relative to the comparative advantage of Treasury.

Mr. OSE. How big is the Treasury or IRS's paperwork reduction office?

Mr. GRAHAM. I think I had asked and the answer I got from my staff was 12 to 15 FTEs devoted exclusively in the paperwork office.

Mr. OSE. OK. So they have 12 to 15 dealing with 80 percent of the information collection requests that stem from the IRS Code. You've got 53.

Mr. GRAHAM. Twenty-two devoted to regulation and paperwork. And of those, it's weighted toward regulation.

Mr. OSE. And we're suggesting that either 2 of those 22 or an additional 2, which would make the number 24 if we can find the resources, would be dedicated to assisting the IRS with reducing some of this paperwork.

Mr. GRAHAM. And you would ask those people not to work on legislative changes because they can't make those.

Mr. OSE. They would be specialists; that's true.

Mr. GRAHAM. They can't work on IRS interpretive regulation, because that would violate our understanding with Treasury. They could only work on those IRS paperwork burdens that aren't in regulation and that aren't in the Tax Code. We're concerned they may not have an adequate amount of work to do.

Mr. OSE. Explain to the committee why it is that someone whose job is to look at regulation and reduce the paperwork required from it can't look at regulation on the Internal Revenue Code.

Mr. GRAHAM. Because as you know, there's been a memorandum of understanding between Treasury and OMB for the last four administrations which has OMB deferring to Treasury on the development of regulations. This is unlike our relationships with any of the other major cabinet agencies and a good political scientist or historian would have to explain to you the full history of that. I do think we have a prior OIRA Administrator with us today who will be testifying later, and you might want to ask her to give you further background on the history of that.

Mr. OSE. Trust me. It's on my list here.

Mr. GRAHAM. Good, I think it would be a good question.

Mr. OSE. Mr. Sullivan, in your written statement you express support for section 3, and just for reference sake, section 3 is the provision in the proposed legislation that Dr. Graham and I were just talking about, mandating two people on the information collection request from the IRS. Your statement is that if dedicated OMB personnel can conduct a more thorough evaluation of IRS information collection requests, opportunities may be identified for paperwork simplification and the elimination of redundant information collections.

Do you think that the American people in general, and small businesses specifically, that being your province, expect and deserve an increase in OMB's efforts to reduce the tax paperwork?

Mr. SULLIVAN. Mr. Ose, my written statement did have one caveat on the support of that provision and that was the designation of existing resources—yes, I did point out the—or stressed the need for additional resources. This was not something that was so obvious to me before coming on board as the chief counsel for Advocacy. Having worked with Dr. Graham's office, I realized the sheer magnitude of the responsibility, and designating exactly what those folks should do could be counterproductive. But the idea that additional resources, whether that be in Dr. Graham's office, whether that be at IRS in a more responsive manner to these times of committees or elsewhere at the government focusing on burden reduction, would be something that small businesses would be supportive of.

Mr. OSE. So your point is that you would support, in the example that Dr. Graham and I just talked about, a 23rd and a 24th person, but not a reduction of the existing 22 to that?

Mr. SULLIVAN. That's accurate. Dr. Graham also does point out that there does need to be some working within the language to clarify exactly what still is the purview of that type of person at OMB. I mean, the desire of the committee is the same as the desire of the small businesses who contact my office every day and look at the volume of paperwork that they are tasked with filing out to comply with the Tax Code. We want to minimize that. The question is, and what John Graham talked about is, "Will the two people, however great they may be, in Dr. Graham's office, actually have the ability to get at those three volumes?"

So additional attention to the burden—fantastic idea. Where those resources are remains unclear.

Mr. OSE. If it please the Chair, I just need to expand on this. There seems to be a little bit of an equivocation here and I want to make sure I understand it correctly. Your testimony is that you would support the dedication of a 23rd and 24th person for examining IRS paperwork reduction in such a manner that would not reduce staffing or resources for the work that the other 22 are doing, is that correct? The written statement here says that you would support additional resources in the form of these two people being committed to IRS paperwork reduction.

Mr. SULLIVAN. That is accurate.

Mr. OSE. OK. All right. We just want to make sure we clarify. You would or you would not support taking any of the existing 22 and dedicating them to IRS tax paperwork reduction?

Mr. SULLIVAN. I, actually, would not support the taking the existing staff and designating them to specific tasks. Given the magnitude of the compliance burden on EPA regulations, tax regulations etc., in order for Congress to designate what those staff do, I think brings us down an extremely slippery slope. But the idea that the additional—that the committee may be open to working with other parts of Congress that may be able to direct additional resources to Dr. Graham's office, I think that the committee is on track to meet the needs that small businesses have articulated to my office.

Mr. OSE. So we've asked the question both ways and the answer is consistent that if additional resources are available, you'd support the creation of two additional slots for reviewing IRS tax paperwork load.

Mr. SULLIVAN. That's accurate.

Mr. OSE. OK. My time has expired. Thank you, Mr. Chairman.

Mr. JANKLOW. Thank you. The Chair recognizes the lady from Tennessee, Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman. And thank you to you all for being here. You know, one of the things that I hear regularly from my constituents is that their taxes are too high and their paperwork is too heavy. And it really does not matter if we are talking to small business owners who are trying their best to comply with IRS regulations, with regulations at the local and State level, if it is educators that we are talking to about complying with the mandates that we place on them, everybody gripes about the paperwork.

So it's frustrating when you go back and you read the history of the things that have been done in the past. And I certainly commend Mr. Ose and his subcommittee for the work they've done in this legislation. It is my hope that there will be some efforts, some serious efforts, on the part of the individuals that make up every agency and department in government, in the Federal Government, to actually comply and do something about this, because paperwork is a tremendous strain on our productivity. Compliance is a tremendous drain on our productivity.

And I would like for each of you to respond to my question. I'd like to know what enforcement mechanisms you feel should be included in the bill so that the agencies which fail to meet the requirements would be assessed some type of penalty. I ask this because in our Government Efficiency Subcommittee, as we talk about compliance with GPRA, compliance with the President's Management Act, looking at the internal audit opinions, we have all of these mechanisms; but I learned a long time ago when I was rearing my family, if you are going to put some kind of stipulation in, some type of requirement, if that is not met there has got to be some kind of just penalty. So I'd like your response to that, please.

Mr. GRAHAM. Let me start by responding to the open part of your remarks because I think you're raising a very important point. As large and as huge as the paperwork burdens are, the actual overall cost of regulation and the compliance cost that you mentioned are a multiple larger economy-wide than the paperwork burdens. This

is reflected in the comments we receive from the business community on how they would like this issue to be handled.

We had over 1,700 commenters raise 300 nominations in the area of regulations, guidance documents, and paperwork requirements. And it's instructive that relatively few of the nominations were in paperwork. They were predominantly in regulation and guidance documents. And that's a signal to us that the real cost, the big chunk of the costs, are in the actual compliance with the regulation even though, as you say, the paperwork burden alone is quite substantial.

I think the enforcement mechanism question you're asking is a very good one, and I think as we look forward, for example, on the pilot test on regulatory budgeting, if we were actually going to implement that in a legally binding way down the road, we would have to ask the same sort of questions we ask on the appropriations side: "What happens to agencies when they actually exceed their appropriated expenditure?" And I know at OMB that's a pretty serious proposition, but we need to ask the same question on the regulatory budget.

Mrs. BLACKBURN. Mr. Sullivan.

Mr. SULLIVAN. Dr. Graham is very humble with mentioning enforcement mechanisms. And I'll simply inform the committee that the ability for Dr. Graham to return an agency rule back to the agency for further consideration is a very powerful enforcement mechanism. And my recommendation, in answer to your question about what can we put in the law or put in process to make this work, would be to encourage Dr. Graham to finalize requirements that if a rule comes through his office for approval and it does not have the type of analysis that flushes out exactly how it's going to impact small business, then, Dr. Graham, return that rule for further consideration from the agency.

I think that there is room within this legislation to build in that type of requirement that when agencies do report often on their regulatory budget, that they go into a level of detail that flushes out the possible burden on small business that their regulations may have.

Mrs. BLACKBURN. Thank you. Mr. Chairman, I have one further question, if I may.

Mr. JANKLOW [presiding]. You go right ahead.

Mrs. BLACKBURN. Thank you. OK. Following along that same line, if you're trying to flush out some of that, how could this bill help address programs that are duplicated in other areas, and eliminate duplication and thereby eliminate some of the paperwork? Is there a mechanism where you could look at filling out one—let's take a small business owner. And if they are having to fill out some type of tax form, if that could be filled out once, and that information—if they share that information with the different levels or entities to which they're having to file, reporting, could the forms be drafted in such a way that they could be dual-use? How do you envision some way that this could be used to help address duplication?

Mr. GRAHAM. I think it's a good question. One example I'd like to give you from the perspective of a desk officer at OMB is suppose they get a request from the Occupational Safety and Health

Administration to approve a new form that asks small businesses to submit information. How do we at OMB know that EPA or the Department of Agriculture isn't already asking those same questions?

One possible solution to that problem is to have an electronic ability for the OIRA, the OMB desk officer, to immediately go into—electronically into a search engine of all the existing information collections that we at OMB have already approved and search for that same type of information. We don't have that capability right now but we're trying to develop it as part of the President's Management Agenda. And that's the Business One-Stop Initiative.

There are skeptics of electronic solutions, but I hope you can see, from the perspective of our desk officers, how do they know when they're looking at OSHA's information collection, whether there are already two or three other Federal agencies who already have that? We review 3,000 information collections every year. I think we need an electronic angle on that problem.

Mrs. BLACKBURN. I think that there needs to be a good bit of review on the technology end. When I was in the State Senate in Tennessee, we started into some comprehensive review there. I think that for many of us that sit on this committee, it's incredibly frustrating when we do not see chief technical officers in place in some spots where they should be, where there seems to be a tremendous amount of trial and error, which is a great expense to the taxpayers. And you know, having software and a program that would allow you to query forms would be tremendously helpful and should be interactive and should be user friendly for you all and for——

Mr. GRAHAM. And for the small business community itself.

Mrs. BLACKBURN. And for our small business, our constituents who are using that service.

Mr. Sullivan, anything to add to that?

Mr. SULLIVAN. I think the Congresswoman certainly points out another oversight opportunity for this committee and its subcommittees. That is, when agencies go ahead and put out a new requirement, they should in fact check to see internally whether or not they already received that information. Some do, some don't. And Dr. Graham's office reviews that prior to finalizing a rule.

I think that there are some examples where that is working. IRS has a national research program ongoing right now where it has an entire pilot in place that looks at what information they have from years and years of audits that they're going to be asking a whole other group of small businesses to report to them. Why not look internally at IRS to see what information they already have that they may not be using before asking for that same information again?

And it gets back to my point to the chairman earlier, which is, what are we doing to hold that up as an example to reward other agencies to stand up and say, "You know, we were going to put out this new form but it just so happens we already get all that information, and so we're going to consolidate all this stuff into one form."

And I don't think that those incentives right now exist. And I believe that the committee is on track to try and build those incentives into the regulatory accounting legislation.

Mrs. BLACKBURN. Mr. Chairman, may I just ask one followup before you——

Mr. JANKLOW. Go ahead.

Mrs. BLACKBURN. To each of you, as we discuss this and look at paperwork and regulation reduction, should this be addressed by GPRA or some other outcome-based scrutiny mechanism?

Mr. GRAHAM. I think the degree of cost burden of regulation and the benefit of regulation should be two of the performance measures that are considered as part of GPRA. And I think that the entire pilot test of regulatory budgeting that is trying to be advanced in this legislation, if it were tweaked in a variety of ways could, I think, bring it more squarely into the GPRA evaluation process.

Mr. SULLIVAN. I'd like to second John Graham's comments, with the addition that, when that type of analysis does come in and an agency is measured on its performance, accounting and analysis, that be broken down even further into their impact on small business.

Mrs. BLACKBURN. Thank you. Thank you, Mr. Chairman, and the committee and the witnesses for your indulgence.

Mr. JANKLOW. Thank you. I've just got one quick question. You know, OMB currently uses the information collection budget, the ICB. Section 6(d) of the proposed legislation establishes pilot projects for regulatory budgeting.

Mr. Graham, back in March when you appeared before the subcommittee you said, "I do think that there would be some significant advantages to such a pilot." What are they?

Mr. GRAHAM. The biggest one is that regulators currently have a big incentive to watch their own budget that they have been appropriated, but there's no limit on how much they can ask the private sector or State and local governments to spend because that doesn't count as part of their budget. So what a regulatory budget immediately does is, it asks them to consider that we're only able to do a certain number of these regulations because we have a private sector and State and local government limit on our regulation, so let's pick the most cost-effective ones. That's a huge advantage.

Mr. JANKLOW. Is this something that could be done without legislation?

Mr. GRAHAM. As a legal matter, I guess I'm not sure of the answer to that question.

Mr. JANKLOW. Mr. Sullivan, how would section (d) which deals with pilot projects for regulatory budgeting—do you think that would affect the—benefit small business?

Mr. SULLIVAN. Yes. If the agencies break down the numbers and analysis to the level of detail to flush out their burdens on small business, yes, Mr. Chairman, it would help.

Mr. JANKLOW. Thank you very much.

Mr. Ose, you said you had some final questions.

Mr. OSE. Thank you. Section 4 talks about some of the agencies or departments that are exempt from paperwork review and regulatory due process requirements. In both of your written statements, you express support for section 4, meaning that you sup-

ported removing the exemption from those agencies that were otherwise currently exempt. Apparently you think that the exemptions are bad public policy. Is that the reason for your statements on removing the exemptions on these agencies?

Mr. GRAHAM. Yes, that's our reason.

Mr. SULLIVAN. That's my reason as well, Mr. Ose.

Mr. OSE. Just one of the concerns I have, Dr. Graham, and I have talked about this in the past and I want to make sure that I get this on the record, is this issue of due process on these regulatory matters, whether it be guidance or something that's actually a rule. There's a huge difference in the two particular issues there. I have serious concerns that the current ad hoc rulemaking that might exist, that comes out in the form of guidance, really violates quite a bit of due process protections for people who might otherwise be interested.

Do you share those concerns about due process and do they extend to these exemptions? Is that part of your concern, Dr. Graham?

Mr. GRAHAM. Yeah, I think that there is a good bit of due process built into the Paperwork Reduction Act, including public comment processes on additional information collections, that when you're exempted from that process then you have, I think, shortchanged the process a bit. So, yes, I would say that's part of the concern.

Mr. OSE. Mr. Sullivan, do you agree with that?

Mr. SULLIVAN. Yes, I would agree. In fact, this very situation played itself out in the House Small Business Committee last week when Mr. Pombo and myself talked with that committee about the implementation of the Endangered Species Act. And there you see a similar dynamic play out where the rules have to go through due process where ideally the ranchers would have an input in this outcome. The Fish and Wildlife Service has put out guidance that has the same effect on ranchers, but the ranchers have not had a chance to influence the outcome of that rule.

And both Judge Manson, who heads the Fish and Wildlife Service, myself, and Mr. Pombo agree that this type of distinction between a rule and a guidance really doesn't matter to a small business. They've got to do it or else they get in trouble with the Federal Government. So as a public policy matter, neither should be subject to exemptions.

Mr. OSE. OK. Mr. Sullivan, in section 5 we talk about the—I want to ask this question very specifically. We talk about the 2000 law that authorized only a 3-year pilot project for the GAO to respond to congressional requests on selective agency rules. Now, the legislation before the committee in section 5 would make that funding permanent for full time analysis. Do you think that section 5 will help ensure that proposed agency rules implement congressional intent for laws enacted by Congress? In other words, the pilot project going from pilot to permanent, is that going to help us address our problem on paperwork?

Mr. SULLIVAN. I think the pilot projects that we're discussing here about narrowly tailoring the regulatory accounting should be just that, a pilot; and then coming before the committee to examine how it works and then acting based on that experience, whether or not we want to make it permanent.

Mr. OSE. I'm talking about the Congressional Office of Regulatory Analysis. If I recall, that was a 3-year pilot authorized and funded in 2000. Now we're talking about moving that responsibility to the GAO. And in your written statement you express support for that provision in the legislation. Yes or no? I'm into yeses and noes. Yes or no, do you support?

Mr. SULLIVAN. I stand by my written statement, Mr. Ose, in supporting the provision and strengthening the regulatory accounting. Yes, sir.

Mr. OSE. All right. Thank you.

Mr. GRAHAM. Mr. Chairman, if I could add a comment to your previous question about guidance. The way the regulatory budget pilot test is designed, costs of regulation would count within the agency's budget but it's not obvious that cost of guidance documents would count in the agency's budget.

One of the reasons I think a pilot test is very important here is that you could have a perverse incentive where you basically encourage agencies to accomplish more of their activity through guidance and less through rulemaking. And that's something we would have to watch very closely as we work through that pilot test.

Mr. OSE. I will tell you, Dr. Graham, one of the things that is on my priority list—and I don't think this is going to surprise you—is I'm after guidance. I mean, I just think guidance is a misuse and abrogation of due process. And I don't care which side of the question you're on, if you're getting guidance that hasn't been through due process, it's just trampling on your rights. You may lose the argument anyway if you go through due process but, absent due process guidance is, frankly, an abomination to me. So I just don't think that comes as any surprise to you.

Mr. GRAHAM. No. In fact, I've read the prior hearings you've held on that subject, sir.

Mr. OSE. If it please the Chair, I have a number of questions I'd like to submit in writing to these witnesses.

Mr. JANKLOW. Without objection so ordered.

Mr. OSE. And then in the interest of time I want to move on. But in closing, I do want to state, and this isn't going to come as any surprise to Dr. Graham because we've had this discussion, I do want to state my disappointment about OIRA's current resistance to what I consider to be its principal statutory mission. Dr. Graham's statement is a little bit broader in terms of what OIRA's role is. Mine is a little narrower. He and I disagree on that issue of how far paperwork reduction predominates OIRA's agenda. I'm respectful of that, but I am disappointed by that disagreement. In my eyes, OIRA's principal responsibility is still paperwork reduction, and I haven't been satisfied. That's why we have these hearings on and on and on and over and over and over. And that is why section 3 of this bill in particular is important to me, because I do want to get at the 80 percent of the paperwork that gets generated by the Federal Government.

So with that, Mr. Chairman, I'll yield back.

Mr. JANKLOW. Thank you very much. And any other members of the committee can also submit questions, if they have any, within the appropriate period of time.

At this time I'd like to thank you both for coming and testifying. We really appreciate the candor with which you——

Mr. GRAHAM. Thank you, sir.

Mr. JANKLOW [continuing]. Both presented your testimony.

At this time we'll move on to our second panel: Mr. Fred L. Smith, Jr., president and founder of the Competitive Enterprise Institute; Dr. Wendy Lee Gramm, the director of the Regulatory Studies Program, Mercatus Center, George Mason University, and the former Administrator of the Office of Information and Regulatory Affairs for OMB; Mr. John Sample, vice president of sales and marketing, Peake Printers, Inc., Cheverly, MD, on behalf of the National Association of Manufacturers; Raymond Arth, president and CEO, Phoenix Products, Inc., Avon Lake, OH, and he is the first vice chairman, National Small Business Association; and once again, Ms. Lisa Heinzerling who is a professor of law at the Georgetown University Law Center.

Welcome to all of you. And at this time it's the policy of this committee that all witnesses have to be sworn before they testify. Please rise and raise your right hands.

[Witnesses sworn.]

Mr. JANKLOW. I'd like the record to show that all the witnesses have been sworn. In order to allow time for questions—and I think you can see from the previous panel, there's no shortage of questions the committee members have—I'd ask that you please limit your remarks to 5 minutes. Your entire written statement will be made a part of the record.

I'd like to recognize Mr. Fred Smith, president and founder of the Competitive Enterprise Institute. Mr. Smith, would you please go ahead and proceed?

STATEMENTS OF FRED L. SMITH, JR., PRESIDENT AND FOUNDER, COMPETITIVE ENTERPRISE INSTITUTE; WENDY LEE GRAMM, DIRECTOR, REGULATORY STUDIES PROGRAM, MERCATUS CENTER, GEORGE MASON UNIVERSITY, AND FORMER ADMINISTRATOR, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, OMB; JOHN SAMPLE, VICE PRESIDENT OF SALES AND MARKETING, PEAKE PRINTERS, INC., CHEVERLY, MD, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS; RAYMOND ARTH, PRESIDENT AND CEO, PHOENIX PRODUCTS, INC., AVON LAKE, OH, AND FIRST VICE CHAIRMAN, NATIONAL SMALL BUSINESS ASSOCIATION; AND LISA HEINZERLING, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. SMITH. Thank you very much. I'm Fred Smith. I head the Competitive Enterprises——

Mr. JANKLOW. Could you hit your mic, sir?

Mr. SMITH. I head the Competitive Enterprise Institute and we focus in on regulatory issues. I'm very pleased that you're addressing this very, very critical issue and, for the record, I'd like to introduce the work of a colleague now at the CATO Institute, Wayne Crews' 10,000 Commandments. God only needed 10, our regulatory state needs 10,000 in accounting.

The goal of disciplining all the political interventions in the economy is a critical goal and something worthwhile doing. There will

always be people who believe that the market has failed or is slow to address a critical problem or will inadequately supply some public goods. They may be right, they may be wrong, but good government requires that their objectives, the objectives of the various regulatory agencies, be compared and contrasted with those of other agencies to ensure that American taxpayers, consumers and businessmen, get their full value from government intervention.

The demand for expanded government can be realized in several ways: via direct expenditures, via loan guarantees or other credit subsides, and via regulation. The latter of these is the most undisciplined element of government intervention and we have seen very weak leadership in this area forever and, unfortunately, even today. In past administrations there was at least one key individual at a higher level than Dr. Graham. Dr. Graham is a wonderful individual, but it would be useful if he had more support. The administration has had many things to do but I would hope we would see more leadership there from this administration. I would recommend that the Treasury, who we've already heard has a major role in the IRS regulation, be given that responsibility because we know John Snow has a tremendous background in regulatory reform.

The regulatory costs that the OMB is trying to deal with is hard. OMB has more than 10 times as many employees involved in reviewing expenditures than there are reviewing regulations, even though regulations now are approximating half the total cost of expenditures of this country. They're growing and they're growing out of control.

Regulations are essentially a state constitution responsibility. Consider two agencies, both of them with the same mission; one of them an expenditure agency, one of them a regulatory agency. Both of them are headed by enthusiasts who know they're doing good for America. They both go out and come back with wish lists. The expenditure agency's wish list doesn't become reality until it gets the approval of the constitutional authorities, the Congress of the United States authorizing, an appropriation committee, and the administration. In contrast, once the regulatory laws are passed, the regulatory agency's wish list can become reality once they jump through the appropriate hoops and hurdles. There is no accountability for regulations when they become reality. We pass broadbrush regulations that promise everything to everyone and the costs are incurred downstream with inadequate accountability.

And this, incidentally, is not new. This happened at a much earlier point in American history on the expenditure side of the coin. I would recommend a phased-in regulatory approach, a regulatory budget. I would start with rules over $100 million in the first year, and then the second year lower to $90 million and so on as we gain experience in how to do these. I would focus strictly on cost, not benefits. We may be able to say something about the cost of implementing spotted owl regulations. I doubt very much that anyone is going to be able to assign a value to the existence or nonexistence of a spotted owl. There's a lot to say there. I can do that in the testimony.

This bill is an important step forward in starting this process. I agree that all the exemptions should be removed, that OIRA does

need new staff. It's totally inadequately staffed for its responsibilities and I would focus, as I've said, on costs not benefits. The idea—benefits are esoteric, costs are real. And we can get real information from the businessmen and others who are affected by these.

I'd like to finally commend this committee for taking on this issue. America is seeking to secure its future, to ensure that every action taken by government delivers full value to the American public, who as business men and women, taxpayers and consumers, bear the burden. We need every value in these periods. We need it always.

Had the founders of this Nation realized how significant a role regulation would play in modern America, they would have required the type of action that your committee is exploring today. Unfortunately, while they were brilliant, they were not gods, they couldn't eliminate Leviathan's tendency to break its bonds. Meeting that challenge is the challenge of every generation. Our challenge is to find—to bring in the regulatory state, not to be pro-regulation or anti-regulation, but to ensure that regulations receive the same level of scrutiny that expenditures do, as John Graham mentioned earlier.

Right now we have regulation without representation. That should be, and I believe is, Constitutional. It certainly should be addressed. Thank you.

Mr. JANKLOW. Thank you very much. You hit it right on the mark.

Mr. SMITH. That helps.

[The prepared statement of Mr. Smith follows:]

The Paperwork and Regulatory Improvements Act of 2003

Testimony of Fred L. Smith, Jr.
President and Founder
Competitive Enterprise Institute
Before the Committee on Government Reform
U.S. House of Representatives
July 22, 2003

Thank you, Mr. Chairman, and members of this Committee, for the opportunity to present testimony on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." I'm Fred Smith, President and founder of the Competitive Enterprise Institute (CEI), a free-market public policy group focusing on regulatory issues.

I commend you for holding this hearing on a perennially important but increasingly urgent issue. Put quite simply, federal regulatory spending is uncontrolled and, therefore, out of control.

Economist Clyde Wayne Crews, Jr., formerly an analyst with CEI and now director of technology studies at the Cato Institute, produces an annual survey of regulatory trends called *Ten Thousand Commandments*. The just-released 2003 edition estimates the annual cost of federal regulation at $860 billion. That is larger than the Gross Domestic Product (GDP) of Canada ($701 billion), and easily exceeds the combined pre-tax profits of all U.S. corporations ($699 billion). Federal regulatory costs equal 42 percent of federal on-budget outlays ($2,011 billion), and dwarfs the federal budget deficit.[1]

Although federal fiscal discipline is far from perfect, federal regulatory discipline is practically non-existent. Consequently, regulation has long been the preferred tool of both special interests seeking to manipulate public policy for competitive advantage and ideological groups pursuing their particular visions of the public interest. For example, government can promote wind-, solar-, and biomass-generated electricity not only through on-budget tax breaks and subsidies but also through renewable portfolio standards—regulatory schemes imposing un-funded mandates on electricity producers and, thus, hidden taxes on electricity consumers.

With the federal deficit once again seen as a major fiscal and political liability, policymakers will increasingly be tempted to use off-budget regulatory spending to achieve their goals. That is why this hearing is so timely. Congress must begin to discipline federal regulatory spending.

CEI strongly supports the "Paperwork and Regulatory Improvements Act of 2003." Although the bill is by no means a cure for the defects of the regulatory process, it is a positive step in the right direction. Of particular importance, by directing the Office of Management and Budget (OMB) to designate at least five agencies as pilot projects in

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[1] Clyde Wayne Crews, Jr., *Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State*, 2003 Edition, Cato Institute, available at http://www.cato.org/tech/pubs/10kc_2003.pdf.

regulatory budgeting, the bill requires the Executive Branch to experiment with an essential component of fundamental reform.

My testimony has three main parts. Part 1 will discuss why federal regulatory spending is uncontrolled. There are two main reasons. First, nothing like a coordinated, unified federal budget exists to discipline regulatory spending. Second, Congress has little incentive to enact regulatory budgets because it does not take responsibility for the cost and quality of regulatory decisions. Rather, Congress delegates the authority not just to develop and propose but also to adopt regulations to bureaucrats—non-elected officials who are not accountable via the ballot box to the public they supposedly serve. Part 2 will briefly discuss steps both big and small Congress and OMB should take to discipline the regulatory state. Part 3 will address three questions raised in the Chairman's letter of invitation.

1. Power without Responsibility

A. Regulation without Representation

The current regulatory process suffers from two major, related defects. First, it is a system of "regulation without representation." Congress passes and the President signs into law the broad regulatory statutes that govern the activities of various industries and sectors. Well-known examples include the Clean Air Act, the Occupational Safety and Health Act, and the Food, Drug, and Cosmetic Act. However, Congress and the President delegate to non-elected bureaucrats the tasks not only of developing and proposing the implementing rules, but also of enacting those rules. The original regulatory law lacked specificity—the implemented regulation creates real costs and benefits. Thus, the legislators largely escape responsibility—they only passed the law, not the regulation. Consumers and taxpayers—those who ultimately bear the costs and reap the benefits of regulation—cannot readily reward or punish anyone at the ballot box for good or bad regulatory decisions.

This system of non-accountability exists, because it provides incumbency protection for elected officials. Elected officials get to claim credit for the real or alleged benefits of regulatory statutes, and yet are free to blame someone else—the bureaucrats—when the implementing rules turn out to be controversial, costly, or unreasonable. New York University Law School Professor David Schoenbrod calls the regulatory state a regime of "power without responsibility." Elected officials exercise and enjoy the power to create regulatory programs but take no responsibility for the associated costs and red tape.

The result is a system of "regulation without representation." Elected officials are accountable to voters for the costs and benefits of tax and spending decisions, but not for the costs and benefits of regulatory decisions.

A key consequence of this non-accountable system is that Congress and the President feel little pressure to establish in the regulatory arena the kind of budget coordination,

discipline, and oversight that everybody acknowledges to be indispensable in the fiscal arena.

B. No Budget and Accounting Act for Regulatory Spending

It is instructive to compare the early 20th century struggle to create the unified federal budget with current efforts, like H.R. 2432, to discipline regulatory decision making. This perspective is valuable, Mr. Chairman, because it clarifies that your bill is not partisan, nor indeed anti-regulation, but rather an important step to ensure that OMB examines regulation—a form of off-budget spending—as carefully as it examines federal spending programs.

The early 20th century struggle to reform federal expenditure policy was complex, took many decades to conclude, and encountered much opposition. However, eventually, both Democrats and Republicans came to realize the necessity for a unified budget and enacted the Budget and Accounting Act of 1921. The following account by the House Committee on Rules reveals striking similarities between that earlier struggle and your current reform effort:

> [Prior to the Budget Act, federal spending was] … a hodge-podge of overlapping efforts compounded by a similar lack of coordination in the executive branch. Executive departments submitted their requests for funds ***directly*** to the various committees with spending jurisdiction, sometimes making ***duplicate or overlapping requests*** to more than one committee. Although the Treasury did begin compiling the requests of the various departments into a single "Book of Estimates" in 1878, there was ***no authority for the President to submit a single, coordinated budget proposal, or for Congress to consider one.*** The President was thus limited in his ability to influence or coordinated the efforts of nominally subordinate cabinet members.
>
> Budgeting in the 19th century was thus quite different from the way it is understood and practiced today … A leading reform advocate, Charles Wallace Collins, wrote that ***"no one knows in advance of action, what the government proposes to spend in the coming year.*** This can be arrived at only at or near the close of a session by summing up the various bills that have been acted on."
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> The result was a pattern of increased Federal spending which caused House Appropriations Committee Chairman James A. Tawney to conclude in 1910 that "the division of jurisdiction and responsibility in the matter of initiating appropriations ***has contributed more than any single cause to the enormous increase*** in appropriations during recent years." This increase, as well as the rising incidence of deficits, inevitably resulted in a renewed call for reforms to pose better spending control.[2]

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[2] *Evolution of the Budget Process—Federal Budgeting Prior to 1921*, emphases added; accessible at http://www.house.gov/rules/jcoc2v.htm

One could readily substitute "regulations" for "expenditures" in the foregoing account. Agencies directly translate legislative mandates into regulatory expenditures with little or no supervision by OMB or Congress. There is no authority for the President to submit a single, coordinated regulatory spending budget, or for Congress to consider one. Agencies are free to propose duplicative and overlapping regulations. No one knows in advance of agency actions what the total price tag for American businesses and consumers will be. The absence of coordinated oversight contributes to the never-ending increase in regulatory spending.

2. How to Discipline Regulatory Spending

A. End Regulation without Representation

Two themes should guide reform efforts: accountability and disclosure. Congress and the President would have much greater motivation to insist that agencies consider low-cost alternatives and non-regulatory alternatives if elected officials had to approve final agency rules before those rules become binding on the public. Politicians could no longer blame "rogue agencies" or "high-handed bureaucrats" when things go awry, because the buck would stop where the Constitution intended it to stop—with the people's elected representatives.

The 1996 Congressional Review Act, which provides procedures for Congress to disapprove final rules, reflected Congress's growing recognition that it should take more responsibility for regulatory decisions. However, the CRA has severe limitations. To stop an unwise regulation, somebody must expend the effort and political capital to organize legislative majorities in both chambers. Moreover, if the President vetoes the resolution of disapproval, then opponents of the rule must assemble super-majorities in both chambers to prevail.

What is needed is a mechanism that deters agencies from proposing bad rules in the first place, not one that makes it almost impossible to stop bad rules after agencies have finalized them. The Congressional Responsibility Act, sponsored by Rep. J.D. Hayworth (R-AZ), would require that Congress sign off on significant agency rules before they can become binding. Under this arrangement, a simple majority in each chamber could stop an ill advised rule just by declining to vote for it.

Critics may complain that Congress could not manage the increased workload if it had to approve regulations. But there are various ways Congress could streamline the review process. For example, administrative and other non-controversial rules could be bundled together and approved by a voice vote. Congress could approve each agency's minor rules as a non-amendable package through an up-or-down vote—the procedure used to close and consolidate obsolete military bases.

My recommendation is to start with "economically significant" rules (those estimated to cost the economy more than $100 million annually), and then gradually roll back this cap as the agencies, OMB, and Congress become more familiar with the process. Within

some phased-in period, each agency would face hearings on the Hill to review the agency's regulatory impact analysis for each major rule. The hearing record, including the committee of jurisdiction's recommendations, would then inform the wider congressional debate and vote on the rule. Such a process would work as well—and no better—than current fiscal policy. But, at least, Congress would be responsible for regulations promulgated under the laws it enacts, and agencies would be more careful to develop sensible, cost-effective rules.

B. Towards a Budget Accounting Act for Regulation

As Congress assumes more responsibility for regulation, it will come under increasing public pressure to control regulatory costs, just as it faces public pressure to control tax and spending burdens. Sunshine statutes like the Paperwork Reduction Act, the Regulatory Right to Know Act, and the Chairman's Paperwork and Regulatory Improvements Act are indispensable to build support for increased oversight and discipline of regulatory spending.

The long-term reform goal should be to establish regulatory budgets for each agency and, ultimately, for the federal government as a whole.

In the fiscal arena, debate swirls around the question of whether an agency's objectives (say, the Department of Defense, or DOD) would be better advanced by spending more in category A (say, a new air mobile division) than in category B (say, a new battleship). An agency will, of course, fight for the highest possible budget, but it does so within the context of a larger debate over whether the Defense budget as a whole is too high, too low, or just about right. It is clear in advance to defense planners that they must make some effort to economize and make tradeoffs among competing programs. They are not free to pretend that the sky is the limit and money is no object.

In contrast, the regulatory debate focuses on the merits of each specific regulation. There is no budget cap because regulatory costs are off budget and therefore largely ignored. Moreover, the absence of any cap means that neither the regulatory agency, nor the Office of Information and Regulatory Policy (OIRA), nor Congress has much incentive to consider less costly or non-regulatory alternatives, let alone significant changes in program design or administration. Agencies fight for all regulations individually without regard to their cumulative cost.

I commend the Chairman for including in H.R. 2432 a provision to establish regulatory budgets in at least five agencies as pilot projects. Only stale and dull habit keeps us from being astonished that regulatory spending—equivalent to 42 percent of the federal fiscal budget—is off budget and subject to no formal constraints.

C. Regulatory Report Card

There are several types of information OMB could and should publish right now to build awareness of uncontrolled nature of regulatory spending, and the need for regulatory

budgets. Wayne Crews, in each edition of his annual *Ten Thousand Commandments* report, has recommended that OMB publish a simple "Regulatory Report Card" that consolidates vast amounts of regulatory data already provided but scattered across government agencies. Such information includes, but is not limited to:

- Total numbers of economically significant and minor rules;
- Number of rules costing more than $500 million, $1 billion, and $10 billion;
- Available cost tallies for the current year's rules;
- Major rules required by statute;
- Rules that are deregulatory rather than regulatory;
- Major and minor rules that are discretionary;
- Rules facing statutory or judicial deadlines;
- Rules for which cost calculations are statutorily prohibited;
- Top rule-making agencies; and,
- Percentages of rules reviewed at the OMB and action taken.

Wayne suggests, and I concur, that the Report Card should be published annually as part of the Budget of the United States, and be supplemented with easy-to-read historical tables reviewing trends in the same types of information over the past five years. Congress and the interested public would be able to see at a glance, for example, whether the number of rules affecting small businesses and localities is going up or going down, whether any significant deregulation is occurring, whether regulatory activity at the top rule-making agencies is primarily driven by statute or agency initiative.

When regulatory cost information like this gains wider currency, and becomes part of the annual debate on the Budget of the United States, many in Congress, the media, and the interested public will see the need for a new Budget and Accounting Act to discipline regulatory spending.

3. Chairman Davis's Questions

I will now address three questions raised by Chairman Davis in his letter to me of July 8, 2003.

> **A. Should the General Accounting Office have a permanent staff devoted solely to evaluating certain regulations for the purpose of providing Congress an independent perspective on the value and effectiveness of these regulations?**

Given that we want to move towards a regulatory budget, and considering the Congressional Budget Office's superior resources in budgetary analysis, I would recommend creating a special unit or department within CBO. However, as I understand, CBO fears it would lose its clear mission and organizational identity if required to devote significant resources to regulatory analysis.

The Government Accounting Office (GAO) is a multi-purpose investigative agency, so enhancing GAO's capability to respond to congressional requests for analysis of

economically significant rules may be reasonable. However, as Congress begins to take more responsibility for regulation, and as OMB begins to implement regulatory budgets, Congress may want to establish a separate congressional agency for regulatory review, or more strongly urge the Congressional Budget office to assure this responsibility. GAO's regulatory review team might develop and analyze alternative means of reaching their goal.

B. Should Congress require agencies to submit annual estimates of the costs and benefits associated with federal rules and paperwork for each of their agency's programs?

Congress should require OMB to compile and submit annual *cost estimates* of federal rules and paperwork for each agency's program, but it is neither necessary nor desirable to require benefit estimates. Indeed, the push for cost-benefit or net-benefits analysis has diverted attention from more effective ways of prioritizing regulation. Moreover, such analyses are of little or no value in containing regulatory costs.

Cost-benefit analysis is designed to enhance the wisdom of each specific regulation, one at a time. Although largely based on the common sense notion that government interventions should do more good than harm (that is, produce more benefit than cost), cost-benefit analysis is easily caricatured as a corporate plot to put price tags on human life, children's health, and unique eco-systems.

More importantly, cost-benefit review has relatively little restraining effect. As long as the regulatory agency can argue that a rule has more benefit than cost, it is home free. OIRA already requires agencies to estimate net benefits for many rules. Most agencies soon learn to employ creative accounting or soft science to ensure high benefit-cost ratios. That is hardly surprising, because agency cost-benefit assessments are "inherently self-serving." As economists Randall Lutter and Richard Belzer explain:

> The same agencies that evaluate performance also design and administer the very regulatory programs they are evaluating. It is hard to understand why anyone should expect self-examinations to be objective and informative. Investors want businesses to be audited by analysts without financial conflicts of interest. Scientists reject research that cannot be replicated independently. Consumers flock to independent testing organizations rather than rely exclusively on sellers' claims. Only in the public sector, where bureaucracies are protected from the discipline of market forces, do we rely on self-evaluations of performance.[3]

The Environmental Protection Agency's Section 812 Report to Congress on the costs and benefits of the Clean Air Act is a prime case in point. In 1997, EPA's first report on rules issued from 1970 to 1990 presented a "best estimate" of net benefits of $22 trillion—roughly the aggregate net worth of all U.S. households in 1990. "We know of no

[3] Randall Lutter and Richard B. Belzer, "EPA Pats Itself on the Back," *Regulation*, Vol. 23, No. 3, 2000, www.aie.brookings.org/admin/pdffiles/epa.pdf

professional economist who takes that estimate seriously," Lutter and Belzer comment. Indur Goklany, formerly chief of the technical assessment division of the National Commission on Air Quality, points out several bizarre implications of EPA's net-benefits estimate:

> One such implication of EPA's estimate is that in 1990 the nation would be willing to pay 20 percent of its GDP for just the health-related benefits of air pollution control despite the fact that it spent only 12 percent of GDP on all health care that year—an amount many [including Bill and Hillary Clinton] thought excessive. Another implication is that the nation is or should have been willing in 1995 to spend 60 percent of its GDP on eliminating all existing cases of chronic bronchitis. A third implication is that the nation should pay hundreds of thousands of dollars to eliminate the loss of one life-year because of air pollution even though there are many underused medical procedures that could provide the same benefit at a tenth or a hundredth of that cost. That would be a recipe for poor public policy and wasteful spending.[4]

Imagine what would happen if we took the same approach to spending agencies. Fiscal restraint would go out the window. For example, what is the monetary benefit of preventing a full-scale nuclear attack on the United States? Surely, whatever it is, it is larger than any expenditure we might make on defense programs. So if we relied solely or mainly on net-benefit analysis to control military spending, the defense budget could easily be two or three times what it is today.

Benefit assessments tend to be more subjective than cost estimates, because frequently benefits are in areas for which markets are weak or non-existent (for example, air quality), often because regulation preempts the evolution of private risk management arrangements. Thus benefit estimates tend to have such a large range as to be useless in guiding policy change. For example, OMB reports that, "health, safety and environmental regulation produces benefits between $30 billion and $3.3 trillion of net benefits per year."[5] That vast range makes it difficult if not impossible to draw any policy conclusions other than to be skeptical of agency benefit assessments.

Reliable cost information is, by comparison, easier to obtain. The Department of Interior (DOI) may not be able to put a price tag on the benefits of saving a population of spotted owls, but economists can probably estimate the impacts of DOI logging restrictions in the Pacific Northwest on timber sales, employment, industrial concentration, tax revenues, and the like.

Leaving out a requirement for benefit estimates would help OMB and the agencies devote more resources to cost estimation and disclosure. That's what we want, because regulatory budgets—the long-term objective of our efforts—are cost budgets, not net-benefits budgets. Agencies already do a reasonable job assessing costs for $100 million

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[4] Indur Gokany, *Clearing the Air: The Real Story of the War on Air Pollution*, Cato Institute, 1999, p. 153.
[5] OMB, *Report to Congress*, 1998, p. 16.

rules in the preparation of Regulatory Impact Assessments, on which many individuals and organizations submit public comments.

Focusing on costs doesn't mean benefits should be ignored. Rather, benefits should be addressed in the same way Congress and the President address them in on-budget spending programs. In both regulatory and spending programs, elected officials should make the "grand judgments" about whether the benefits are worth the costs. Presumably, they do this every time they enact, amend, or re-authorize such programs. The aim of reform should not be to require agencies to claim a net-benefit for every rule. Rather, the goal should be to encourage each agency to seek that mix of regulatory activities that would best advance their mission—and fall within their regulatory budget ceiling. Of course regulatory agencies would seek larger budgets by arguing the value of their programs—just as do spending programs. Greater cost disclosure combined with regulatory budgets would create the framework and incentives for such healthy competition. Ultimately, this dynamic would allow Congress to reallocate regulatory authority based on results achieved or not achieved.

Again, though, Congress will have a stronger incentive to link regulatory budgets to regulatory performance if Congress assumes responsibility for approving and disapproving agency final rules.

C. Should Congress integrate OMB's regulatory accounting statement into the President's Budget and make this statement cover the same time period as the President's Budget?

Yes, of course. What matters to the economy is the total burden of federal intervention. Consolidating the presentation of tax, spending, and regulatory cost information would help clarify the big picture for Congress and the public. Federal regulatory costs of $860 billion combined with on-budget outlays of $2,011 billion bring the federal government's share of the economy up to 27 percent. That is the total cost of the federal government, and that is what must be contained to preserve the dynamism and growth of the U.S. economy.

Furthermore, since our long-term objective is to establish regulatory budgeting, OMB should begin as soon as possible to integrate the presentation of regulatory cost information with its annual presentation of tax and expenditure information.

Conclusion

CEI strongly supports the "Paperwork and Regulatory Improvements Act of 2003." The bill is by no means a complete cure for the defects of the regulatory process, as the sponsors surely know. Moreover, CEI questions the wisdom—both on political and policy grounds—of attempting through net-benefit requirements to make regulatory agencies police themselves. Instead, the Committee should put its emphasis on cost estimation and disclosure. The bill should require OMB to produce an annual Regulatory Report Card, with easy to read historical tables, so that Congress and the public can see at

a glance the scope and scale of off-budget regulatory spending. Concentrating on cost-information and disclosure will also help set the stage for future regulatory budgets, which address the costs of regulatory spending, not the net-benefits thereof.

H.R. 2342, like the regulatory budgets it envisions, should be seen as complementary to accountability reforms designed to end "regulation without representation." In the final analysis, the purpose of regulatory budgeting and of congressional review of agency actions is one and the same: to make the regulatory state more obedient to Congress and the President and, thus, more accountable to the American people.

Thank you.

Mr. JANKLOW. Dr. Wendy Lee Gramm. Dr. Gramm is the director of the Regulatory Studies Program at Mercatus Center at George Mason University, and she's the former Administrator of the Office of Information and Regulatory Affairs at OMB so she brings particular insight to this hearing.

Ms. GRAMM. Mr. Chairman and members, thank you for the opportunity to testify today on a very important bill. I have long argued that the cost of complying with regulations is a tax, since individuals who must use their resources to comply with a regulation are doing so in pursuit of a public goal specified by a government agency or by legislation. Rather than government levying taxes or borrowing and then using those tax revenues to fund a project, in the case of regulation, government simply requires private citizens and businesses to bear the cost of the government program directly through mandates. Regulatory taxes that the government imposes on businesses and individuals are off-budget expenditures of the government. Individuals pay these expenditures out of their pockets because the government requires them to do so, but these expenditures are not reflected in the budget of the United States, at least not so far. I call these hidden taxes.

Indeed, there is relatively little information on the size of these regulatory taxes or the regulatory budgets of programs. We do not collect or use information on the size of this regulatory budget the way we collect and use information on the fiscal budget. This lack of information hinders the ability of Congress and citizens to hold agencies and policymakers accountable for the effectiveness of various programs and how programs compare with other methods of achieving the same goal, or indeed with other ways of using their scarce dollars.

My testimony outlines various measures of the size of the regulatory budget, and you are aware of these measures. I would like to note that just this morning, the Mercatus Center at George Mason University, my organization, and the Weidenbaum Center at Washington University in St. Louis have released the latest report of the on-budget costs of regulations. This report, which tracks the size of the fiscal budget and staffing devoted to the writing, administering, and enforcing of Federal regulations, has been published since 1977 by the Weidenbaum Center. Recently this report has become a joint project of the Weidenbaum Center and the Mercatus Center, and I'm pleased to have this latest report, just released, available for today's hearing.

This important series provides one view about the growth of regulations, but it is just one part of the picture. It is high time that we track the other part of the picture, the part that is much larger, according to the best estimates available, and that is the off-budget costs of regulations and the size of the regulatory tax burden on American citizens.

I strongly support H.R. 2432 because it takes important steps in bringing accountability and transparency to the regulatory process. My testimony makes clear that I support all sections of H.R. 2432 because it begins to make the treatment of regulatory programs similar to other programs of government.

However, I'd like to emphasize just a few issues. First, there should not be exemptions from the Paperwork Reduction Act and

the time-tested Administrative Procedures Act. There is flexibility enough in the acts themselves. I do not understand why one would want to take protections away from farmers. These exemptions set a bad precedent and should be repealed.

Second, I testified in favor of a Congressional Office of Regulatory Analysis and have been very disappointed that it has not yet been funded. It is high time for Congress to put its money where its mouth is. Fund it and make it permanent.

Finally, I strongly support section 6 and believe that section 6(d), which establishes pilot projects for regulatory budgeting, is perhaps the most important provision of the whole bill. It would begin to do what I have long advocated: bring the off-budget cost of government on budget, expose the hidden taxes of regulations that Americans are paying each year, and hold agencies and Congress, where appropriate, accountable for the taxes they impose on citizens and businesses.

You will hear many complaints about this, but if I'm not mistaken, when agencies were first required to create and submit their fiscal budgets to the Bureau of the Budget—I think it was way back in 1919—there was much complaining and belly aching, but it was done. And now the same should be done in the regulatory arena.

Thank you very much.

Mr. JANKLOW. Thank you very much, Dr. Gramm.

[The prepared statement of Ms. Gramm follows:]

MERCATUS CENTER
GEORGE MASON UNIVERSITY

Testimony
of
Dr. Wendy L. Gramm, Director
Regulatory Studies Program, Mercatus Center
George Mason University, Arlington, Virginia

before

Committee on Government Reform
U. S. House of Representatives

July 22, 2003

Mr. Chairman and Members of the Committee on Government Reform: I am pleased to be able to testify on regulatory reform, and specifically on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." I am an economist and have spent years in academics as well as in various regulatory positions in government and am the founder and director of the Mercatus Center's Regulatory Studies Program. This testimony reflects my views and does not represent an official position of George Mason University.

I especially appreciate the hearing today because I strongly support the proposals contained in H.R. 2432 and because I believe you are addressing a very real problem that is affecting the long term health of our economy and the welfare of U.S. citizens.

The cost of complying with regulations is a tax, since the individuals who must use their resources to comply with a regulatory mandate are doing so in the pursuit of a public goal specified by a government agency. Rather than government levying taxes and then using those tax revenues to fund the project, in the case of regulations, government simply requires private citizens and businesses to bear the costs of the government program directly through mandates. Regulatory "taxes" that the government imposes on businesses and individuals are "off-budget" expenditures of government – individuals pay these expenditures out of their pockets because government requires them to do so, but these expenditures and the associated programs are not reflected in the budget of the U.S.

In fact, there is relatively little accurate information on the size of these regulatory "taxes," or the regulatory "budget" of the U.S. Currently, we do not collect information on the size of the regulatory "budget" of the U.S. the way we collect information on the size of the fiscal budget. Congress does not consider and discuss specific regulatory

programs and the costs they impose the way it debates the impact of specific spending programs on the size of the fiscal budget. Congress may spend much time discussing the need to increase or decrease the tax burden on American citizens, but it cannot effectively debate the size of the "regulatory tax" burden on citizens.

This lack of information hinders the ability of Congress and citizens to hold agencies and policymakers accountable for the effectiveness of various government programs. It is difficult to evaluate which programs are most effective at achieving their goals without sufficient information about the cost of the programs.

Estimates and Proxies for the Size and Growth of the Regulatory Budget

Currently, the most cited and arguably the best estimate of the total annual cost of regulations imposed by the federal (state and local too?) government on Americans is $843 billion in 2000. This estimate is the result of a 2001 study by Professors W. Mark Crain of George Mason University and Thomas Hopkins of the Rochester Institute of Technology and commissioned by the Small Business Administration. The Small Business Administration had previously published estimates of the total cost of regulations in 1995 and these studies remain the most consistently cited estimates on the total cost of regulations. Unfortunately, these studies are not published regularly, although it appears that the SBA is attempting to update the study more frequently than in the past.

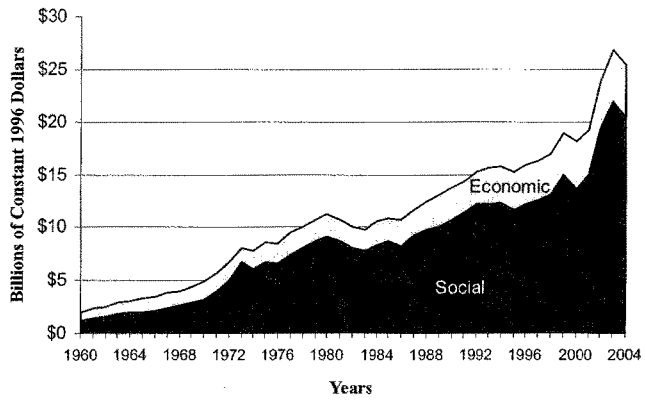
OMB is required by law (Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (section 638(a))) to estimate the total costs and benefits of all federal regulations each year. Unfortunately, OMB's study, which has been produced since 1997 (every year except 1999), does not provide a reliable estimate of the total cost of regulations for several reasons. First, OMB simply uses the estimates of costs and benefits that agencies provide, and many of these estimates are very inaccurate. OMB has not made their own independent estimates of the costs of individual regulations. Second, OMB's estimates cover only a few years (the last 10 years in the most recent report). Third, OMB's estimates include the costs of the largest regulations (generally over $100 million or more per year), which OMB recognizes may significantly understate total costs. The combination of relying on agency estimates and focusing on a subset of regulatory costs is that the resulting total estimates are simply not believable. In its 2003 report, OMB reported total regulatory cost estimates of $38 to $48 billion per year – a small fraction the SBA's more comprehensive estimate of $843 billion per year.

Our Regulatory Studies Program is attempting to provide further estimates of the regulatory burden. As an example, we have published a study on the total cost of workplace regulations, and on the impacts on the manufacturing sector of workplace regulations. We have other studies under way to estimate costs of specific regulations. But there is much more to do.

Until such time as we have a more accurate estimate of the cost that each regulatory program imposes on Americans, we cannot track the growth or size of government, and we cannot have true picture of the total taxes paid by U.S. citizens to fund public programs. Indeed, it is difficult to even know what is happening to the size of the regulatory state from year to year.

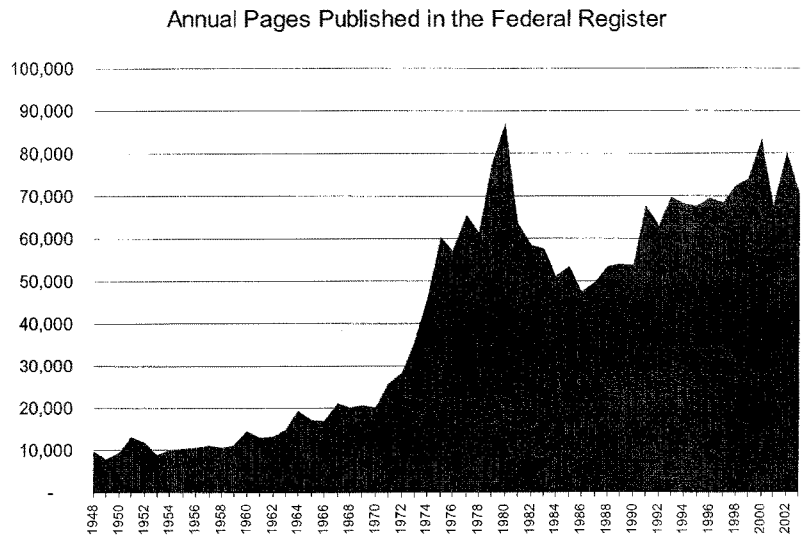
There are several proxies that are commonly used to try to track the year-by-year change in the regulatory costs imposed on Americans. Perhaps the best measure for the growth in the regulatory state is the total size of the budgets of regulatory agencies, or the on-budget cost of writing, administering, and enforcing regulations. This information was originally published by the Weidenbaum Center at Washington University in St. Louis in 1977, and includes fiscal costs going back to 1960. Since last year, this report has been a joint project of the Weidenbaum Center and the Mercatus Center. The newest report, authored by my colleague Susan Dudley and Melinda Warren of the Weidenbaum Center has just been released today, and I would like to include the report as part of this testimony. Figure 1 is taken from this latest study, and shows the same pattern in the growth of the regulatory state as the other studies and measures of regulations.

Figure 1
Administrative Costs of Federal Regulation



A simpler proxy for regulatory growth is the number of pages in the Federal Register. However inaccurate this may be, at least the trends in the number of pages in the Federal Register, as depicted in Figure 2, appears to be consistent with the information in the SBA and Mercatus-Weidenbaum studies.

Figure 2



Another study published annually tracks the number of proposed and final rules published in the Federal Register. "Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State," authored by C. W. Crews, Jr. and published by the Cato Institute, shows that while Federal Register pages increased dramatically in 2002, the number of final rules issued was only slightly in 2002.

All the available evidence indicates that the cost of regulations that is paid by private individuals and businesses is large and growing. The increase was dramatic during the latter part of the 1970's, slowed somewhat during the 1980's, but is increasing again, especially September 11, 2001.

Past Efforts at Regulatory Reform

Every modern President has tried to manage the regulatory state. Every President since President Nixon had some kind of regulatory review program within the executive office of the President or Vice President. Executive orders provide instructions to agencies about how to analyze regulations, and the procedures they must follow in writing regulations have been. Congress, for its part, has enacted a number of regulatory reform laws over the years, from the Paperwork Reduction Act, the Regulatory Flexibility Act, the Unfunded Mandates Reform Act, the Small Business Regulatory

Enforcement Fairness Act, the Congressional Review Act, the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (section 638(a)), and the Truth in Regulating Act of 2000.

These actions by the executive and the laws passed by Congress have been helpful, but if one considers the information in the Figures 1, 2, and 3 above, it appears that all these efforts have not managed to control the growth in regulations.

Furthermore, as noted by members of this Committee, there are significant gaps in the implementation of some of these past reform efforts.

Current Reform Proposals in H.R. 2432, The Paperwork and Regulatory Improvements Act of 2003

In order for Congress and policymakers to discuss and make decisions about regulatory programs, I would argue that they should have more accurate information about the size of the regulatory state and the regulatory "taxes" that the program will impose on citizens in pursuit of the benefit of imposing the regulation. That is, I believe that policymakers should have the same kind of information about regulations that is produced for government programs when Members debate how much to appropriate to a specific program. Furthermore, Congress and executive branch policymakers should have "regulatory budgets" as well. That is, they should know the total regulatory burden they place on the private sector; increasing those "regulatory taxes" should be debated in the same way that policymakers debate whether or not to increase other kinds of taxes.

In short, I believe it appropriate, fair, -- and indeed essential -- for regulatory programs to be treated just like other fiscal programs of the federal government.

H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003" takes several important steps in this direction. All the elements of this bill will provide valuable information and incentives to make better regulatory decisions.

The following are answers to the specific questions you raised.

1. **Should Congress eliminate exemptions from various paperwork review and regulatory due process requirements in the Farm Security and Rural Investment Act of 2002?**

It is my firm belief that there should be few exemptions, if any, to the requirements of the Paperwork Reduction Act or the Administrative Procedures Act. These are important procedural and substantive, restraints on the ability of departments and agencies to impose regulatory and paperwork burdens. These restraints are time-tested and not overly constraining; but they are important since agency rule-writers are not accountable to the public for their jobs or their livelihoods

in the event that the burdens of the regulations they write are harmful, capricious, or overly burdensome.

In the case of the Farm Security and Rural Investment Act of 2002, it is my understanding that there is little justification for the exemptions provided. The paperwork and regulatory burdens of this law should be subject to the same treatment and standards as those of other agencies.

2. **Should the General Accounting Office (GAO) have permanent staff devoted solely to evaluating certain regulations for the purpose of providing Congress an independent perspective on the value and effectiveness of these regulations?**

I believe it is very important to have some organization provide Congress with an independent perspective on regulations. Indeed, I founded the Regulatory Studies Program because my experience in regulatory agencies and as Administrator for Information and Regulatory Affairs exposed the need for high quality, independent analyses of regulations and regulatory issues. Our Regulatory Studies Program's objective is to provide quality regulatory analyses from the perspective of the public interest, and independent of any special interest. But there is much to do, and I welcome the addition of other organizations, especially the GAO to the task.

Agency regulation-writers receive few comments and analyses of their regulatory proposals that are independent of a special interest. Even OIRA is not totally independent, as it is part of the Administration that is proposing the regulation. Few speak for the average citizen or the public interest. Yet it is the average citizen who often bears a large portion of the cost of a regulation.

Accordingly, I have testified in favor of an independent office of regulatory analysis. And I believe that the General Accounting Office will not be able to implement its mandate to review and analyze regulations as required without permanent staff.

This question raises two issues: first, Congress has never appropriated funds to fund the Congressional Office of Regulatory Analysis; second, the GAO has indicated that it intends to fulfill its mandate, if funded, by contracting the analysis to outsiders.

With regard to the first issue, I have been very disappointed that the office has not yet received funding for the pilot project. It would make a skeptic question whether Congress was really sincere in its vote to establish the office. It is high time for Congress to "put money where its mouth is" and fund the office.

On the second issue, there are both costs and benefits of contracting out the analytical work. The benefits are that the GAO will not have to have as large a staff dedicated to regulatory analysis and would have greater flexibility in its staffing decisions. Using outside contractors also could make it easier for the agency to be

responsive to Congressional requests, if the requests do not flow evenly over a period of time or if specialized expertise is required. The use of outsiders could also provide the GAO with greater access to a wider variety of skills and knowledge than it might otherwise have if all the analysis was done in-house. The use of outside analysts, especially if they are academics, can also foster new knowledge over time, if GAO projects spawn follow-on research by the analyst.

There are also disadvantages of using outside analysts. The greatest disadvantage is that the GAO might not be able to answer regulatory queries as quickly as desired, as using outsiders generally requires a longer lead time. In addition, the GAO would have to have some expertise in-house in order to monitor and evaluate the analysis provided.

Our Regulatory Studies Program uses academics and other outside analysts for some of our studies and Public Interest Comments. The Public Interest Comments evaluate regulations from the perspective of the public interest rather than any special interest, and provide a careful analysis of proposed regulations. In our experience, outside academics can be excellent regulatory analysts, and can bring good quality analysis and academic knowledge to a regulatory issue. We also like to use academics because the regulatory work can stimulate their own further research, which will pay benefits to regulatory knowledge in the future.

However, one should also understand that our RSP staff spends a considerable amount of time working with academics to provide background information about regulatory analysis and the regulatory process, at least at the beginning. GAO will need to have some very experienced and knowledgeable individuals if this program is to generate useful studies and analyses.

3. **Do you believe Congress should require agencies to submit annual estimates of the costs and benefits associated with Federal rules and paperwork for each of their agency's programs?**

Yes. Furthermore, I believe these estimates should be reviewed by OMB's Office of Information and Regulatory Affairs (OIRA) and the GAO office of regulatory analysis, and made available for public analysis and discussion. Agencies can't be held accountable for the regulatory taxes they impose on American citizens unless these off-budget expenditures are measured and tracked.

4. **Should Congress integrate OMB's regulatory accounting statement into the President's budget and make this statement cover the same time period as the President's budget?**

Yes. The off-budget impact of regulations should be not be hidden from public scrutiny. Regulatory costs should be treated like a tax, or a cost of a government program, and should be tracked as such. Regulatory accounts should be treated the way that the fiscal budget is accounted for. Only then can agencies be held accountable for

their work, and only then can we have an educated discussion of how we want to allocate the scarce resources of our nation. H.R. 2432 takes important steps toward this objective.

Thank you for giving me the opportunity to share my views on this important topic.

Mr. JANKLOW. And now we go to Mr. John Sample. Mr. Sample is the vice president of sales and marketing, and I believe it's Peake Printers.

Mr. SAMPLE. Peake Printers, sir.

Mr. JANKLOW. Peake Printers, Inc., at Cheverly, MD. He's here to testify today on behalf of the National Association of Manufacturers. Mr. Sample.

Mr. SAMPLE. Mr. Chairman, and members of the committee, thank you for the opportunity to testify on behalf of the National Association of Manufacturers.

Mr. JANKLOW. Sir, could you hit your mic? I have my hearing device in so I could hear you, but I'm the only one.

Mr. SAMPLE. Thank you for the opportunity to testify on behalf of the National Association of Manufacturers in favor of H.R. 2432. First let me give you a little background on the National Association of Manufacturers, and then on my own company. The National Association of Manufacturers is the Nation's largest industrial trade association. The NAM represents 14,000 members, including 10,000 small and mid-sized companies and 350 member associations serving manufacturers and employees in every industrial sector in all 50 States.

I serve as the vice president of sales and marketing for Peake Printers, a commercial printing company located nearby in Cheverly, MD. Our 100 production employees print, bind, and distribute brochures, magazines, annual reports, and other principal collateral for corporate clients, trade associations, educational institutions, and the U.S. Government.

The printing industry has been hit hard by the sluggish economy of late. At Peake, our reality is that we need to produce more work with less people than ever before just to maintain the status quo. Everyone within our company must wear multiple hats.

A perfect example of this is that a guy with the title of vice president of sales and marketing is sitting in front of you today talking about paperwork and regulatory improvement. Not a traditional sales role. We clearly understand and value the important role of regulation and the reporting that is associated with it. That being said, we would surely see a tangible benefit from any reduction or simplification to the paperwork that we complete monthly, semiannually, and annually.

The National Association of Manufacturers supports passage and enactment of most of H.R. 2432 and urges the Committee on Government Reform to make a favorable recommendation to the full House of Representatives after amending section 3.

The Paperwork and Regulatory Improvement Act of 2003 makes minor changes to the current system and the NAM hopes that it will not be controversial as it winds its way through the legislative process. Although the changes proposed in H.R. 2432 may be minor, even small improvements in regulatory policy can have a large effect. For example, in 2001 the U.S. Small Business Administration released, "The Impact of Regulatory Costs on Small Firms," a report from noted economists Mark Crain and Thomas Hopkins. The widely cited study found that the total regulatory burden in 2000, which was the last year for which data was avail-

able, was $843 billion, with businesses shouldering $497 billion of that total burden.

The study also reaffirmed the findings of previous reports that the business regulatory burden falls disproportionately on smaller companies as they fight to remain competitive. Specifically, the regulatory costs per employee of businesses with fewer than 20 employees is $6,975, some 60 percent higher than the cost per worker of $4,463 for firms with more than 500 employees.

The NAM supports H.R. 2432 as an opportunity to improve the regulatory process and the ability to analyze its effects without decreasing the benefits of regulation. The NAM recommends, however, that section 3 be changed before passage to simply authorize additional staff for OIRA without a statutory mandate as to responsibility. Unless a compelling case can be made, the NAM opposes exemptions to the Paperwork Reduction Act in the OIRA review of agency regulations, notwithstanding the fact that nearly every agency thinks that its activities should be exempt.

The NAM was a fervent supporter of the Truth in Regulating Act prior to its passage in the 106th Congress. The NAM continues to believe that giving the General Accounting Office the ability to review major rules upon request will allow Congress to have more and better information in reviewing the implementation of legislation.

The NAM supports the pilot program for regulatory budgeting. The pilot program will help determine whether the regulatory budgeting program for the Federal Government as a whole makes sense. The NAM agrees with the agencies included in the text of H.R. 2432 for the pilot project, since the Department of Labor, the Department of Transportation, and the Environmental Protection Agency are the three top sources of rulemaking.

The primary goal of a regulatory program should be voluntary compliance. This goal is more easily reached when affected entities believe that the system is fair, that the regulation makes sense and is cost effective, and that the ease of compliance is considered while regulation is being promulgated.

Thank you, Mr. Chairman and members of the committee, for the opportunity to appear before you today.

Mr. JANKLOW. Thank you very much, Mr. Sample.

[The prepared statement of Mr. Sample follows:]

NAM National Association of Manufacturers

MANUFACTURING MAKES AMERICA STRONG

Testimony of

John Sample

Director, Sales and Marketing
Peake Printers, Inc.

on behalf of the National Association of Manufacturers

before the Committee on Government Reform, U.S. House of Representatives

on "Support for enactment of H.R. 2432, the Paperwork and Regulatory Improvements Act of 2003"

July 22, 2003

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EXECUTIVE SUMMARY

In this testimony, the NAM expresses its general support for enactment of H.R. 2432, the Paperwork and Regulatory Improvements Act of 2003. The NAM believes that this legislation, if enacted, will help lead to greater voluntary compliance with federal regulations by making needed reforms. Specifically, the NAM:

- has concerns about dedicating OIRA staff to the review of IRS regulations, but encourages authorizing additional staff for the agency;
- supports repeal of the exemptions from various paperwork review and regulatory due process requirements contained in the Farm Security and Rural Investment Act of 2002 (P.L. 107-171);
- supports having the General Accounting Office review major regulations for Congress;
- supports the bill's improvements to regulatory accounting; and
- supports the proposed regulatory budgeting pilot project.

JOHN SAMPLE
PEAKE PRINTERS, INC.
ON BEHALF OF THE

NATIONAL ASSOCIATION OF MANUFACTURERS
BEFORE THE

COMMITTEE ON GOVERNMENT REFORM
U. S. HOUSE OF REPRESENTATIVES

JULY 22, 2003

Mr. Chairman, members of the U.S. House of Representatives Committee on Government Reform, thank you for the opportunity to testify on behalf of the National Association of Manufacturers (NAM) in favor of H.R. 2432, the Paperwork and Regulatory Improvements Act of 2003. My name is John Sample, and I serve as director, Sales and Marketing, for NAM member company Peake Printers, Inc. First, let me give you a little background on the NAM, and then on my own company.

The NAM is the nation's largest industrial trade association. The NAM represents 14,000 members (including 10,000 small and medium companies) and 350 member associations serving manufacturers and employees in every industrial sector and all 50 states. Headquartered in Washington, D.C., the NAM has 10 additional offices across the country.

Peake Printers is a commercial printing company located in Cheverly, Maryland. Our 100 employees print, bind and distribute brochures, magazines, annual reports and other print collateral for corporate clients, trade associations, educational institutions and the U.S. government.

The printing industry has been hit hard by the sluggish economy of late. At Peake, our reality is that we need to produce more work with less people than ever before just to keep the status quo. Everyone within our company must wear multiple hats – a perfect example of that is that a guy with the title of director of Sales and Marketing is sitting before you talking about paperwork and regulatory improvement – not a traditional "sales" role. We clearly understand and value of the important role of regulation and the reporting that is associated with it. That being said, we would surely see a tangible benefit from any reduction or simplification to the paperwork that we complete monthly, semi-annually and annually.

The NAM supports passage and enactment of most of H.R. 2432, and urges the Committee on Government Reform to make a favorable recommendation to the full House of Representatives, after amending Section 3. The Paperwork and Regulatory Improvements Act of 2003 makes minor changes to the current system and the NAM hopes that it will not be controversial as it wends its way through the legislative process.

Although the changes proposed in H.R. 2432 may be minor, even small improvements in regulatory policy can have a large effect. This is because of the huge importance that regulations have, both to businesses and to average American citizens. For example, in October 2001 the U.S. Small Business Administration released "The Impact of Regulatory Costs on Small Firms," a report by noted economists Mark Crain and Thomas Hopkins. The widely cited study found that the total regulatory burden in 2000 (the last year for which data was available at the time) was $843 billion, with business shouldering $497 billion of the total burden. The study also reaffirmed findings of previous reports that the business regulatory burden falls disproportionately on smaller

companies. Specifically, the regulatory costs per employee of businesses with fewer than 20 employees was $6,975, some 60 percent higher than the cost per worker of $4,463 for firms with more than 500 employees.

The Crain-Hopkins study cautions that it does not take into account the benefits of regulation, and that development of better methodologies for determining this figure is "an important challenge that would be a logical next step toward achieving a more rational regulatory system." (From the last paragraph of the introduction.) As noted below, the NAM appreciates that there are benefits from regulations, and hopes that the methodology can be improved so that the estimates of benefits can become more reliable.

The NAM supports H.R. 2432 as an opportunity to improve the regulatory process and the ability to analyze its effects without decreasing the benefits of regulation. The NAM recommends, however, that Section 3 be changed before passage to simply authorize additional staff for OIRA without a statutory mandate as to responsibility.

Section 3: Reduction of Tax Paperwork

Given Finding 1 in H.R. 2432 – that the IRS is responsible for 83 percent of the federal paperwork burden – it is understandable that the committee would like for OIRA to devote more of the agency's staff time and attention to paperwork generated by the IRS. The NAM has concerns about this provision, however.

Attached to this testimony is a chart that was published in the 2002 OMB report on the costs and benefits of federal regulatory programs that shows year-by-year OIRA staff levels. As you can see, in 1985 OIRA had 75 full-time equivalent positions on its staff. In 2003, that level stands at only 55. In addition, when the Paperwork Reduction

Act created OIRA in 1980, the staffing level was around 90 full-time equivalent positions. With all that this committee and others in Congress want OIRA to do, it can and should provide OIRA with the necessary personnel.

Certainly, before this committee commits by law two full-time staff members to nothing but IRS regulations, at a minimum the committee also needs to provide two additional positions. Even then, however, the NAM questions whether this is the best use of OIRA resources. Rather than micromanage the use of existing staff, the NAM urges the committee to authorize additional staff positions.

Section 4: Repeal of Exemptions for Paperwork Reduction Act, Etc.

Unless a compelling case can be made, the NAM opposes exemptions to the Paperwork Reduction Act and OIRA review of agency regulations – notwithstanding the fact that nearly every agency thinks that its activities should be exempt. This is why the NAM supported subjecting even regulations issued by the Department of Homeland Security to the Administrative Procedures Act. The NAM also supported repealing a provision in the legislation creating the Transportation Security Administration (TSA) that could have allowed "emergency regulations" to continue indefinitely; TSA emergency regulations are now suspended after 90 days unless affirmatively approved by the Transportation Security Oversight Board.

The NAM is not sure why the Farm Security and Rural Investment Act of 2002 (P.L. 107-171) contained any exemptions from various paperwork review and regulatory due process requirements. On the other hand, it is well known (and a bit ironic) that agencies simply hate that they have to comply with the equivalent of

regulatory requirements in order to impose their own regulatory burdens. Unless the Department of Agriculture can make an excellent and persuasive case that the programs exempted under P.L. 107-171 deserve such treatment, the NAM strongly supports removing the exemptions.

Section 5: Amendment of Truth in Regulating Act

The NAM was a fervent supporter of the Truth in Regulating Act (TIRA, P.L. 106-312) prior to its passage in the 106th Congress. The NAM continues to believe that giving the General Accounting Office (GAO) the ability to review major rules upon request will allow Congress to have more and better information in reviewing the implementation of legislation. While OIRA does a good job in this capacity, it should be useful to have a competing and independent evaluation of agency rulemaking, similar to the respective roles of OMB and CBO in budget analysis.

The most important aspect is for the review function to be free from partisan and/or political pressure, and the NAM respects that the Comptroller General and the GAO have demonstrated their ability to meet this goal. Congressional committees, while certainly expert in their respective jurisdictions, too easily fall prey to political agendas; even when a congressional committee finding that a regulation is problematic is objective, however, the criticism that the finding was politically influenced by the majority party is easily made. Thus, having the independent GAO with specified procedures and non-partisan staff analyze regulations will provide Congress with impartial information about the practical utility of a regulation, as well as whether the agency adhered to applicable laws and procedures during the promulgation process.

With the Congressional Review Act in place, GAO can offer members of Congress an independent analysis of whether a regulation should remain in place or if it should be overturned.

Since the TIRA-authorized amount of $5.2 million was never appropriated, P.L. 106-132 has never been implemented. H.R. 2432 rightly removes the statutory requirement for the Comptroller General to issue a report following the end of the three-year pilot project that TIRA established. Such a report could only, by necessity, announce that the pilot project had failed because the Act was never used – primarily because the funds were never given to GAO to hire the personnel that it would need.

The GAO review function has another advantage in that if OIRA is tempted to not do its job – which has happened under Administrations of both parties – then the threat of embarrassment from the GAO report will provide a useful counterweight to whatever political pressure is being brought on OIRA. If for no other reason than this, then, H.R. 2432 should provide that the GAO establish a separate office with dedicated staff and then ensure that that office is funded at the same amount as OIRA.

Section 6: Improved Regulatory Accounting

In 1996, Congress first ordered OIRA to make a report on the costs and benefits of federal regulatory programs, both in the aggregate and by agency program. At first, Congress made this a directive in year-by-year appropriations bills, but since 2000 this has been a permanent function of OIRA. The report is somewhat useful in allowing comparisons between agencies, which should be helpful to Congress and the

Administration in designating where regulatory dollars should go in order to provide for the most benefit.

There have been recurring problems, however, that OIRA has been unable to overcome. Specifically, OIRA relies on the agencies to supply the raw data that form the basis of the report. Unfortunately, and all too often, the agencies do not present OIRA with estimates that are as reliable as they could be and with a very broad range – particularly for the benefits of regulation. As the NAM has noted on the several occasions that it has commented on the OMB draft report, OIRA needs to come up with a mechanism whereby agencies will supply their data in a common format – and OIRA needs to enforce this requirement with the agency heads and/or department secretaries.

Another recurring problem, as Drs. Crain and Hopkins note in their report for the SBA, is that it is more difficult to estimate the benefits of regulation than the costs. As the lead agency for the process of promulgating regulations, OMB should work with academics in regulatory analysis to establish a statistically sound methodology so that agencies will have better guidance in estimating the benefits of regulation. This would make the annual report more useful and meaningful.

H.R. 2432 provides for a seven-year accounting for regulations, coinciding with reporting requirements for the federal budget: for the previous fiscal year; for the current fiscal year; for the year that the statement is issued; and for the next four fiscal years. As it takes several years for the costs and benefits of a regulation to be felt, this should help both in giving a truer picture of the costs and benefits of a regulation as well as comparison (at least for major rules) of how well the estimates for the costs and benefits of a regulation hold up. Including the regulatory accounting report in the federal budget

would also help to underscore the link between on-budget costs and off-budget costs in the form of regulatory compliance.

Finally, the NAM supports the pilot program for regulatory budgeting. Both Congress and the Administration should try to direct regulatory dollars where they supply the most benefit and at the least cost. This pilot program will help determine whether a regulatory budgeting program for the federal government as a whole makes sense. The NAM agrees with the agencies included in the text of H.R. 2432 for the pilot project since the Department of Labor, the Department of Transportation and the Environmental Protection Agency are the three top sources of rulemaking. The NAM suggests that H.R. 2432 also mandate that at least one independent agency (although the NAM does not take a position as to which it should be) be included in the pilot project. Independent agencies are subject to the Administrative Procedures Act and the Paperwork Reduction Act, although they are not subject to various Executive Orders concerning regulations. Some independent agencies also contribute greatly to the regulatory burden, so a clarification that they at least are subject to section 6(d) if so chosen by the Director of OMB may help in case the agency affected objects to being included.

Conclusion

The primary goal of a regulatory program should be voluntary compliance. This goal is more easily reached when affected entities believe that the system is fair, that the regulation makes sense and is cost-effective and that the ease of compliance is considered while the regulation is being promulgated. By providing OIRA with much-needed additional staff, removing the exemption for the programs under the 2002 farm bill,

providing for GAO review of regulations, improving the annual OMB report on the costs and benefits of federal regulatory programs and creating a pilot project for regulatory budgeting, H.R. 2432 should assist in improving voluntary compliance with federal regulations.

Thank you, Mr. Chairman and members of the Committee for the opportunity to appear before you today.

Table 6. OIRA Staff Ceiling	
Fiscal Year	**Full Time Equivalents Ceiling**
1985	75
1986	75/69*
1987	69
1988	69
1989	62
1990	65
1991	65/60*
1992	60
1993	57
1994	52
1995	50
1996	49
1997	47
1998	47
1999	47
2000	47
2001	49
2002	55
2003	55

* Indicates a ceiling was reduced in mid-year.

Mr. JANKLOW. And now we go to Mr. Raymond Arth. Mr. Arth is the president and CEO of Phoenix Products, Inc., from Avon Lake, OH. He is the first vice chairman of the National Small Business Association. Mr. Arth.

Mr. ARTH. Thank you, Mr. Chairman, and members of the committee. I appreciate having the opportunity today to be testifying on behalf of the National Small Business Association, which you may have known formerly as National Small Business United. I came to manufacturing by way of accounting, having earned a degree in that field and practiced as a CPA for several years before starting Phoenix Products. And so I believe that over the last 25-plus years as a small business owner, I've had a little different perspective on regulation and paperwork than a lot of my peers who didn't have the technical background that I brought to my business. And in the 25 years plus that I've been in business, I've just had to stand back and watch as paperwork has grown and as we've taken steps to try to get control of it.

There was the Paperwork Reduction Act in 1980, amended in 1995, providing specific annual reduction targets for paperwork reduction. The paperwork burden continued to grow. As a delegate to the White House Conference on Small Business, I was involved in the efforts supporting the enactment of the Small Business Regulatory Enforcement Fairness Act. Unfortunately, most of the agencies have chosen to ignore SBREFA and, despite a lot of input and time spent by small business volunteers working on the regulatory fairness boards and the small business advocacy review panels, we haven't really been able to have much impact on the continuing growth of regulation and paperwork.

Nonetheless—and you've heard all the numbers here—the one I find most staggering is 8 billion hours; $230 billion is a big number too, but 8 billion hours to comply with regulations is pretty astounding. And, as you heard from Mr. Sample, the burden falls disproportionately on small businesses. The reason for that should be obvious. First of all, by the very nature of a small business, we can't afford the large staffs of professional people to deal with the tax and regulatory filings. We need to rely on outside accountants, attorneys, H.R. specialists and so forth. So to begin with we need to spend more money because we don't have the people in house.

One result of this, just to give you an example, is the growth of the payroll preparation industry. Every business has to pay their employees but it has become so complex and so risky that most of us let an outside firm do the work for us. There are eight potential deposit due dates per month for payroll tax remittance, depending on the amount of payroll dollars—more specifically, the taxes withheld by the employer; eight chances a month to make a mistake. And believe me, if you're late with that deposit there are substantial penalties to be paid. We need to have emergency action plans, etc. It becomes a staggering burden.

NSBA supports the Paperwork and Regulatory Improvements Act of 2003 as we have supported prior efforts to get a handle on the regulatory and paperwork burden. Specifically we do feel that section 3, as it targets the Internal Revenue Service, deserves support because it has been identified as the major source of paperwork burden. We also believe that the section 5 pilot program

should be made permanent. It's our understanding that because it was a pilot program, there was never a full-time staff committed to providing the support that section 5 would provide.

In closing, I'd like to make a couple points. And this was made once, earlier. Paperwork is not the problem, it's a symptom of the problem; and that is the tendency to overregulate. You folks and your counterparts at the State and local level want to regulate everything we do in our lives. As you may know, near and dear to my heart in the plumbing industry, you've even regulated how many gallons of water we can use every time we flush our toilets. So paperwork comes out of regulation.

Second, paperwork is what you do after you've spent the money to comply with a regulation in the first place. It consumes about 27 cents of every compliance dollar. And so we need to look at whether or not that money is being well spent.

Finally, let me put the regulatory cost burden into a little different perspective. The paperwork burden cost is $230 billion a year. That's about the same size as the GDP of Denmark or Turkey. Total compliance costs are $843 billion. That's twice Mexico, greater than Canada, who is our largest trading partner, greater than South Korea, Spain, or even India and Indonesia combined. The burden is falling on small businesses like mine. And I have to ask you folks, how can we continue to maintain our economic leadership if we're going to devote nation-sized chunks of our output to compliance and paperwork with regulations?

Thank you very much.

Mr. JANKLOW. Thank you very much.

[The prepared statement of Mr. Arth follows:]

Testimony of Raymond Arth,

Phoenix Products, Inc.

On Behalf of
The National Small Business Association

House Government Reform Committee Hearing
"Paperwork and Regulatory Improvements Act of 2003"

July 22, 2003

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Thank you. Chairman Davis, Ranking member Waxman, members of the Committee, I appreciate the opportunity to speak on behalf of the National Small Business Association (NSBA), formerly National Small Business United. My name is Raymond Arth, and I am the President and CEO of Phoenix Products, a faucet manufacturer based in northeast Ohio. I currently serve as the First Vice Chair of NSBA, and I am a past Chair of the Council of Smaller Enterprises, which is the largest local small business organization in the nation and an affiliate member of NSBA.

As a small business owner and long-time board member of NSBA, I can attest to the dire need for paperwork relief for small business owners across the country. I commend you for your efforts and dedication to small business through the introduction of the Paperwork and Regulatory Improvements Act of 2003. Before I get started, let me state that paperwork is a symptom, not the root problem. Government's tendency to over-regulate is the source of all the paperwork; did you know that that Government actually regulates the amount of water our toilets are permitted to flush?

Moving on, we all know what the numbers say: federally mandated paperwork equates to 8 billion hours with the IRS accounting for 80 percent of that figure. The Small Business Administration reports that the average per-employee cost of all federal regulation for companies with fewer than 20 employees is approximately $6,975, nearly three times what large companies pay. In many cases, paperwork is a burden imposed after a business enterprise has taken steps to comply with the regulation in question. I'd like to use my testimony to outline the current state of affairs leading to the need for legislation and reform in the paperwork and regulation arena.

Where we've come from:

Small business owners have long been supporters of a strong and viable Paperwork Reduction Act (PRA), which was passed in 1980. The Act authorizes the Office of Management and Budget (OMB)—through its Office of Information and Regulatory Affairs (OIRA)—to review all regulations being promulgated by executive branch agencies. This review is designed to centralize the regulatory process, end redundancy in

data collection, simplify and reduce paperwork requirements, and ensure that small business is not inadvertently harmed by unreasonable federal regulations and paperwork. Yet, despite the best intentions of the PRA, small businesses have been fighting for years to fill the holes that federal regulatory agencies have punched into this law.

By their very nature, unnecessary federal regulation and paperwork burdens discriminate against small businesses. Without large staffs of accountants, benefits coordinators, attorneys, or personnel administrators, small businesses are often at a loss to implement or even keep up with the overwhelming paperwork demands of the federal government. Big corporations have already built these staffs into their operations and can often absorb a new requirement that could be very costly and expensive for a small business owner. Oftentimes, regulation and its accompanying paperwork burden are manipulated by large companies to create additional barriers to entry by smaller competitors.

Most federal officials who develop regulations are largely unaware of the many activities and requirements of their fellow agencies. The Paperwork Reduction Act simply intends to bring small business reality and a sense of regulatory necessity into the thinking of the federal bureaucracy--and eliminate excessive redundancy.

In order to accomplish these goals, OIRA was given the authority and duty of preventing needless and redundant information requests from being imposed on the public. While the agencies are required to demonstrate the necessity of the data request and to publish it in the Federal Register for public comment, a strong OIRA is necessary to provide an adequate check for these agencies. The original intent of the PRA and the work that OIRA has been doing has not yet accomplished the overall goal. Over the last decade there have been numerous attempts to amend and improve the Paperwork Reduction Act, however agencies have continued to increase the amount of paperwork leading to a seven-year upward trend of the paperwork burden.

Duplication is another serious concern. Agencies must seek ways to eliminate duplication of paperwork. The paperwork requirements for filing mandatory emergency

plans is an excellent example. As you know, many agencies require emergency plans, such as a plan for hazardous waste, a fire report, a leak report or a storm-water plan. As one small business owner recently informed me, he must maintain nine notebooks each containing a different emergency plan. From these notebooks, he has to scramble to find the booklet that covers a particular area when agency personnel regulating each area come to inspect or paperwork is due. Inevitably, the paperwork due dates are all different and require him to keep a separate calendar simply dedicated to these dates. This is not uncommon, and it would be a huge relief to simply streamline dates.

Another implication with complicated and duplicative layers of paperwork is that it is easy for a well-meaning small business to overlook a requirement or a deadline because they don't have dedicated compliance staffs to research the vast federal (not to mention state, city and local) regulatory paperwork quagmire.

The Small Business Regulatory Enforcement Fairness Act of 1996 was designed to get small business more involved, provide small businesses plain-English explanations of new regulations, require federal agencies to do the research on the most cost-effective implementation methods available for small businesses to achieve compliance, and establish Regulatory Fairness Boards to rate the regulators. Where does the SBREFA law stand today? At this point, I believe that federal agencies have yet to take it seriously. It isn't for a lack of involvement or process. There are Small Business Regulatory Fairness Boards in every region and there are Small Business Advocacy Review panels. Additionally, SBA Office of Advocacy continues making every effort to weigh in on the issues and keep small business informed and active on regulations.

Regardless, small businesses are still being pummeled by the federal government's mandates on paperwork and needless regulations. During a hearing held by your subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, one of NSBA's members brought stacks upon stacks of paperwork he is currently mandated to complete. In addition to that, new rules proposed by the EPA will add another 80+ hours of paperwork burden to his already entangled process of federal compliance. We must

also keep in mind that when an agency is estimating the burden hours, they are not taking into account that a pipe-organ builder who owns his own business knows pipe-organs, not complex federal regulations. The time it takes to wade through the forms, read the multiple schedules, exemptions, extras, so on and so forth significantly increases any number of hours proposed by a federal agency.

Possible solutions:
All this being said, I do understand there is a need for some regulations and paperwork. Yet the small businesses who make up 99 percent of all employers are by and far carrying the brunt of the burden.

I'd like to again commend Chairman Davis, Reps. Ose, Tanner, Moore, Janklow, Matheson and Ryan for working to bring HR 2432 to fruition. This bill would solve many of the problems we see with the current lapse in diligence to reduce the paperwork and regulatory burden on America's small businesses.

As a businessman, I know what it means to be short staffed, I understand that people can only do so much. This is why I, along with the NSBA membership, support Section 3 of the bill to dedicate two full-time employees solely to the purpose of reducing the tax paperwork burden. As NSBA has been urging for years through our Tax Equity Study, small businesses need more government resources dedicated to reducing the burden imposed by the IRS. Additional people within OMB is a solid start, and we would even support increased staffing to further the goal of reduction of paperwork.

In what would seem to be a common sense idea, this legislation would also streamline the processes in which information is collected by OMB from federal agencies. Perhaps this "leadership by example" is exactly what federal agencies need to establish their own streamlined methods of information collection. I'd like to also state for the record NSBA's support of the proposed requirement of federal agencies to submit the estimates of the cost as well as the benefit associated with rules and paperwork for each of their

programs. Again, a common-sense move from a business perspective where the terms "return on investment" and "cost-benefit analysis" are in the daily vernacular.

Finally, I'd like to comment on section 5 of HR 2432. Regardless of whether or not a regulation is good, bad, necessary or frivolous, we need to keep in mind that even the "good" piles of paperwork take time away from the vital task of a small business owner. When we're completing our 5500's or the myriad of EPA required reporting, we are not running our businesses, we're not creating jobs and we're not spurring economic growth.

Section 5 of this bill aims at creating a proactive versus reactive method of dealing with regulations and paperwork. By aiming to make permanent a current pilot program within the General Accounting Office, this bill would give the GAO the authority to respond to requests on proposed rulemakings that may have significant economic impacts. Section 5 would enable Congress to take true responsibility for oversight through the guidance of independent studies and evaluations.

If you ask any small business owner his or her opinion of federally required paperwork, the responses overwhelmingly will indicate there is redundancy and excessiveness in the filing process. I'd like to reiterate one figure before I close: companies with fewer than 20 employees pay nearly $7,000 per employee per year to comply with federal regulations, three times more than what large companies are faced with. I, and many small business owners like me, don't want to "play outside the rules" we merely want to stay in the game.

Large and small companies alike are facing enormous competition from foreign companies, with the fiercest competitors coming from Asia where regulations are lax for business. Regulation and paperwork are impairing American companies' ability to compete in global markets, which are all markets now-a-days, and thus costing jobs in the U.S. While our primary goal is to reduce the burden on small businesses, we must keep in mind the ramifications of excessive regulation on all businesses, and the economy overall.

For all of these reasons, we would like to offer our strong support for HR 2432 and commend this committee for working to create the tools to help keep the federal regulatory juggernaut in check.

I'd like to again thank you, Chairman Davis and Committee Members, for this opportunity to speak. I welcome any questions the committee may have for me.

Mr. JANKLOW. Welcome back, Professor Lisa Heinzerling. Professor Heinzerling is with Georgetown University Law Center, and welcome back for your comments, ma'am.

Ms. HEINZERLING. Thank you. Thanks for inviting me here today. I'm going to focus my comments on section 6, on regulatory accounting, which several witnesses have already labeled the most important part of this bill.

This provision would require OMB and several Federal agencies to develop so-called pilot projects in regulatory budgeting. The bill is exceedingly vague in its details. It does not specify whether the regulatory budgets are to serve as binding constraints on the agencies as advisory guidelines or merely as informational tools. The bill does not define the programs to which the new regulatory budgets are to be applied. Perhaps most egregiously, the bill does not even specify how regulatory budgets are to be set. The bill in reality is merely an outline of an idea, sketched in language broad and vague enough that it amounts to a deregulatory blank check to OMB.

Beyond the bill's vagueness, I see four large problems with the concept of regulatory accounting. First, agency programs already have regulatory budgets. They're called statutes. They are the directives under which the agencies shape private behavior. It is incorrect to say, as Dr. Graham said earlier, that there is no limit on the amount agencies can require private parties to spend. The limits are embodied in the statutes passed by this Congress. If it seems like the regulatory budgets were set by OMB at a level below the level called for under current statutory directives, then the regulatory budget would become an opaque way of condoning noncompliance with existing law.

If Congress wants to change existing law, if it wants to weaken, for example the Clean Air Act, then it has far more open and honest ways of doing so than the regulatory budget. It can simply change the law it thinks too onerous for industry. This bill does not offer this kind of transparency. If, as Dr. Graham suggested, regulatory burdens are hidden taxes, then this bill amounts to a hidden tax cut.

Second, the regulatory budget does not act like a budget at all. Unlike the Federal budget, the regulatory budget is not set by establishing a certain maximum amount an entity is actually allowed to spend under law. Instead, the regulatory budget will presumably be set by referring to advance estimates of the costs of certain levels of regulatory compliance. These advance estimates are notoriously unreliable. Retrospective analyses of cost estimates often show them to have been greatly overstated.

Third, this bill seems to suggest that the regulatory budget should be set without regard to the regulatory benefits a Federal program produces. Indeed, Mr. Smith suggested that we shouldn't look at regulatory benefits at all. This approach makes no sense. It could result in placing arbitrary and artificial limits on spending for programs that produce large-scale benefits for society, that indeed produce benefits out of all proportion to their costs. One program like this is the Clean Air Act which, oddly enough, is often targeted by OMB for special scrutiny in its cost/benefit reviews.

Finally, requirement of regulatory budgeting adds burdens to already overstrapped agencies, burdens that, ironically enough for purposes of today's hearing, take the form of increased paperwork. Perhaps this portion of H.R. 2432 should be renamed the Paperwork Production Act.

Thank you.

[The prepared statement of Ms. Heinzerling follows:]

Testimony of

Lisa Heinzerling

Professor of Law
Georgetown University Law Center

Vice-President
Center for Progressive Regulation

Before the
Committee on Government Reform
U.S. House of Representatives

Hearing on

The Paperwork and Regulatory Improvements Act of 2003
(H.R. 2432)

July 22, 2003

TESTIMONY OF

LISA HEINZERLING

PROFESSOR OF LAW,
GEORGETOWN UNIVERSITY LAW CENTER

VICE-PRESIDENT,
CENTER FOR PROGRESSIVE REGULATION

BEFORE THE
COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

JULY 22, 2003

Thank you for the opportunity to testify before you today. My name is Lisa Heinzerling. I am a Professor of Law at the Georgetown University Law Center. I have also been a visiting professor at the Harvard and Yale Law Schools. I am a graduate of the University of Chicago Law School, where I served as editor-in-chief of the University of Chicago Law Review. After law school I clerked for Judge Richard Posner on the U.S. Court of Appeals for the Seventh Circuit, and then for JusticeWilliam Brennan of the U.S. Supreme Court. I was an Assistant Attorney General in the Environmental Protection Division of the Massachusetts Attorney General's Office for three years before coming to Georgetown in 1993. My expertise is in environmental and administrative law. I am also the Vice-President of the Center for Progressive Regulation.

The Center for Progressive Regulation is a nonprofit research and educational organization of university-affiliated academics with expertise in the legal, economic, and scientific issues related to regulation of health, safety, and the environment. CPR supports regulatory action to protect health, safety, and the environment, and rejects the conservative view that government's only function is to increase the economic efficiency of private markets. Through research and commentary, CPR seeks to inform policy debates, critique anti-regulatory research, enhance public understanding of the issues, and open the regulatory process to public scrutiny.

My testimony today concerns H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." This bill would require certain agencies to develop a "regulatory budget" that would limit the amount private parties could be required to spend to comply with federal rules. The regulatory budget is a bad idea, in principle and in the form proposed in this bill. The regulatory budget contemplated in this bill is a stealth tax cut, which would arbitrarily restrict the amount of money businessesmust spend to limit their pollution and to engage in other activities required by law.

As I explain in detail below, H.R. 2432's requirement of a regulatory budget suffers from these major flaws:

1. Limiting the amount of money private entities must spend to comply with federal regulatory requirements undermines those requirements without changing the laws under which the requirements arise. The regulatory budget is deregulation in disguise.

2. Regulatory budgeting is fundamentally different from the federal budgetary process: the federal budget limits the actual expenditures federal entities may make, while regulatory budgeting rests on mere estimates – which often prove wildly off the mark – of private expenditures.

3. Limiting private parties' regulatory expenditures, without consideration of the benefits those expenditures would produce, makes no sense.

I. Deregulation in Disguise

Federal agencies impose requirements on private entities in accordance with existing laws, passed by Congress. These laws typically do not set a pre-determined limit on – or "budget" for – the expenditures private parties must make in order to comply with the law. H.R. 2432, in contrast, would impose arbitrary limits on private expenditures by setting such a pre determined limit. The "budget" contemplated in this bill would be inconsistent with many of the existing legal obligations of private entities. Indeed, such a budget could be seen as condoning outright legal violations by private entities where compliance with the law would lead to an exceedance of the budgetary limit.

Let me provide a concrete example. One of the agencies covered by the regulatory budget created by this bill is the Environmental Protection Agency (EPA). A large portion of the environmental progress madeby this agency has come through requirements for polluting facilities to install state of-the-art pollution control technology. The Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, and other important environmental laws all have such requirements at their cores. One well-known program of the Clean Air Act, for example, requires major existing sources of air pollution to install the best available control technology when they undertake major modifications of their facilities. This is the New Source Review program.

Now suppose that, under section 1120(a) of this bill, the Office of Management and Budget, in consultation with the EPA, decided to designate New Source Review as one of the programs subject to the new regulatory budget. And suppose that they decided that the regulatory budget– the limit on the amount private polluters would be required to spend in complying with the law – would be, say, $100 million. It is easy enough to see that this limit on private expenditures could well be insufficient to pay for private companies' legal obligations under the law. Yet nothing in H.R. 2432 prevents OMB and EPA from together limiting private parties' existing legal obligations through the device of the regulatory budget.

In fact, one might go further and say that the *only* plausible purpose of the regulatory budget is to deregulate, and to do so opaquely so as to avoid the political ramifications of reductions in environmental protection and other governmental benefits. To see this point, consider the three general levels at which the regulatory budget might be set.

First, the regulatory budget for a program might be set at a level that exceeds the expenditures that would be expected given current legal obligations. In this case, the regulatory budget would have no effect on existing legal arrangements; indeed, there would be no point in a budget that had this effect. Second, the budget could be set just at the level expected to be spent under existing legal obligations. In this case,too, again, the budget would have no operative effect; it would merely reiterate private parties' existing obligations. Third and finally, the regulatory budget could be set at a level *below* the amount that would be spent by private entities under existing regulatory requirements. This result is clearly the aim of this bill.

Certainly, this approach would give the regulatory budget operative effect (unlike the other two approaches just described), but only by lessening private parties' obligations under existing law. The regulatory budget is thus deregulation in disguise: its only purpose and effect would be silently to relax rules set under other laws.

II. The Regulatory Budget Is Not A Real Budget

The federal budget places a limit on the actual expendiures the federal government may make in a given year. The budget describes the actual financial outlays that will be made. It is fundamentally different from the regulatory "budget" contemplated in this bill.

"Regulatory budgeting" and the "regulatorybudget" are not defined in H.R. 2432 (part of a pattern of vagueness in this bill). However, these terms are typically used to refer to limits on the amounts private parties can be required to spend to comply with regulatory requirements. These limits are set in advance of actual expenditures. The limits are therefore*estimates* of regulatory costs. They are not, as is the case with the federal budget, limits on the amount of money regulated entities will actually spend.

This distinction between the federal budget and regulatory budgets is of enormous significance. Ex ante estimates of regulatory costs are notoriously unreliable. Empirical studies have demonstrated that actual costs often end up being far lower than the costs estimated in advance of regulation. There are a number of reasons for this pattern, including: cost estimates are usually provided by the regulated entities themselves, and these entities have an incentive to exaggerate costs to avoid regulation; after regulation, technological innovation often produces compliance at a lower cost than anticipated; and unanticipated efficiencies associated with regulation can achieve compliance at a lower cost. Whatever the reason, the fact remains that regulatory costs estimated in advance of regulation tend to be overstated. Thus regulatory budgets based on such estimates will be unreliable predictors of actual costs. Most likely, regulated entities will end up spending far less than their "budgeted" amount because the estimates on which the budget is based will likely be too high.

For a comprehensive analysis of these issues, see Thomas O. McGarity and Ruth Ruttenberg, *Counting the Cost of Health, Safety, and Environmental Regulation*, 80 TEXAS LAW REVIEW 1997 (2002).

III. Ignoring Benefits

Many federal regulatory programs cost a lot of money but also do a lot of good. The Clean Air Act as a whole, for example, has required large regulatory expenditures, but it also produced $22 trillion in net benefits in the first 20 years of its operation. (EPA, The Benefits and Costs of the Clean Air Act, 1970 to 1990, at ES-8 (Oct. 1997).) It would be foolish to limit the amount private parties must spend on controlling, say, air pollution without considering the health and environmental benefits that would be lost in doing so. The only effect of such a limit would be to enrich corporate polluters at the expense of the public.

Yet this is exactly what H.R. 2432 appears to do. The bill provides no guidance for how regulatory budgets are to be set, and certainly does not require that budgets be set with careful attention to the benefits that might be lost under the regulatory budgets. Indeed, H.R. 2432 appears to contemplate that regulatory benefits will be considered only *after* the regulatory budgets are set. Section 1120(b) of the bill requires the "regulatory budgets" to "present, for one or more of the major regulatory programs of the agency, the varying levels of costs and benefits to the public that would result from different budgeted amounts." This provision seems to assume that regulatory budgets will first be set – according to some mysterious, unnamed criterion – and then those already-established budgets will be compared by considering the varying cost-benefit profiles of the budgets.

This approach makes no sense, as it would allow OMB to limit expenditures for programs that are highly beneficial. The bill also gives completely unfettered discretion to OMB, "in consultation with" the agencies, to set these regulatory budgets. OMB should not be entrusted with this much power. On other occasions when OMB has taken it upon itself to target regulatory programs for reform, it has done so in a patently political fashion: recall the regulatory "hit list" OMB infamously developed in its 2001 report on the costs and benefits of federal regulation. In OMB's hands, the regulatory budget has a very good chance of becoming just another hit list favored by private industry.

Mr. JANKLOW. Thank you all very much. Every one of you did a marvelous job of staying within the guidelines and also being very, very substantive and thorough in your comments.

If I may, I have a couple of questions. Professor Heinzerling, do you feel there's a paperwork problem at all in the Federal Government? If so, to what extent?

Ms. HEINZERLING. My testimony has been concerned predominantly with the regulatory accounting or budgeting process of section 6 of this bill. As I understand it from learning from Dr. Graham's testimony, much of the paperwork burden imposed on businesses and individuals today is a result of IRS requirements that are either imposed by Congress or by the IRS itself. And so it seems to me that there's probably a lot of paperwork and it also seems to me that he was right to suggest that the problem is one that is shared by Congress and the executive branch together.

Mr. JANKLOW. But my question is, do you think there's a problem? And I assume from your answer, the answer is no.

Ms. HEINZERLING. No, I didn't say no. I'm not an expert in the paperwork requirements that you're talking about or in the tax requirements that Dr. Graham was talking about. Certainly from hearing the testimony this afternoon, there seems to be a lot of paperwork requirements and it strikes me that some of the suggestions he made make some sense.

Mr. JANKLOW. Mr. Smith, if I could, I notice you grabbed your pen and started writing when she commented that she disagreed with you on the benefit side of it as opposed to the cost. You want to comment on that?

Mr. SMITH. Sure. I think she's quite right.

Ms. HEINZERLING. "She" is me.

Mr. SMITH. I'm sorry. Lisa. Lisa made the point, quite rightly, that there clearly could be benefits to regulations, benefits that might far outweigh the costs. I think no one doubts that's possible. The problem is, that's also true with expenditures. We do not basically try to do a cost/benefit analysis of an expenditure in OMB. OMB doesn't say, "Well, we think a carrier is worth a billion dollars or a bridge is worth this amount, or an educational program."

We expect the agencies to understand that they have a mission to perform: national defense, education, or national transportation infrastructure. They are to take the limited budget they have been assigned to try to find out which programs they think are optimally designed to meet those goals that they have as advocacy agencies. Of course it's agreements between Congress, the administration and the particular agency, but we do not go around and try to second-guess the people who have been assigned the expertise to advance transportation and so forth.

Only in this area of regulations do we expect a handful of people at OMB to be gods, to know exactly what the benefits are of saving or not saving a spotted owl. That is something I think EPA can decide whether or not, or Interior, whether its budget should be used for that or to be used for other areas that they think are more important.

Mr. JANKLOW. If I could ask you one more question, Professor Heinzerling, when you look at the scheme or, I should say, at the paperwork that's required within the government, do you see any

utility at all in our regulatory side as we talked about, section 6? Would there be any utility at all in finding out what the cost is to comply with paperwork, or is it relevant if you're carrying out the social mission that you're trying to do with respect to statutes or regulations?

Ms. HEINZERLING. It seems perfectly sensible to think about how much regulations can cost. In that regard let me say, I was surprised when a major regulation of the Department of Labor which imposed new reporting requirements on labor unions passed through OMB's review in a single day, and without extensive review of the costs of that rule. So it makes some sense. There's some evidence that there are reporting requirements out there that have not been analyzed.

Mr. JANKLOW. Would you agree the same should apply with respect to business, sole proprietors, big business, little business, would apply to the costing with respect to the labor unions? Aren't we really talking about a philosophy as opposed to targeting individuals? I mean, were you really that surprised?

Ms. HEINZERLING. Well, let me say that I have long said, I've said here I think in this room, that I think that OMB targets its ire to regulations of industries and individuals and private entities that it politically favors and that therefore it's passing this labor rule through in a day didn't surprise me. I wish it had.

Mr. JANKLOW. All of you, all the rest of you appear to broadly support the bill, at least your testimony is that. Let me ask you if I can, Dr. Gramm, do you support—unequivocally support section 6?

Ms. GRAMM. I do, sir.

Mr. JANKLOW. Without any hesitation.

Ms. GRAMM. Without hesitation.

Mr. JANKLOW. Do you agree with the complaints that were put forward by Professor Heinzerling.

Ms. GRAMM. I do not agree with them.

Mr. JANKLOW. Why?

Ms. GRAMM. For example, while agencies have statutes, they also have statutes with regard to the regular fiscal programs. And they still have to have a budget. Agencies frankly, if given the ability, would spend a lot more on their programs than we have available to spend.

So I agree with John Graham before, and with most of my colleagues here, that there really shouldn't be a difference between how you treat a fiscal program or how you treat a regulatory program. There are just different ways in which government gets resources from individuals and reallocates them to uses that they would not otherwise do by themselves. I think those things should be tracked just like we track our fiscal taxes.

Mr. JANKLOW. Mr. Sample, and also you, Mr. Arth, both of you heard the criticisms of Dr.—excuse me, Professor Heinzerling with respect to section 6. Does that cause you to pause at all in terms of your support for that particular section?

Mr. SAMPLE. No, it does not.

Mr. JANKLOW. It doesn't?

Mr. ARTH. No, because—and I also would support this—it seems to be trying to bring awareness of what the total cost is, not just

the dollars that I send to Washington in the form of taxes, but the amount of money I'm going to have to spend to comply with the agency's regulation.

Mr. JANKLOW. Yes, sir.

Mr. SMITH. Just one point. I think obviously the goal is to establish a pilot program to begin to flush out the details, to gain the expertise in doing regulatory budgeting. I think there is a question as to whether picking a specific agency and then trying to do a particular—a total budget for that agency might be better or worse than picking major rules, in whatever agency they occur, and then gaining the expertise for those large rules, because those will be where the major gains might be expected to occur.

Mr. JANKLOW. Professor Heinzerling, I was intrigued with a comment that you made criticizing what could be called a hidden tax decrease. Did you really mean it when you said it that way?

Ms. HEINZERLING. Yeah.

Mr. JANKLOW. You did.

Ms. HEINZERLING. I've seen a lot of different forms of regulatory reform in the past few years. This strikes me as another way in which Congress is proposing to reform regulation without changing the underlying statutes which happen to be very politically popular. If you take an axe to the Clean Air Act directly, I think you'll take a lot of flak. If you call it regulatory budgeting, make it obscure enough, give it to OMB to implement, then a lot of people are not going to know about it. I think it's hidden.

Mr. JANKLOW. Ma'am, you keep coming back when you call it a tax cut—that's what I was intrigued by—but, too, you keep coming back to the same little group of suggestions. The Clean Air Act, environmental statutes, etc. Let's switch over for just a moment to the other side of the equation, the types of things that you're dealing with with respect to the paperwork that—you heard Mr. Sullivan's testimony here today—you were here—with respect to that kind of environment that small business has to exist in, filling out form after form after form after form, not the socially popular ones, but the ones that are put forth by the bureaucracy.

Ms. HEINZERLING. Well, then make this bill about that. This bill is not about that. Section 6 is not about what you're talking about. It's about the Environmental Protection Agency, the Department of Labor, and the Department of Transportation.

Mr. OSE. I know what it's about. Please don't put words in my mouth. I don't mind your testifying from your perspective but don't put words in my mouth.

Ms. HEINZERLING. I don't think I put words in your mouth but I'm suggesting——

Mr. JANKLOW. I'll recognize the chairman from California, Mr. Ose.

Mr. OSE. I just wanted to make sure that I didn't have words put into my mouth, that's all. I'm happy to listen to Professor Heinzerling, the rest of her comment.

Ms. HEINZERLING. I'd be happy to hear how section 6 is about paperwork and the other matters that we've discussed this afternoon and is not about the EPA, the Department of Labor and the Department of Transportation, which are the agencies specifically dis-

cussed in that section. Section 6, as I read it and maybe I've missed something, is not about paperwork.

Mr. SMITH. Could I follow just briefly on to what she just——

Ms. HEINZERLING. That would be me again.

Mr. SMITH. I'm sorry. Professor Heinzerling. I wanted to try to explain why I think she's obscuring something very important here. There's a presumption—I was at the Environmental Protection Administration for 5 years, and I watched that legislation that governs much of EPA and our environmental laws being created. And to assume that these are crisp, precise guidelines for action is to deny every study that's ever been done at EPA. The regulatory policies are passed to be—they promise all things to all people. Absolutely no economic consequences, if you happen to be a business person. Absolutely pristine environment, if you happen to come from the environmental side.

Congress has been able to evade its responsibilities in the regulatory area by essentially promising all things to all people. The dirty work, the hard decisions, are made by the regulatory agencies later on. Regulatory laws can't be costed out, so they're passed, they're free. It's the regulations that have real consequences to real people and those are totally out—it's not our responsibility, the Congress can say, it's those horrible regulators, and they can say they're horribly green or horribly pro-business. It doesn't really matter. Regulations are the children of Congress and Congress should assume parental responsibility again.

Mr. ARTH. Mr. Chairman, if I may. There is a principle in economics, I think it might even be a law of diminishing returns. And I think it applies in this discussion. And we can talk about the Clean Air Act——

Mr. JANKLOW. Sir, if it's not a law we can make it one.

Mr. ARTH. We could talk about the Clean Air, the Safe Drinking Water Amendments of 1996. As our technology—well, first of all I think it's safe to say that the air in Cleveland, OH is cleaner today than it has been at any point in my life. Part of that is because half our steel industry is gone and the portion that remains is much cleaner today than probably any other steel plant anywhere outside of the United States. I think it's probably fair that per unit of GDP, we have the cleanest economy on the planet. We could always make it better. We could always make the air a little cleaner. We could always make the water a little more pure. We have the technological ability to measure in parts per billion. And so we have regulated 11 parts per billion of lead leaching from a faucet into drinking water.

We can always go another step, but every incremental step has enormous cost for the benefits that society and people will realize. And we need to quantify what those costs are if we want to continue to make products here, if we want to continue to have an economy that works. And that's what I see here—trying to bring some method to putting a price tag on what that next incremental little improvement is going to be. Thank you.

Ms. HEINZERLING. If I may. Many of these improvements are not incremental. They're not little by anybody's standards. There was a study done some time ago about the effects of fully implementing the equivalent of the new source review program as it used to exist

under the Clean Air Act before the administration changed it. That rule, that program, would have saved, it was estimated, thousands of lives every year if fully implemented. We're not talking about tiny little incremental changes, we're talking about changes that affect thousands of people's lives every year.

Mr. SMITH. That's, of course, why we need a budget approach that makes sense rather than one that creates fictions by advocacy agencies.

Let me quote from my testimony. Randal Ludder, who was an economist at the American Enterprise Institute, discussing this benefit analysis, "It is hard to understand why anyone should expect self-examinations to be objective and informative, interpreted by EPA. Investors want businesses to be audited by analysts without financial conflicts of interest. Scientists reject research that cannot be replicated independently. Consumers flock to independent testing organizations rather than rely exclusively on sellers' claims. Only in the public sector . . ."—and Professor Heinzerling's discussion of the Environmental Protection Administration's self-created aggrandizement statements—". . . where bureaucracies are protected from the discipline of market forces, do we rely on self-evaluations of performance." EPA, of course, thinks it's a valuable agency. We wouldn't expect otherwise but they should be accountable for the costs they spend. Let them decide on whether they want to spend the money on a clean air program, a clean water program or hundreds of other things. They have no priority-setting mechanisms. They have no mechanisms to stop. They just want to spend more and more money. There is no stopping rule. There never will be as long as they're spending other people's money.

Mr. JANKLOW. And on that point, the Chair recognizes the chairman of the committee, excuse me. The Chair recognizes the ranking member—the chairman of the committee, Mr. Ose.

Mr. WAXMAN. I would like to be recognized.

Mr. JANKLOW. I'll recognize the ranking member, Mr. Waxman. I'm sorry.

Mr. WAXMAN. I thank you very much, Mr. Chairman.

Professor Heinzerling, Dr. Gramm and others have said there should not be any difference between how a fiscal budget is treated and how a so-called regulatory budget is treated. Could you please respond to that argument?

Ms. HEINZERLING. Yes. Unlike the fiscal budget, which is based on actual monetary outlays that agencies make, the regulatory budget, I presume, will be based on estimates of regulatory costs that are made in advance of regulation.

As I have stated in my testimony, these estimates are notoriously unreliable. They are often inflated. They're provided by industry itself. We talk about incentives to give information that is less than accurate, there is an incentive here to exaggerate the cost of regulation in order to avoid it. Often, there's technological innovation that occurs when regulation is imposed and so the costs go down. And so the idea is, that in one sense, there is a fundamental difference between these kinds of budgets. One is based on actual costs, and one is based on estimated costs, and those estimates

turn out to be very unreliable in many cases. As well in this case——

Mr. WAXMAN. Well, my experience has always been that the costs are overestimated, and the benefits are underestimated when you try to quantify them, and, of course, how do you quantify a life that is prolonged or the health that is continued?

Ms. HEINZERLING. Exactly. And we have recently seen the difficulties of this with the fracas over the senior death discount at OMB and EPA which involves——

Mr. WAXMAN. That's a good point. Let me ask Mr. Smith because he's a strong supporter of this regulatory budget requirement in H.R. 2432. The regulatory budget, this would require regulatory budgets to present the varying levels of costs and benefits that would result from different budgeted amounts; who would set these regulatory budgets?

Mr. SMITH. One would expect that it would be the—my proposal was that Congress would get involved in that act. The administration or the agency would. But remember, costs are vague figures. Benefits are totally fictions of imagination. But it's not exceptional—it's not——

Mr. WAXMAN. Do you believe that?

Mr. SMITH. Oh, I certainly do.

Mr. WAXMAN. Excuse me. It's my time.

Mr. SMITH. Yes, of course. You're the Congressman.

Mr. WAXMAN. And I'm not going to debate you. I'm going to ask you questions, and I'd like you to respond.

Now, in your testimony you indicated regulatory budget limits should not be set with the aim of maximizing net social benefits; is that right?

Mr. SMITH. That's exactly right. Because nobody's smart enough to know that.

Mr. WAXMAN. What criteria would be used to set regulatory budgets under these pilot projects? How would the administration determine that $1 billion would be the right limit for one agency, while $5 billion would be the right limit for another agency?

Mr. SMITH. Congressman, that's what you've been elected to decide about, whether or not the Army or the Navy or the Air Force or the Department of Education can be decided. It's your responsibility to set those numbers, and it's your decision as to whether the agency has spent that budget in ways that you, and the other Members of Congress, believe are appropriate.

Mr. WAXMAN. Should a regulatory budget be set at a level above or below the current estimated costs of an agency's regulations?

Mr. SMITH. That, again, is not a decision for the—you have been elected and the others in Congress have been elected to make those decisions. Should the Navy get more? Or should EPA get more? Those are good questions and different people will, of course, differ on that. But remember, costs are also highly imprecise. When you look at the cost of a capital budget——

Mr. WAXMAN. I guess that's Ms. Heinzerling's point. Costs are imprecise and benefits are imprecise. These provisions in the bill are troublingly vague, but the intent is clear. The aim is to limit new regulations and force agencies to weaken existing regulations. Given the serious and widespread problems that still need to be ad-

dressed, from water pollution to corporate accounting, this requirement, I think, takes us in the wrong direction. There's no indication in H.R. 2432 as to how these regulatory budgets would be enforced and how they would interact with preexisting statutory directives. Would you expect OMB to enforce the budget limits and if so, should OMB refuse to prove additional regulations once an agency is at its budget limit?

Mr. SMITH. What I had suggested was a slight refinement of this legislation; as soon as a large regulation starts coming down the pike, that the appropriate congressional committees be notified of that fact, that they be kept informed at every step of the process of that regulation through the thing. And then yourself and others in Congress would be asked for your advice and consent. Right now, there is no legislation or requirements that Congress take responsibility for its paternity. I think it should, but that's going to take legislation.

Mr. WAXMAN. Now, what would happen if an agency were under a statutory or court ordered deadline to promulgate a regulation? What would happen if a regulatory budget limit drove agencies to issue weak regulations that failed to meet the underlying budget, underlying statutory requirements?

Mr. SMITH. Well, as you're aware, we are a rule of law as well as a rule of legislative responsibility. But, by informing Congress at the earliest stage in a timely way, Congress would have the opportunity to make its input known along the proces, not waiting until the very end of the process when both time and legal suits might well force an untimely and inappropriate action.

What we need to do is to recognize in Congress that there are many things EPA should do and that many of us think they are good to do. Some of us think they are less wise than others, but setting priorities is a critical responsibility of the agency and Congress. And right now, neither have any reason to set meaningful priorities.

Mr. WAXMAN. Well, I'm concerned that the regulatory budgeting provisions in this bill would be read to trump agencies' statutory directives to issue regulations necessary to protect the public and the environment.

Basically, you're saying that the level of environmental or public health protection should be constrained by some arbitrary limit, no matter what the benefits of additional regulation might be, and I don't think the American public agrees with you on that. I don't think benefits are a fiction of the imagination. I've been around too long where I've seen regulations produce enormous benefits but the industry groups underestimated what the benefits would be and overstated what the costs would be. And, therefore, I don't think these things can be as clearly quantifiable. And, as I gather, that's Ms. Heinzerling's point as well.

Ms. HEINZERLING. Yes, I've spent several years actually thinking about that precise question. That's exactly right.

Mr. SMITH. Congressman, may I say one last thing on that last point. I agree with many of the things you said. Certainly, imprecision is an element here but EPA, some years ago, did an assessment. It looked at everything that the political process and the interest groups' pressures on it believed it should spend. It went from

the highest spending level down to the least, and then, as an environmental agency, it looked at every area that it thought would have the greatest environmental benefits, the greatest human health benefits, the greatest environmental benefits, and they created another list. There were two lists, what it was actually spending money on, based on the political pressures it faced, and what it thought it should be spending money on based on it's environmental professionals. Those two lists were almost the reverse of each other. We will have a better environmental agency by giving it the restraints that force it to think through priority-setting, rather than be buffeted by whatever the political pressures of the moment are.

Mr. WAXMAN. Sounds to me like the political pressures could then be brought to bear on this priority-setting and budgetary imaginative system that's being created here which has, in many ways, no reality to what, in fact, is going to be the cost and the benefits. So it just gives some groups that don't want environmental protections or public health protections an opportunity to try to stop them based on a whole fictitious world that would be created.

I see my time is up, Mr. Chairman, so I'll let you move on.

Mr. JANKLOW. Thank you very much, sir. The Chair recognizes the gentleman from California, Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. If I may, if I could just ask clarification from the Chair, it seems to me that as we discuss regulatory obligations that get placed on businesses or individuals, there is a clear belief that the numbers, the costs, that there's very little accurate information. I mean, Dr. Gramm testifies to that here in the bottom of page 1. But, it also seems to me that's not much different than the fiscal issues we deal with on an annual basis in appropriations. Those are prospective numbers that really are just kind of like ball park things. We're ball parking that, you know, "Defense is going to cost this much." And then we're ball parking that the Department of Interior is going to need this much money. And we're ball parking that the Department of Labor is going to need that much amount. And so, I just want to clarify for everybody that the concept behind the bill, as proposed, is that it mirrors the appropriations process, putting it in the lap of those elected by the people of this country to work out the burdens that get placed on those people on an annual basis.

Now, you know, if the majority rests on one side, or the majority rests on the other, maybe the burden's higher or lower. But, the fact of the matter is, conceptually, it virtually mirrors the appropriations process. That's not anything new, it's what we do. It's what we're doing on the floor of the House today with the Commerce/Justice/State Appropriations bill. It's what we are going to do tomorrow with Foreign Ops or VA/HUD or whatever it is that comes down the pike.

Now, having said that, I do want to get to some specific questions about the proposed legislation. Mr. Smith, Dr. Gramm, current law requires OMB to include in its annual regulatory accounting statement data separately for each agency and for each agency regulatory program. OMB's most recent draft, sixth report dated February 3, is missing data on many agencies and most agency regu-

latory programs. And I would refer you to this chart over here, where the red areas denote the lack of information that is otherwise currently required. Now, we've heard a lot of discussion about section 6. Section 6(a) requires systematic agency input that would eliminate the red up there. Now, as one vehicle to improve OMB's annual regulatory accounting reports, do you support or oppose a requirement for agency estimates of aggregate and new regulatory burdens OMB receives in response to its annual OMB bulletins to agencies for aggregate and new paperwork burden? In other words, do you believe that OMB's annual regulatory accounting reports need a requirement for agencies to report aggregate and new regulatory burden? I don't care where we start.

Mr. SMITH. I'll let her go first.

Mr. OSE. All right. Dr. Gramm.

Ms. GRAMM. I believe that all agencies should make those reports and I also believe very strongly, and we have urged OMB to do this on their own, that they need to provide their own independent analysis of those estimates as well, because the agency estimates just are not, in many cases, reliable.

Mr. SMITH. I would agree with that. I would also suggest that, as she said earlier, that it would be very useful for Congress to urge that, I would think in the Congressional Budget Office, that a capability of evaluating regulatory costs also be included. And if I could just followup on the point you raised in the beginning of yours, I think the analogy between expenditure programs and regulatory programs is ideal. Congressman Schrock earlier mentioned he had been with the Defense Department. It's not easy to determine what the eventual costs are going to be of a new fighter system, a new carrier fleet, or indeed of a war itself. We make rough and ready estimates and we come back when we realize we have made mistakes and it is then up to Congress to decide whether to continue the program or whether to rethink that program, in light of its change in costs. It is for Congress to assimilate whether it thinks it's worth while to do it or not.

Mr. OSE. Mr. Sample, do you have any input on this?

Mr. SAMPLE. I am certainly not an expert in the policy area, but I do know that every month we pay an employee 50 hours a week of overtime to fill out——

Mr. OSE. Fifty or 15?

Mr. SAMPLE. Fifty.

Mr. OSE. Fifty hours of overtime per week?

Mr. SAMPLE. Of overtime per month—I'm sorry—to complete the regulatory paperwork that's necessary.

Mr. OSE. All right. Mr. Arth any input on?

Mr. ARTH. I don't think I have anything to add at this point, no sir.

Mr. OSE. Professor Heinzerling.

Ms. HEINZERLING. I'm opposed to this requirement. Agencies already produce this information for major rules. OMB itself has said that for rules in the aggregate, the information is all but useless, and this is another example of paperwork production, rather than paperwork reduction. So I oppose this section.

Mr. OSE. So you're OK with the areas on the chart?

Ms. HEINZERLING. You know what, my eyesight isn't—if that means that I oppose this section, then——

Mr. OSE. I apologize for that.

Ms. HEINZERLING. Yes.

Mr. OSE. All right, I'm going to go back. We'll go from right to left this time. In July 1999, the House passed the bipartisan Regulatory Right to Know Act, which called for OMB's annual regulatory accounting report to use the same 7-year time series as statutorily-required for the President's fiscal budget. That is past year, current year, the budget year, and then the following 4 out years. To increase utility to Congress in its decisionmaking, what is your view of section 6(b) which requires that on-budget and off-budget costs be presented for the same 7-year time series so that those of us in Congress can evaluate them simultaneously? Professor Heinzerling.

Ms. HEINZERLING. If you are going to have this bill, I think the bill is not a good idea. And so I'm not that impressed one way or another by the timing of the measures that I think are not good ideas.

Mr. OSE. OK. So if the President puts forward a budget, you don't care whether it's correlated to the regulatory estimates or not. From a chronological standpoint?

Ms. HEINZERLING. It seems fine. Even if it's correlated it still seems like a bad idea.

Mr. OSE. OK. Mr. Arth.

Mr. ARTH. As I see all of section 6, we're really working at trying to identify, to the best of our ability, those currently unconsidered compliance costs. And it seems to me if we're going to take that step, it certainly makes sense to use the same time window that we are using when we are forecasting what the actual cash-dollar outlays originating in Washington will be to try to assess what the total impact on the economy is going to be. So I just think it makes sense if I'm understanding this whole section appropriately.

Mr. OSE. Mr. Sample.

Mr. SAMPLE. If I understand it correctly as well, I agree with Mr. Arth.

Mr. OSE. Dr. Gramm.

Ms. GRAMM. I support 6(b).

Mr. OSE. You do support 6(b)?

Ms. GRAMM. Yes, I do.

Mr. OSE. Mr. Smith.

Mr. SMITH. Yeah, and I think, in general, the goal is that every part of the budget allocation or the budget assessment process should be applied equally to both expenditures and to regulatory burdens from the very beginning. Estimating in advance attempts to create a budget in conjunction with the relevant agencies and so on. I think the equivalence of those two is critical if we are going to ensure that we're spending money, the taxpayers' money, in wise ways.

Mr. OSE. Right. If it please the Chair, I see my time has expired and the gentleman from Virginia, one of my mentors, is here so I need to yield back.

Mr. JANKLOW. The Chair recognizes our mentor from Virginia.

Chairman TOM DAVIS. Thank you very much, Mr. Chairman. You look pretty good in that chairman's chair. Don't get any ideas. I appreciate everybody being here. I apologize for not being here earlier. We were on the floor with some matters that concerned the committee.

Let me ask this question, and I'll start over there on my right and your left with Professor Heinzerling. Obviously, there are regulations that save money, and I understand in reading your testimony the argument for that. There's some regulation that I think we would probably all agree is stupid. It's hard in a statute to try to ferret out which is which. But, at a minimum, I'll ask each of you, don't you think the government ought to be able to tell the public what it's going to cost each year for regulations in some way, just in the interest of disclosure; to make the case for the regulation, it's going to cost this? "We think it'll get you here," but have some kind of cost benefit beside it. Wouldn't that enhance the transparency and the political accountability for regulations in the same way that Congress is ultimately accountable for government expenditures? And wouldn't that concept budget make Congress more accountable for making judgments about the costs and benefits of regulations if we conclude this cost. And let me start over with you.

Ms. HEINZERLING. No, I don't believe it would, with respect, sir. The aggregate estimates of cost benefits of Federal regulations that are provided by OMB every year are, as I have said, in OMB's own language, almost useless as a means of regulating individual programs. The cost estimates are wildly inflated in many cases. The benefit estimates are way too low in many cases. In many cases, as Fred Smith himself has said, we just don't know what those benefits are.

Chairman TOM DAVIS. I understand your position on that, but doesn't that really go to how this is measured as opposed to the concept? If there were a satisfactory way of measuring the costs, would you feel differently? Granted, the track records may be bad.

Ms. HEINZERLING. There would still be the extremely difficult problem of measuring benefits and I think I'll wait my lifetime until those benefits can be quantified and monetized in any kind of reliable way. And, in fact, what happens instead is, OMB is forced to rely on data that comes from mainly the 1970's and 1980's. For example, for environmental programs, the data are way out of date. They're unreliable, and so no, I don't think the report provides a good way of evaluating Federal regulation.

Chairman TOM DAVIS. Well, how are we to know or the public to know what the hidden costs are? I mean, shouldn't that be part of our decision to promulgate some regulation or pass some rule, reporting in fact what the costs are?

Ms. HEINZERLING. Well, you can look at any of the regulatory impact analyses that are required by Executive Order 12866 and find out what those costs are. If you're talking about more minor regulations, then those costs might be harder to find but any major regulation you can just go and look it up on the docket of the agency.

Chairman TOM DAVIS. You think those cost analyses are more accurate?

Ms. HEINZERLING. No, I'm just saying that if you're wondering where to find them, that's where to find them.

Chairman TOM DAVIS. Right. OK. Thank you.

Mr. ARTH. I think, clearly, we have to start trying to identify the costs, and I'll concede that estimates are probably wrong. The time estimated to complete paperwork that you find in your tax booklet, I think, is also wrong and, typically, it understates the amount of time that an individual would take to complete it, especially someone who's not familiar with the Tax Code or the regulation in question. The problem we have is that too many citizens seem to believe they're getting all sorts of things for free. If the government passes a law and business has to clean up the air or clean up the water, that's free. The fact that it may result in higher product prices when they go to the store, when it results in their not being able to buy the product made in this country anymore because manufacturers can build it for a fraction of the cost in another country, and they're out of a job or their kids are out of job, I mean the costs of regulations ripple through the whole economy. And right now, a substantial part of the business that goes on here, a substantial part of the cost, is just being ignored. And I think that's a big part of what this is trying to address.

Mr. SAMPLE. As a businessperson, we are used to looking at cost and benefit analyses, and I think it would certainly be a good first step.

Mr. OSE. Would the chairman yield for a minute?

Chairman TOM DAVIS. I would be happy to.

Mr. OSE. On that particular point, what is the quality of the information you use in making your evaluation? We've heard a lot of concerns about the quality of information that we might have in evaluating costs and benefits. How do you go about ascertaining the quality of the information you would use in making your determination? Do you just wing it?

Mr. SAMPLE. I would have to say, yes.

Mr. OSE. OK. Thank you.

Chairman TOM DAVIS. OK.

Ms. GRAMM. I believe that transparency is one of the big benefits of this bill. I would not hold out that much hope that this is going to be the silver bullet, as John Graham pointed out. The point is that if the measurements are not good, if they're overstated one way or the other, or if they're just inadequate, well, then having that at least reported will start the debate, and then you can debate about the quality of those estimates.

I have another question though. If the estimates are really overstated, if the agencies are putting forth their regulatory budget with regulatory costs that are overstated, seems to me that would be good for them. Then they get a big budget right? As a matter of fact, I really do think that if you recall—and I was going to say this when Congressman Waxman was here, except my colleague wouldn't let me get a word in edgewise—but when Medicare was first started, and the first estimates of Medicare were made back in 1977, of course there were huge underestimates of the cost of that program. But that is the process that you go through in terms of analysis. There was a debate about what those costs were, because I know people who were involved in that debate. And then

over time, those costs, of course, changed depending on what actually happened. And I think that's what the idea is here with the starting of this regulatory budget. With regard to the transparency and with laws, I would even go one step further, and it's not in the purview of this bill, but one of the things that I have long advocated is that I wish that whenever a bill came up for passage or reauthorization, someone would just add an authorizing amendment that says that the regulatory costs imposed on the private sector, on State and local governments, Indian tribes and so on—"To enact this bill shall not exceed X amount of dollars," and when those costs exceed that amount of dollars, you have to come back to Congress for a further discussion. I believe that if that's put on a bill it would again foster a discussion of what the potential costs of the bill are.

And with regard to benefits, I think that we spend a lot of time talking about the benefits on this panel but I would also go back to the Medicare argument. I think that when you talk about fiscal programs like Medicare when it started, we talk a lot about costs but I think everybody understood and talked about the benefits as well, and I think the same can be done for regulatory issues. You're talking about how you allocate the scarce resources of our economy, and that's why this bill is so important. Thank you.

Mr. SMITH. OMB does not play the same role on the cost side of expenditure programs as it does on the benefits side. The administration decides how much money it wishes to spend on educational programs, defense programs and so on. OMB is very important in that process, but that's a political decision, the type of program the administration wants to puts forward. OMB then insures that the agency's estimates of how much it is spending remain within those budgets.

Are there games played with budgets by cost busters? There certainly are. Whether you put it on capital, whether you stretch it out over time, what interest rate you use and so on; and those questions have been asked since the beginning of the expenditure budget process back around 1901 or 1910. Have we gotten better it? Are we great at it? No. We make big mistakes as we've heard earlier but at least we have some ability to know that we're getting into trouble when we overspend on a defense program or any other program.

In the regulatory area, we've developed none of that expertise because we haven't started that process. We need to start that process. A pilot program is the right term because we're going to make lots of mistakes as we learn how to do this but we're never going to learn how to account for the overall consequences of an overregulated or an interrelated economy unless we begin to make explicit the hidden taxes that regulations now represent.

Mr. JANKLOW. If I could, I'd like to ask Professor Heinzerling just for a moment. I've gone back and reread section 6, where it talks about regulatory budgeting. One of the complaints I believe you testified to a little while ago was, that this is probably a rather transparent attempt, if I can take license with language, to gut some of the provisions of law that we have in place like the Clean Air Act, etc. Am I paraphrasing you correctly, Professor Heinzerling?

Ms. HEINZERLING. Yes, that is my understanding of how this bill would operate.

Mr. JANKLOW. OK. Could you tell me: what is it in the Department of Transportation that you think, if we passed this, we would be gutting?

Ms. HEINZERLING. Well, I don't know. That's part of the problem I have with this bill; it's very vague. It doesn't define programs, it doesn't specify which programs it's talking about and, it doesn't give any guidance to OMB about what a program means and what programs are included.

Mr. JANKLOW. I was asking you if you had any facts?

Ms. HEINZERLING. And so I don't know which program——

Mr. JANKLOW. OK. Do you know which programs in the Department of Labor, the sponsors or the supporters of this bill would be targeting? You were very specific about the Clean Air Act and one other which I can't remember. So what I'm wondering is, was that a speculative statement by you or is it based on any factual information that you have?

Ms. HEINZERLING. Well, if I may, the bill is so vague, I don't know exactly which programs it will cover. And it gives complete authority, apparently, to OMB, in consultation with the agencies, to figure out which programs to cover. That seems to me to be one problem. The second problem is if you think as examples——

Mr. JANKLOW. Excuse me. Don't you think it would cover the entire agency? The way I read it, it would cover the entire agency.

Ms. HEINZERLING. Well, let's look at the language.

Mr. JANKLOW. OK.

Ms. HEINZERLING. I think the language refers to programs.

Mr. JANKLOW. Well, why don't you, let's go to line 13 of page 9 for starters. "The designated agencies shall reflect a representative range;" and then it includes three specific ones. Then if you go down to line 18, it talks about pilot projects in the designated agencies. So what it does is, it lays out the three designated agencies and then says, "let's them pick some more." It doesn't say you can do part of an agency. If I can, ma'am, if you go to line 24, it then says, "The Director of [OMB] shall include, as an alternative budget presentation in the budget submitted under section 1105 [for fiscal year 2007], the regulatory budgets of the designated [agencies] for that fiscal year." So, what they're telling us is, it'll be the whole agency. So it doesn't sound to me, or doesn't appear to me as I read it, are you reading it in such a way that they would pick and choose from EPA, which would be subjected to a regulatory budget and which wouldn't?

Ms. HEINZERLING. Certainly, I don't want to put any words in anybody's mouth, but then given——

Mr. JANKLOW. I know you don't.

Ms. HEINZERLING [continuing]. But then given your interpretation I do wonder what lines 19 through 23 are doing in the bill, which say such, "budgets shall present, for one or more of the regulatory programs of the agency, the varying levels of costs and benefits to the public that would result from different budgeted amounts."

Mr. JANKLOW. Well, doesn't that refer to the additional agencies that are being selected and not the three that are delineated about

which you complained, Environmental Protection, Transportation and Labor?

Ms. HEINZERLING. But it refers to programs there. So for those agencies, are you suggesting that language would for those agencies apply to programs alone?

Mr. JANKLOW. Professor, let's just read it. Let's go back to line 13 and read the sentence. "The designated [agencies] shall reflect a representative range of Federal regulatory programs, and shall include at least the Department of Labor, [the] Department of Transportation, and the Environmental Protection Agency."

Ms. HEINZERLING. If that's what it means is, that we're talking about budgeted amounts for entire agencies and not for agency programs, then I think it's even more troubling than I thought it was when I thought it applied only to programs.

Mr. JANKLOW. And why is that, ma'am, that it's more troubling?

Ms. HEINZERLING. Because I'm wondering, then it becomes particularly problematic that the bill doesn't give any guidance about exactly how these budgets are to be set. And so the entire——

Mr. JANKLOW. The existing law doesn't give any—does the existing law set forth anything now?

Ms. HEINZERLING. Yes. If you read the statutes that Congress has passed they're actually quite specific about what requirements are to be imposed on private entities and they provide lots of guidance.

Mr. JANKLOW. What private entities? I'm talking about the government agencies that are funded under the current budgetary process.

Ms. HEINZERLING. And what is your question about then?

Mr. JANKLOW. My question is, isn't the existing governmental process—what are the rules that are in place now that you think are—proscribe how an agency prepares the budget?

Ms. HEINZERLING. Oh, prepares its own budget?

Mr. JANKLOW. Sure.

Ms. HEINZERLING. I see. Yes. If this were a statute that said that Congress—if Congress were going to say, "we think that EPA should not require more than $1 billion in private expenditures in any given year," that would be a very different bill from this bill. And as Fred Smith suggested, that would require a minor refinement. I think that would require a major overhaul of this bill.

Mr. JANKLOW. But I'm not aware that's in this bill. What I'm trying to do is get to the focus specifically of this bill and your specific objections. And I understand some of them may be philosophical. I appreciate that. I understand some of the support from some of the proponents may be philosophical and, professor I appreciate that. But what I'd like to get to, specifically is, if the Director of OMB submits to the Congress a budget, an alternative budget presentation that is a regulatory budget consistent with this law, at that point in time, doesn't it become transparent and doesn't the Congress, both the House and the Senate, as well as all the individuals in America that care or don't care, become involved in the process before it becomes law?

Ms. HEINZERLING. So you're suggesting that what the bill does is, it requires OMB to present to the Congress a particular proposal for regulatory budget?

Mr. JANKLOW. No. Let's just read what it says, I'm not suggesting anything. "The Director of [OMB] shall include, as an alternative budget presentation in the budget submitted under Section 1105 for fiscal year 2007, the regulatory budget[s] of the designated agencies for that fiscal year." That's what I'm suggesting. At that point in time, with all of the exaggerated claims of expenses and all of the exaggerated claims of benefits—which goes on all the time anyhow I mean, that's the process in America—with all of these exaggerations, won't they then be subject to the scrutiny of the appropriations process, both the House and the Senate, the majority, the minority, and the public? Am I wrong in what I'm saying?

Ms. HEINZERLING. I think so, yes.

Mr. JANKLOW. All right. Tell me why.

Ms. HEINZERLING. Well, because a lot of the information that would be required here, we already have.

Mr. JANKLOW. Well, that doesn't make me wrong, that it's open to scrutiny.

Ms. HEINZERLING. Well, I thought you were asking would we be better off.

Mr. JANKLOW. No, I didn't say that. I said, am I wrong; tell me why. You said, yes, and I said, tell me why.

Ms. HEINZERLING. And you're wrong—I'm suggesting that you're wrong specifically about whether it would be more transparent to have a number like $100 billion for the EPA as a regulatory budget.

Mr. JANKLOW. Professor, you're a professor of law aren't you?

Ms. HEINZERLING. Yes, I am.

Mr. JANKLOW. If someone exaggerates before the jury, they usually pay for it, don't they? What would be the difference between that, if they're caught, and an agency exaggerating before the Congress or the American people and getting caught? Is there a difference?

Ms. HEINZERLING. If you're asking about exaggerating the cost estimates, they've been exaggerated for decades and nobody's caught that.

Mr. JANKLOW. Yes, that's a good point. On all sides, in all arguments, and not just under a regulatory budgeting system. I agree with that. Thank you. Do you have anymore questions, Mr. Ose?

Mr. OSE. Yes I do, Mr. Chairman.

Mr. JANKLOW. Go ahead, sir.

Mr. OSE. Thank you. I want to continue on with some questions I have about section 6. Let's see. It went that way, and then I came back.

So we're going to start here with Mr. Smith. Current law requires that OMB submit its annual regulatory accounting statement and associated report on impacts with the President's budget. This year, for the first time, OMB met the statutory deadline for submission but did not include these documents in any of the five fiscal budget documents. Instead, OMB published them separately in the Federal Register. Now, my interest is in making sure that when a document drops on my desk, I've got all of the little ingredients of that thing, instead of having to go hunt around for them, and what have you.

What is your view of section 6(c) of the legislation that requires that the off-budget regulatory cost-benefit information be presented with—and I say with in the ordinary sense of the word, as in "the water in this pitcher is with the pitcher; it's right there."—the on-budget cost performance information in the President's fiscal budget documents? Mr. Smith.

Mr. SMITH. I think that's a very good idea, although, I can have some sympathy with why Dr. Gramm or OMB, generally, might not do so. There's a difference when you think about the three categories of government intervention that I mentioned: expenditures, which clearly are presented to the Congress of the United States, credit allocations, which are presented to the Congress of the United States as part of the agencies' budgeting process, and regulatory costs, which you have suggested are required, would be required to be submitted and haven't yet been done. So, the problem with the first two is, Congress votes on those. They vote on what the expenditures are going to be. They vote for or against authorization, for how much credit authority an agency will have. At the moment, there is no accountability to Congress, these are just information requirements, and I can imagine that an agency stressed in many ways might place more emphasis on information that will have consequences than an agency that is just educational. I think the whole goal of this, in time, is to bring regulatory expenditures under the same degree of congressional approval or disapproval that we have for expenditure decisions and credit decisions.

Mr. OSE. Dr. Gramm, do you believe that the off-budget regulatory cost-benefit information should be or should not be presented with the on-budget cost-performance information in the President's fiscal budget documents?

Ms. GRAMM. I believe it should be provided with the fiscal budget documents for all the reasons I stated earlier, but with another one: I think it would get the attention of the OMB Director and the higher-ups in the executive branch and get them to pay more attention to this issue.

Mr. OSE. OK. Mr. Sample.

Mr. OSE. Any thoughts?

Mr. SAMPLE. I'm certainly not an expert in this area, but it seems to make a great deal of sense to me.

Mr. OSE. OK. Mr. Arth.

Mr. ARTH. I agree.

Mr. OSE. Professor Heinzerling.

Ms. HEINZERLING. As I said previously, I think the timing is a matter of less consequence than the substance of the bill, which I oppose.

Mr. OSE. But you don't have any comments on this particular section that are unique to this section?

Ms. HEINZERLING. No.

Mr. OSE. All right. In his written statement for the Government Reform Subcommittee on Government Efficiency and Financial Management's March 11, 2003 Regulatory Cost Accounting hearing, former OMB and OIRA Deputy Administrator, Jim Tozzi, said, "There's little need to develop a regulatory cost accounting system if, ultimately, it is not going to be used to implement a regulatory budget." Section 6(d) of the legislation establishes pilots projects for

regulatory budgeting. Conceptually, such a test could evaluate if the agencies are able to rank risks and prioritize, then make choices between new or revised regulatory programs and among alternative approaches, the purpose being to maximize benefits for the greatest number and to minimize costs to the regulated budget. I'm going to move right to left. My question is, do you support section 6(d)'s pilot projects for regulatory budgeting? Professor Heinzerling.

Ms. HEINZERLING. No, I do not for the reasons I've already stated.

Mr. OSE. Mr. Arth.

Mr. ARTH. Yes, I do, and again pretty much for the reasons I've previously stated in this whole section.

Mr. OSE. Mr. Sample.

Mr. SAMPLE. Yes, I do.

Mr. OSE. Dr. Gramm.

Ms. GRAMM. I support section 6(d).

Mr. OSE. Mr. Smith.

Mr. SMITH. I think pilots are a good idea. We're going to learn a lot from this, hopefully.

Mr. OSE. Excuse me for a minute. Now, I want to look at Dr. Gramm's statement for the record, the written statement. I'm trying to understand, in reading the different statements, Dr. Gramm, you make the point on page 1 that there's relatively little accurate information on the size of these regulatory taxes or the regulatory budget of the United States, and I can take that to mean we don't know if it's properly quantified too high, properly quantified too low, properly quantified exactly right. We just don't know.

Ms. GRAMM. We just don't know. That's right.

Mr. OSE. OK. Now, you go on in page 2 to cite an OMB report of total regulatory cost estimates of $38 to $48 billion a year.

Ms. GRAMM. But that doesn't cover all regulations, and it only covers——

Mr. OSE. Is that a 20-year window?

Ms. GRAMM. That's right. That's right.

Mr. OSE. OK. Now, your point had been that the regulations that might underlie a lot of the burden on individuals and businesses precede that 10-year window?

Ms. GRAMM. Yes.

Mr. OSE. All right.

Ms. GRAMM. Or are not covered otherwise. Just because they're not economically significant regulations for example.

Mr. OSE. They don't hit that $100 million threshold?

Ms. GRAMM. They don't hit the threshold.

Mr. OSE. OK. And that would explain the difference between SBA's higher estimate of $843 billion per year?

Ms. GRAMM. Yes.

Mr. OSE. OK. Now, Professor Heinzerling——

Ms. GRAMM. And, don't forget, the estimates, even the small number of estimates that OMB presents in the report, are estimates made by the agencies—in analyzing some of those regulations, we have found vast, vast inaccuracies.

Mr. OSE. Could be too high, could be too low?

Ms. GRAMM. Yes.

Mr. OSE. OK. Professor Heinzerling, in your testimony on page 5, under benefits you have a number, it looks like the citation is the EPA. You have a number of $22 trillion in net benefits in the first 20 years of the Clean Air Act's operation. I think that's right, page 5. And what I'm trying to figure out is, whether or not you share my skepticism about how well the costs and benefits are quantified on these different regulatory issues.

Ms. HEINZERLING. Depends on which way your skepticism runs, sir. I believe that number may, in fact, be an understatement of the benefits of the Clean Air Act. That number is the result of a multi-year, millions-of-dollars effort on the part of EPA to quantify the costs and benefits of the Clean Air Act. It was peer-reviewed. People at the time said it was state-of-the-art cost-benefit analysis and it produced that number, despite the fact that many of the benefits of the Clean Air Act were not even quantified in that analysis, much less monetized.

Mr. OSE. I actually have appreciated the fact that you brought this issue of how valid the numbers are forward because, if I read this report correctly, the $22 trillion number is constant dollars as of the date of the report which would have been 1997 for that 20-year timeframe 1970 to 1990. Now, the skepticism, and it's healthy on all of these numbers from my perspective, I have relates to my understanding of the gross domestic product for that period of time which, in 1997 dollars, was probably only about $200 trillion. So you're saying that the benefits from the Clean Air Act during that 1970 to 1990 timeframe is equivalent to about 10 percent of the aggregate gross domestic product of the United States?

Ms. HEINZERLING. I have no reason to dispute the account that EPA gave in that report which was reviewed by experts in the field. I'll say that about 90 percent of those benefits were from reduced human mortality or, that is, avoiding human death and the figure used in that report for unavoided human death was $6.1 million. Now, I don't know if you think that number is too high or too low, but that is the number to think about in thinking about whether that $22 trillion estimate is too high or too low. My opinion is, it might be a little too low. I don't know what your opinion is——

Ms. GRAMM. But there were other parts of that study, if you'll allow me to interrupt, where EPA did not consider the health risks of the Clean Air Act. In fact, there would be increased numbers of skin cancers and melanomas and increased numbers of deaths caused by, for example, the latest ozone regulation that was put into effect——

Ms. HEINZERLING. Excuse me. If I may respond to that, EPA has recently said that information, which was the result of sort of economist's back-of-the-envelope guess, was just not reliable enough.

Ms. GRAMM. That information was used in EPA's own regulation. It was prepared by the Department of Energy, and it was used in EPA's own regulation with regard to stratospheric ozone.

Mr. SMITH. You'll find that when you look at—I'm sorry.

Ms. GRAMM. But I don't think we need to discuss that particular issue in this hearing.

Ms. HEINZERLING. But if we are, we should do it right.

Mr. OSE. Let me just explore something. In other words, there is a standard of particulate matter in the atmosphere——

Ms. GRAMM. And this was in ozone.

Mr. OSE [continuing]. That was issued by the Department of Energy, used by the Environmental Protection Agency to analyze a net-benefit, net-cost question to the economy as a whole of the Clean Air Act, and there's some question as to the validity, as there is today perhaps of our calculations. There's some question as to the validity of that original Department of Energy analysis?

Ms. GRAMM. The Department of Energy analysis was never allowed or was not included in the EPA's analysis of the ozone standard act, although it was used for an earlier analysis——

Mr. SMITH. Could I try to explain it to you? When EPA wanted to show its programs had benefits, as you would expect it would, it evaluated the benefits of preventing ozone from dropping, because the argument was, if you had an umbrella up high you prevented ultraviolet radiation and so forth. But when EPA wanted to ignore that effect, because now the umbrella was going to be held low, it ignored the benefits—the disbenefits in this case—of reducing ozone shielding. Ozone shielding was good when you held the umbrella high. Ozone shielding wasn't good when you held the umbrella low. One can put different interpretations on that but it appeared as if EPA wanted its benefit estimates to look higher than they would have looked if it had used that information in the same way in both analyses.

Mr. OSE. So if I may, I perceive by your comments, Mr. Smith, that you have a, what you would probably describe as a healthy skepticism of these numbers, both from a cost and a benefit standpoint.

Mr. SMITH. I think probably this whole panel has a certain skepticism from that.

Mr. OSE. Well, I'm going to go through the rest of the panel.

Mr. SMITH. But I certainly do and the reason is that there haven't been as many attempts as one would like to evaluate the EPA. One of the most fertile ones was a survey done some years ago. EPA asked the wrong question. It looked quite thoroughly at the argument that EPA was a major public health contributor as we've heard here earlier. It had rejected that. They thought EPA was a very important agency but it made the question over and over again that EPA had very little value it could add as a major public health agency. It could do a lot to improve aesthetics, it could make us like the environment, it could eliminate smog and nuisances, but the idea that EPA was out saving trillions of dollars of human life was as fanciful then as it is now.

Mr. OSE. Dr. Gramm, do you share Mr. Smith's skepticism about the degree of accuracy in these cost and benefit numbers?

Ms. GRAMM. I believe the Agency estimates have been grossly overvalued in terms of benefits on many, many counts, and especially in this particular case; so it's very troubling to see these numbers being produced every year in OMB's reports.

Mr. OSE. Mr. Sample.

Mr. SAMPLE. I'm sorry. Again, I don't have any background in this but I don't have any reason to disbelieve that.

Mr. OSE. OK. Mr. Arth.

Mr. ARTH. Quite frankly, I guess I'm a little surprised that we're discussing this at such length because everybody seems to feel that the numbers are wrong; either they're too high or too low depending on where our perspectives are. The fundamental issue here is that there is this huge expenditure that's being incurred by the private sector as a result of regulation and it's being ignored at the present time. And so whether it's $800 billion or $1 trillion or $600 billion, it's a huge number and we can only get better government, better regulation, if we started to try to take into account not just the tax dollars we're going to spend, but the dollars we're going to require the private sector to spend as we pass new laws, adopt new regulations.

Mr. OSE. So you do have a skepticism?

Mr. ARTH. I have a skepticism. You know, I was a CPA once upon a time, and I have worked with actuaries, and I really respect their ability to make numbers sing.

Mr. OSE. I sit on Financial Services. We're not going into the corporate statements. Professor Heinzerling, do you have a skepticism on these numbers, whether it be too high or too low given the circumstances?

Ms. HEINZERLING. Well, as I've said, I do have skepticism about the numbers. I happen to think that they're probably wrong in a different direction from everybody else on the panel. My opposition to this bill and to other efforts at regulatory reform is, in fact, based on a deep-seated skepticism about numbers like these.

Mr. OSE. So let me ask this central question: Absent a pilot program to at least test the hypotheses as to whether or not something is valid or not, how do we ever improve the situation? Professor Heinzerling.

Ms. HEINZERLING. I think that a person can think conceptually about an issue without actually putting it into place. Some ideas seem like bad ideas even if you don't try them out. You can use what you know about the world and think about whether it seems like a good idea or not. Looking at this bill I think it's not a good idea and I don't think a pilot project is going to help change that.

Mr. OSE. So at least in that context you're not willing to test it against a real world situation?

Ms. HEINZERLING. Well, I don't even know what we're testing really, because the bill is so vague.

Mr. OSE. Mr. Arth, are you willing to test this?

Mr. ARTH. I think it's absolutely essential that we do.

Mr. OSE. OK.

Mr. ARTH. And would be very supportive of that.

Mr. OSE. You're not focused on doing it in any particular agency or department, just test it and then refine your test, and test it again?

Mr. ARTH. Test it, refine it, get some numbers that mean something, and we need to start realizing that all these little—and there are good regulations. Don't misunderstand me. But there are an awful lot of them that no one would ever vote against—clean air, motherhood, apple pie—but we're spending a whole lot more in a lot of areas than the benefits would suggest is a worthwhile investment.

Mr. OSE. And the only way to determine that is to run a test?

Mr. ARTH. To start to get some ideas of what those costs are.

Mr. OSE. Mr. Sample, you've got a wag going on over in your business on your analysis.

Mr. SAMPLE. My observation is that it isn't working the way it is, so the only alternative that I see is to try something.

Mr. OSE. Dr. Gramm.

Ms. GRAMM. I think this is a very important part of the bill, and I believe we should try it. Absolutely.

Mr. OSE. And you're willing to leave what it is that's tested to OMB's discretion?

Ms. GRAMM. Absolutely.

Mr. OSE. OK.

Mr. SMITH. In 1921, we enacted the first Budget and Accounting Act. We didn't get it perfect back then, and we don't have it perfect now on expenditures, but we started and we've made some progress. I think it's well overdue to start the progress on regulatory accounting too.

Mr. OSE. I thank the Chair for his indulgence.

Mr. JANKLOW. Thank you very much, Mr. Ose. I just have one comment and a very brief question. I was really struck by the previous testimony before this committee of the gentleman I believe from somewhere in the East who built organs and the document that he had to fill out. He actually held up all his documents he had to fill out and said the key one was involving lead. There's no dispute about lead and the regulatory aspects required for lead, but the documentation that he had to fill out and the cost was astronomical. With respect to—and it doesn't change anything with respect to the way he handled lead within his business, which was in compliance with the law—but Professor Heinzerling, I'm really struck with one thing that you said. This $22 trillion number that you think might be too low, even though you said that at that time it was state-of-the-art and it had been reviewed by specialists in the area and praised in effect. Am I correct?

Ms. HEINZERLING. Yes.

Mr. JANKLOW. Can you tell me who these specialists were in the area that reviewed this analysis of the $22 trillion savings and gave it those accolades?

Ms. HEINZERLING. The Scientific Advisory Board of EPA, I mean the Scientific Advisory Board on Economics of the EPA review.

Mr. JANKLOW. Of the EPA. So the agency issued an analysis and then their board said it was a great job?

Ms. HEINZERLING. They're not within the EPA. They're other people, private people, professors and the like who looked at the report.

Mr. JANKLOW. These were science people or fiscal people or both?

Ms. HEINZERLING. I believe they had both scientists and economists.

Mr. JANKLOW. Can you furnish to us the documentation about the accolades that scientific group gave to that?

Ms. HEINZERLING. Sure.

Mr. JANKLOW. If you would.

Ms. HEINZERLING. Yeah, I don't remember if it was a scientific group, but I think it was state-of-the-art in economic analysis. That was the point of the report was to take the existing science——

Mr. JANKLOW. Well, you said, I believe your testimony under oath was that this other group, after it was submitted, that had praised the accuracy of the and the efficiency of——

Ms. HEINZERLING. Yes. Correct and I'm just being precise about what—so that we understand they praised it as a state-of-the-art economic analysis, and I'd be happy to supply that information.

Mr. JANKLOW. Sure. I'd appreciate that. I have nothing further. Do you have anything further, sir?

Mr. OSE. You're the Chair.

Mr. JANKLOW. Well, I just wanted to know. I may be the Chair, but you're the boss. I've been told by both the chairman and the ranking member that they both have statements that they want put into the record today, but because of the voting process we weren't able to do that. And so we're going to hold the record open for 5 days for any member of the committee that chooses to submit statements for the record.

And with that, really these things get contentious, but they sure help at least people like me figure out what the right thing to do is. I'm really struck, really struck, that some people think the regulatory burden is $230 billion a year. We throw a lot of billions around in Washington, and I know I'm from a small Western State, Midwestern State. But you could run every single thing in the whole government of the State of South Dakota for a 115 years for that $230 billion.

Ms. GRAMM. $843 billion in the year 2000? It's more than that.

Mr. OSE. To the extent that we have questions, we need to ask the panel, are you going to leave the record open for us to submit them in writing?

Mr. JANKLOW. How long do you suggest?

Mr. OSE. Ten days.

Mr. JANKLOW. All right. And to the extent any members of the panel have questions—excuse me, any members of the committee have questions of the panel, we'll also leave the record open for 10 days for them to submit the questions. Is it agreeable with you? You'll respond to those questions. Is it agreeable with you folks?

Ms. HEINZERLING. I'll be on vacation for 2 weeks.

Mr. JANKLOW. Thank you all very much. And the hearing is adjourned.

[Whereupon, at 5:12 p.m., the committee was adjourned.]

[The prepared statements of Chairman Tom Davis, Hon. Henry A. Waxman, Hon. Wm. Lacy Clay, and additional information submitted for the hearing record follow:]

TOM DAVIS, VIRGINIA,
CHAIRMAN

DAN BURTON, INDIANA
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Opening Statement of Chairman Davis
Committee on Government Reform

June 22, 2003 at 2:00 p.m.
2154 Rayburn House Office Building

The Paperwork and Regulatory Improvements Act (H.R. 2432)

Good afternoon and thank you for coming. The purpose of today's hearing is to discuss H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." This bill is the result of much hard work and effort by Subcommittee Chairman Doug Ose as well as Vice Chairman Bill Janklow. I thank them for their untiring commitment to the oversight and improvement of the nation's regulatory regime. Through multiple hearings, Chairman Ose's Subcommittee has established a substantial record for the need for this legislation.

The true cost of government is not just the amount government spends. It is also the costs to the economy of the regulatory burden, which consists of two components: the cost of paperwork requirements imposed on private entities to comply with government reporting requirements and the dollars lost from economic activity that, but for the regulations, would have occurred. The Paperwork and Regulatory Improvements Act is designed to aid Congress's ongoing efforts to rein in the growing paperwork and regulatory burden on this nation's citizens and small businesses. Despite Congress's long history of attempting to identify the costs of these

requirements on Americans, Congress and the public still do not have accurate and timely estimates of what each program and rule will cost the people from whom we require compliance.

It is time to be honest with America about the costs of the programs we demand. The OMB has estimated that the cost imposed on the public for all government-required paperwork is $320 billion a year, which does not include the cost of the underlying regulations for which the paperwork is required. One of our witnesses today, Fred Smith of the Competitive Enterprise Institute, cites an estimate of the annual cost of Federal regulation as high as $860 billion. These costs amount to an invisible tax on the nation, for which there is, at present, no effective way for Congress to decide whether these costs are justified. As a result, it is very difficult to hold anyone accountable for the costs of regulations. It is time to turn the lights on and look at the whole cost of a rule or program. H.R. 2432 does this by establishing pilot programs for regulatory budgeting in at least five agencies.

The bill also provides relief from paperwork requirements and improves current regulatory accounting reporting. There is no justification for the exemptions from paperwork reduction and regulatory due process requirements in the Farm Security and Rural Investment Act of 2002. Those exemptions are eliminated. Also, OMB is directed to dedicate two full time staff to the source of over 80 percent of paperwork – Internal Revenue Service paperwork.

The bill requires agencies to submit to OMB annual estimates of costs and benefits of rules and paperwork in each of their programs and coordination and integration of its regulatory accounting

statement within the President's budget. Such coordination and integration will provide Congressional decision-makers more information at the point where it is most useful - when the decision to appropriate funds is actually being made.

Finally, under the bill, Congress will be able to turn to the General Accounting Office for an independent evaluation of significant rules issued by Federal agencies. Such an analysis will enable Congress to conduct stronger oversight of the exercise of Federal regulatory power.

It is time for Congress to ensure it has the tools to fulfill its constitutional responsibility to control undue burdens imposed on the American public by agency rulemaking. Better information and analysis of the impacts of such rules will make agencies more accountable to the Congress and the public.

I thank Chairman Ose for his leadership on these issues. We hope to build on that good work today. I look forward to the testimony from our expert witnesses.

Statement of Rep. Henry A. Waxman, Ranking Minority Member
Committee on Government Reform
Hearing on
H.R. 2432, "Paperwork and Regulatory Improvements Act of 2003"
July 22, 2003

Today's hearing addresses H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." Frequently, the real purpose of so-called "regulatory reform" efforts is to delay, weaken, and eliminate regulatory protections. This bill appears to be no exception.

As we consider this bill, it's important that we remember the important role regulations can play in our society.

Before the government stepped in, children worked 16 hours a day in factories. The horrors of the unregulated meatpacking industry were described by Upton Sinclair. Unregulated financial industries produced bank failures and economic devastation, while tenants died in slum housing.

Even today, we are still poisoning lakes and streams and suffering choking smog in our cities.

We've made progress on these problems through government regulation. In fact, government regulation ensures the quality of life that Americans enjoy today.

The American people know this. A recent Gallup poll found that 88% of Americans believe that the U.S. government is doing the right amount or needs to do more in terms of protecting the environment, while only 7% believe the government is doing too much.

Of course, no one supports wasteful or unnecessary regulation. But I fear that this bill isn't about reducing waste or regulating more efficiently. Instead, it will slow new regulations and weaken existing regulations by adding complexity to the process and diverting agency resources.

For example, agencies currently must analyze the costs and benefits of major regulations, which have annual costs exceeding $100 million. But under H.R. 2432, agencies would have to estimate the costs and benefits of all regulations and paperwork requirements currently on the books. And agencies would have to do these estimates every year.

This should be called the "Full Employment for Economists Act." Either this requirement will divert agency resources from core missions, or the estimates will be shoddy and worthless. Most likely, both will occur.

The pilot program for regulatory budgeting is even more troublesome. As stated by one of today's witnesses, "regulatory budgets – the long-term objective of our efforts – are cost budgets, not net-benefits budgets." The explicit goal of regulatory budgeting is *not* to increase overall benefits to society. Rather, the goal is solely to minimize overall costs to regulated parties.

Let's say that air pollution from a factory is causing disease, lost work days, lost school days, and even some premature deaths. EPA estimates that eliminating the pollution would cost $100,000, but would produce $500,000 worth of health benefits. Overall, society would be better off if the pollution were controlled. But under a regulatory budget, that doesn't matter. If EPA has reached its "budget" limit, it cannot impose any new regulations.

The net social benefits are just one of the values ignored under a regulatory budget. A regulatory budget also ignores equity issues and entirely disregards benefits that cannot be monetized. It cannot recognize the pain a mother feels watching her child struggle to breathe, or the degradation of a wilderness area damaged by pollution.

There's another problem with H.R. 2432. The bill assumes that we can readily and accurately determine the costs of a regulation. But this just isn't true.

Agency regulatory cost estimates are usually based on estimates made by the regulated industry before a regulation is adopted. Industry has every incentive to overestimate these costs. And after a regulation is adopted, technological innovations and unanticipated efficiencies usually reduce costs, often dramatically. But the analyses required by this bill won't reflect the actual lower costs.

There is certainly room for improvement in regulations and the regulatory process. But I believe H.R. 2432 is a step in the wrong direction. Particularly given the aggressive deregulatory efforts of the current Administration, we need to figure out how we can strengthen efforts to protect public health and the environment – not create additional roadblocks to essential protections.

Statement of the Honorable William Lacy Clay
Before the
Government Reform Committee
July 22, 2003

"Paperwork and Regulatory Improvements Act of 2003"

Mr. Chairman, I would like to thank you for convening this important hearing. H.R. 2432, the Paperwork and Regulatory Improvements Act of 2003 is an important bill that would greatly ease the burden of current bureaucratic paperwork to our constituents. This legislation enjoys bi-partisan support although limited. The bill as I understand would in effect:

- Increase the probability of results in paperwork reduction;
- Assist Congress in its review of agency regulatory proposals, and
- Improve regulatory accounting.

These are admirable goals; however there are some issues that must be addressed first before I can put my support behind this legislation. When the minority staff requested a representative from the Environmental Protection Agency (EPA) be invited to address the issues of feasibility, burden, and desirability the response from the majority was that the Office of Management and Budget (OMB) adequately represents the Administration. So what happened to the bi-partisan support?

I am also concerned about a provision of H.R. 2432 that calls for "regulatory budgeting" of the five agencies selected for the pilot project under this new bill in FY's 2006 and '07. Currently, H.R. 2432 does not specify details regarding how the pilot projects would be structured, who would set the budgets, whether the agencies would be encouraged or

required to comply with the budgets, or whether this would simply be a hypothetical exercise.

These concerns may seem insignificant given the enormity of the situation; however I cannot support this legislation until these questions have been fully addressed. Mr. Chairman, I ask unanimous consent to submit my statement into the record.

Questions from: Cong. Wm. Lacy Clay
Government Reform Committee

Questions for either - Majority Leader Delay / Dr. John Graham, Office of Information and Regulatory Affairs (OIRA) & (OMB).

1. H.R. 2432 does not specify details regarding how the pilot projects would be structured, who would set the budgets, or how agencies would be encouraged or required to comply with the budgets. Would this simply be a hypothetical exercise?

2. H.R. 2432 makes permanent the authorization given the "Truth in Regulating Act" for GAO to respond to requests from Congress for an independent evaluation of selective economically significant agency rules. How will H.R. 2432 address the funding issue?

3. Why in spite of additional efforts to control the paperwork burden supported by the Paperwork Reduction Act of 1980 (PRA) were there annual increases instead of decreases?

Progress in OMB's Regulatory Accounting Reports

DEPARTMENT/AGENCY	Date Started	Agency PROGRAM	Date Started
Agriculture	3/02		
Commerce			
Defense			
Education	3/02		
Energy	3/02	Energy Efficiency & Renewable Energy	2/03
		All Other DOE	
Health & Human Services	3/02	FDA	2/03
		All Other HHS	
Housing & Urban Development	3/02		
Interior			
Justice			
Labor	3/02	OSHA	2/03
		All Other DOL	
State			
Transportation	3/02	NHTSA	2/03
		Coast Guard	2/03
		All Other DOT	
Treasury			
Veterans Affairs			
EPA	3/02	Office of Air	2/03
		Office of Water	2/03
		All Other EPA	

Red = Missing information from OMB's reports

Blue = Only Agency Program information in OMB's report, i.e., all other Agency Program information is missing (e.g., HHS's Centers for Medicare and Medicaid Services, and Treasury's IRS)

Prepared for Congressman Doug Ose

REGULATORY BUDGET REPORT — *twenty-five*

REGULATORY SPENDING SOARS:

An Analysis of the U.S. Budget for Fiscal Years 2003 and 2004

Susan Dudley and Melinda Warren

JULY 2003

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Regulatory Spending Soars:

An Analysis of the U.S. Budget for Fiscal Years 2003 and 2004

By Susan Dudley & Melinda Warren

2004 Annual Report

July 2003

Regulatory Budget Report 25

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Regulatory Spending Soars:

An Analysis of the U.S. Budget for Fiscal Years 2003 and 2004[1]

Introduction

This report examines the *Budget of the U.S. Government* presented by the President to Congress for Fiscal Year 2004 to track the expenditures of federal regulatory agencies and the staff needed to run these agencies. A joint product of the Mercatus Center at George Mason University and the Weidenbaum Center on the Economy, Government, and Public Policy at Washington University in St. Louis, this report continues an effort begun in 1977 by the Weidenbaum Center (formerly the Center for the Study of American Business).

Regulations impose social costs on individuals and businesses beyond the direct tax dollars expended to write and enforce them. Not only are there costs associated with compliance, but regulations can restrict opportunities and choices, which also impose opportunity costs. Nonetheless, the expenditures of federal regulatory agencies (as tracked in this report), and the trends in that regulatory spending over time, can serve as a useful barometer of regulatory activity, providing policy makers and others with useful insights into the composition and evolution of regulation.

The Office of Management and Budget, in a recent draft report to Congress, estimated that the annual costs to society of major federal regulations issued between 1992 and 2002 ranged from $38 billion to $44 billion. This is only slightly higher than the direct budget costs of administering regulation, which our analysis of the fiscal budget indicates was $24 billion in 2002. If accurate, OMB's estimate suggests that Americans spend about $1.50 in compliance costs for every $1.00 in tax costs devoted to regulation. Other, more comprehensive, estimates, however, suggest that for every dollar of direct budget expenditure devoted to regulatory activity, the private sector (individuals as consumers, investors, workers, etc.) spends $45 in compliance.[2]

President George W. Bush's budget for 2004 requests expenditures on regulatory activities of $28.9 billion in fiscal year 2004. This reflects a 4 percent decrease from estimated actual budgeted expenditures of $30.1 billion in fiscal year 2003. Estimated 2003 expenditures were almost 15 percent higher than fiscal year 2002 expenditures.

---

[1] Susan Dudley is a Senior Research Fellow and Deputy Director of the Regulatory Studies Program at the Mercatus Center at George Mason University. Melinda Warren is Director of the Weidenbaum Center Forum at Washington University.

[2] Professors Mark Crain and Thomas Hopkins estimate that Americans spent $843 billion in 2000 to comply with federal regulations. In comparison, the direct combined budget of the 60 federal regulatory agencies tracked in this report was $18.9 billion in 2000. W. Mark Crain and Thomas D. Hopkins, *The Impact of Regulatory Costs on Small Firms*, Office of Advocacy, U. S. Small Business Administration, RFP No. SBAHQ-00-R-0027. 2001.

Staffing in the FY 2004 budget request is 3,074 full-time equivalent people less than in 2003. However, staffing in 2003 was 62,340 full-time employees greater than 2002, due in large part to the airport screening employees hired at the Transportation Security Administration. Total staffing of the regulatory agencies is budgeted to be 195,284 in 2003, and 192,210 in 2004.

The remaining sections of this report provide more detail on the types of regulatory activities that comprise these figures. We examine expenditures in nominal and real (constant 1996) dollars, as well as staffing levels by agency and regulatory category.

Overview of the 2003 and 2004 Regulatory Budget

As has been the practice in past reports, this report divides federal regulatory activities into two main categories. The first category, social regulations, are designed to address issues related to health, safety, and the environment. The Environmental Protection Agency, the Occupational Safety and Health Administration, the Food and Drug Administration, and the National Transportation Safety Board are examples of agencies that administer social regulations. Their activities are generally limited to a specific issue, but they also have the power to regulate across industry boundaries. This report further divides the social regulation category into (1) consumer safety and health, (2) transportation, (3) job safety and other working conditions, (4) environment, and (5) energy. We began separating transportation-related regulatory activities from the consumer safety and health category last year, since they had increased relative to other activities, particularly after September 11, 2001. In 1990, transportation-related regulatory expenditures were below 15 percent of the total regulatory budget. This year, when we include the budget of the Transportation Safety Administration, the budget request for transportation-related regulatory activity represents the largest category at 36 percent of the total regulatory budget.

Economic regulations, which make up the second category, tend to be industry-specific. The Securities and Exchange Commission, the Federal Communications Commission, and the Federal Energy Regulatory Commission are examples of agencies that fall into the economic regulation category. They regulate a broad base of activities in particular industries using economic controls such as price ceilings or floors, quantity restrictions, and service parameters. The economic regulation category is divided into three subcategories: (1) finance and banking, (2) industry-specific regulation, and (3) general business. Note that the industry-specific regulation category includes economic regulation of transportation and energy industries.

Spending

Table 1 summarizes spending for regulatory activities by category and subcategory for decennial years from 1960 to 2000, as well as annually from 2001 through 2004. Note that figures for 2003 and 2004 are estimates. The 2003 figures reflect the budget that was appropriated by Congress for the current year, while the 2004 figures reflect the budget requested by the President.

The budget request for social regulation is $23.2 billion in fiscal year 2004, a nominal decrease of 5.9 percent from the budget Congress appropriated for FY 2003. In real terms, the budgets of social regulatory agencies are estimated to have increased 13.9 percent between 2002 and 2003, while the 2004 budget request reflects a 7.3 percent decline from 2003 actual budgets.

The largest projected real percentage increase in 2003 occurred in agencies that regulate the environment and the transportation sector, with real increases of 17.8 percent and 17.3 percent respectively. The budget request for 2004 includes an increase only in the job safety and other working conditions category (1.5 percent in real terms). All the other areas see a decline under the President's budget request.

The budgets of agencies in the economic regulatory category are smaller than their counterparts involved in social regulatory activity. The budget request for economic regulatory activities is $5.7 billion in 2004, a nominal increase of almost 4 percent over the appropriated 2003 budget. The 2003 budget is expected to reach $5.5 billion by the end of the fiscal year, a real increase of 10.4 percent over 2002. In real terms, the budgets of economic regulatory agencies are projected to increase by 2.2 percent between 2003 and 2004. Activities classified in the general business subcategory are estimated to receive the largest real increases—16.1 percent in 2003 and another 4.0 percent in 2004.

Overall, federal spending on regulatory activities is budgeted to decline by 5.6 percent in 2004 from the appropriated 2003 budget. This follows appropriated increases of 23.5 percent in 2002 and 13.2 percent in 2003.

Table 1

Spending Summary for the Federal Regulatory Agencies, Selected Years

(Fiscal Years, Millions of Dollars in "Obligations")

	1960	1970	1980	1990	2000	2001	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
					Current (Nominal) Dollars						
Social Regulation											
Consumer Safety and Health	$111	$236	$1,245	$1,908	$3,672	$4,272	$4,427	$4,845	$4,734	9.4%	-2.3%
Transportation	86	284	1,037	1,727	3,239	3,703	8,511	10,124	10,027	19.0%	-1.0%
Job Safety and Workplace	35	128	753	1,002	1,450	1,642	1,624	1,648	1,699	1.5%	3.1%
Environment	21	214	1,651	4,164	5,641	6,049	6,088	7,276	6,021	19.5%	-17.2%
Energy	12	64	481	485	610	661	690	759	719	10.0%	-5.3%
Total Social Regulation	$265	$926	$5,167	$9,286	$14,612	$16,327	$21,340	$24,652	$23,200	15.5%	-5.9%
Economic Regulation											
Finance and Banking	$30	$86	$362	$1,362	$1,868	$1,871	$1,879	$2,008	$2,043	6.9%	1.7%
Industry-Specific Regulation	102	281	492	497	729	826	836	911	942	9.0%	3.4%
General Business	47	115	355	743	1,717	2,003	2,151	2,533	2,673	17.8%	5.5%
Total Economic Regulation	$179	$482	$1,209	$2,602	$4,314	$4,700	$4,866	$5,452	$5,658	12.0%	3.8%
GRAND TOTAL	$444	$1,408	$6,376	$11,888	$18,926	$21,027	$26,206	$30,104	$28,858	14.9%	-4.1%
Annualized Percentage Change		11.7%	17.0%	6.5%	4.8%	11.1%	24.6%	14.9%	-4.1%		
					Constant (Real) 1996 Dollars						
Social Regulation											
Consumer Safety and Health	$500	$812	$2,182	$2,205	$3,435	$3,904	$4,008	$4,324	$4,161	7.9%	-3.8%
Transportation	388	978	1,818	1,996	3,030	3,384	7,705	9,034	8,814	17.3%	-2.4%
Job Safety and Workplace	157	441	1,320	1,158	1,357	1,501	1,471	1,471	1,493	0.0%	1.5%
Environment	95	737	2,894	4,812	5,277	5,528	5,511	6,493	5,293	17.8%	-18.5%
Energy	54	220	843	560	571	604	625	677	632	8.4%	-6.7%
Total Social Regulation	$1,194	$3,188	$9,057	$10,732	$13,670	$14,922	$19,319	$21,999	$20,394	13.9%	-7.3%
Economic Regulation											
Finance and Banking	$135	$296	$635	$1,574	$1,748	$1,710	$1,701	$1,792	$1,796	5.3%	0.2%
Industry-Specific Regulation	460	967	862	574	682	755	757	813	828	7.4%	1.9%
General Business	212	396	622	859	1,606	1,831	1,947	2,260	2,350	16.1%	4.0%
Total Economic Regulation	$807	$1,659	$2,119	$3,007	$4,036	$4,295	$4,405	$4,865	$4,974	10.4%	2.2%
GRAND TOTAL	$2,001	$4,847	$11,176	$13,739	$17,706	$19,217	$23,725	$26,864	$25,367	13.2%	-5.6%
Annualized Percentage Change		9.1%	9.8%	2.2%	2.6%	8.5%	23.5%	13.2%	-5.6%		

Note: Numbers may not add to totals due to rounding.

Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Staffing

Table 2 summarizes the staffing at Federal regulatory agencies between 1970 and 2004. The FY 2004 budget request reduces staffing at agencies engaged in social regulatory activities by 2.4 percent. Staffing levels in FY 2003, however, reflect an increase of 61.2 percent over the previous year, largely due to the over 56,000 new employees brought on as airport baggage screeners under the auspices of the Transportation Security Administration. Staffing at social regulatory agencies is estimated at 160,831 in 2003 and is projected to be 156,941 full-time equivalent employees in 2004.

The economic regulatory agencies have fewer staff than the social regulatory agencies. Personnel is projected to increase by 2.4 percent in 2004 to 35,269 full-time equivalent employees.

Table 2

Staffing Summary for the Federal Regulatory Agencies, Selected Years
(Fiscal Years, Full-time Equivalent Employment)

	1970	1980	1990	2000	2001	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Social Regulation										
Consumer Safety and Health	13,912	33,242	28,730	31,150	32,141	30,513	32,792	32,861	7.5%	0.2%
Transportation	14,678	19,824	18,388	25,724	23,649	28,992	87,761	83,571	202.7%	-4.8%
Job Safety and Other Working Conditions	6,486	17,894	13,610	12,141	12,218	12,340	12,311	12,465	-0.2%	1.3%
Environment	4,525	16,993	20,057	24,555	24,814	24,950	24,873	24,964	-0.3%	0.4%
Energy	219	3,225	3,293	2,923	2,897	2,977	3,094	3,080	3.9%	-0.5%
Total Social Regulation	39,820	91,178	84,078	96,493	95,719	99,772	160,831	156,941	61.2%	-2.4%
Economic Regulation										
Finance and Banking	4,969	9,524	16,353	14,188	13,240	13,451	13,269	13,252	-1.4%	-0.1%
Industry-Specific Regulation	18,548	11,885	7,977	6,438	6,384	6,464	6,595	6,569	2.0%	-0.4%
General Business	6,609	9,251	9,611	12,509	12,839	13,257	14,589	15,448	10.0%	5.9%
Total Economic Regulation	30,126	30,660	33,941	33,135	32,462	33,172	34,453	35,269	3.9%	2.4%
GRAND TOTAL	69,946	121,838	118,019	129,628	128,181	132,944	195,284	192,210	46.9%	-1.6%
Annualized Percentage Change		6.2%	-0.2%	1.0%	-1.1%	3.7%	46.9%	-1.6%		

Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University.
Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Changes from previous reports

Beginning with last year's report covering fiscal years 2002 and 2003, we now separate transportation-related spending and staffing from other consumer safety and health regulatory activities. Last year, we excluded from this transportation category spending and staffing associated with the new Transportation Security Administration (TSA), which is now part of the Department of Homeland Security. Congress created the TSA in November 2001 to take full control of all passenger and airline baggage screening operations at airports. We did not include TSA expenditures in our tables last year on the grounds that its activities largely replace, rather than regulate, private sector activities.

However, on reflection, there are various activities that we think of as regulatory today that were once conducted by private parties. For example, we include federal meat inspectors employed by the FDA in our tallies of regulatory costs. The activities of the TSA are analogous, as it regulates private activity by checking passengers and their luggage.

The line delineating what is a regulatory function from other federal activities is not always a bright one. In this report, we are including the spending and staffing of the TSA in our totals. The totals for 2002 and 2003 have also been adjusted to reflect this change.

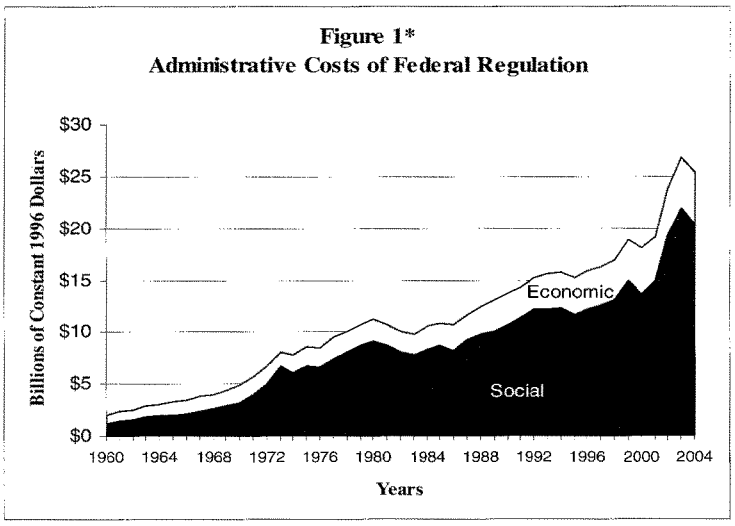
Trends in Federal Regulatory Spending, 1960 – 2004

Figure 1 graphs the changes in real (adjusted for inflation) regulatory expenditures since 1960. While spending has generally increased over time, the rate of growth has varied depending on the philosophies of elected officials in the executive and legislative branches of the federal government. In the early years of the Reagan administration, regulatory expenditures declined.

The 1960s were characterized by very rapid growth in regulatory expenditures. Total spending at federal regulatory agencies increased by $2.8 billion between 1960 and 1970. This represents a real annual growth rate of 9.3 percent and a total increase of 142 percent over the decade. Most of this growth—almost $2 billion—occurred in social regulatory agencies. Economic regulatory programs expanded more slowly, by $0.9 billion.

This trend continued in the 1970s. Over that decade, spending at regulatory agencies grew by $6.3 billion or 131 percent (9.0 percent per year on average). Social regulatory expenditures continued to grow rapidly and increased by $5.9 billion while economic agencies showed a much smaller increase of $0.4 billion. Most of the growth occurred in the early part of the decade, when several of the significant social regulatory agencies (particularly the Environmental Protection Agency and the Occupational Safety and Health Administration) were formed. Double-digit increases in the first three years were followed by much slower growth in the budgets of both social and economic regulatory agencies during the latter part of the decade.

This slower rate of growth continued into the early 1980s. Total spending on regulatory programs declined by 3 percent between 1980 and 1985, but picked up again in the second half of the decade, increasing by 27 percent overall between 1985 and 1990. Throughout the decade, spending on economic regulation increased at a faster rate—41.9 percent between 1980 and 1990—than spending on social regulation, which grew by 18.5 percent over the same period. On an annual average basis, spending increased by 2.2 percent per year over the decade.



* 2003 estimates reflect the budget appropriated by Congress for the current year. 2004 estimates reflect the budget requested by the President.

Regulatory spending continued to increase in the 1990s, for a total increase of 29 percent over the decade. The budgets of agencies administering economic regulations increased by 34 percent, and the budgets of agencies involved in social regulation increased by 27 percent. The first half of the decade witnessed slightly greater percentage increases than the second half—15 percent overall between 1990 and 1995, compared to 11.6 percent between 1995 and 2000. On an annual basis, the real rate of increase averaged 2.6 percent over the decade.

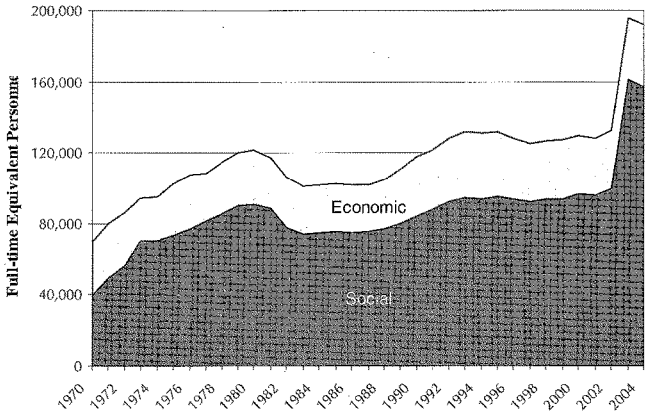
Budgets devoted to regulatory agencies have grown over 50 percent in real terms between 2000 and 2003. The annual average increase of 15 percent for this period is the highest since the early 1970s. The President's budget request for 2004 calls for a 5.6 percent decline.

Trends in Federal Regulatory Staffing, 1970 – 2004

Figure 2 shows the trends in staffing at federal regulatory agencies over the past 35 years. Over the decade of the 1970s, the number of personnel at regulatory agencies grew by nearly 52,000, or 74.2 percent. Social regulatory agencies gained almost 51,400 new personnel, and economic agencies added over 500 new staff members.

Staffing at regulatory agencies was cut back significantly in the early 1980s, so that between 1980 and 1985, staffing at regulatory agencies declined by 16.1 percent (almost 17 percent at the social agencies and almost 14 percent at the economic regulatory agencies). Starting in 1988, additional staff was added to regulatory agency budgets, and the second half of the decade saw increases of 11 percent for social regulatory agencies and 28 percent for the economic regulatory agencies—an increase of over 15 percent between 1985 and 1990. By 1990, staffing at federal regulatory agencies was about 3 percent lower than it had been in 1980 (almost 4,000 employees). Social agencies lost nearly 8 percent of their staff, while economic regulatory staff grew by over 10 percent during this decade.

Figure 2
Staffing of Federal Regulatory Agencies



The staffing increases that began in the late 1980s continued in the 1990s. Between 1990 and 1995, full-time equivalent personnel at regulatory agencies increased by 11.7 percent overall, with increases of 13.0 percent at economic regulatory agencies and 8.4 percent in social regulatory agencies. After staffing reductions in 1996 and 1997, the decade ended with 11,609 new federal regulatory employees (a 10 percent increase). Social agencies

added 12,415 employees (almost 15 percent increase) while economic agencies declined by 2.5 percent (806 people).

After a 1 percent reduction in staffing at regulatory agencies in 2001, 2002 saw an overall increase of 3.7 percent. The establishment of the Transportation Security Administration, with its large staff of airport screening agents, caused the federal workforce to jump 46.9 percent in 2003, by far the largest increase in the nation's history. The budget request for 2004 calls for a slight decline in federal personnel from 195,284 to 192,210.

Summary of Federal Regulatory Activity for FY 2003 and 2004

The Budget Message of the President identifies three national priorities: "winning the war against terrorism, securing the homeland, and generating long-term economic growth." These priorities are reflected in the budgets of regulatory agencies tracked here. The President's message also stresses fiscal restraint and imposing "spending discipline in Washington D.C." to meet priorities. Overall, the budget request for 2004 reflects a decline in spending (5.6 percent) and staffing (1.6 percent) at regulatory agencies. Congress will likely alter the total FY 2004 budget as well as the priorities within the budget. The FY 2003 budget estimate reflects a 13 percent increase over 2002. Note that the percentage change shown below are presented in real (1996 dollar) terms while the dollar amounts are in nominal terms.

Social Regulation

About 80 percent of the administrative costs of federal regulation in 2004 are for social regulation. We divide these social regulatory agencies into five subcategories. Table 1 shows that spending on "consumer safety and health" is estimated to reach $4.8 billion by the end of fiscal year 2003 (a 7.9 percent increase, after adjusting for inflation) and is budgeted at $4.7 billion in 2004 (a 3.8 percent real decline). The real budget of the "transportation" subcategory increased 17.3 percent in 2003, to $10.1 billion. The current budget request calls for a 2.4 percent decline to $10.0 billion in fiscal year 2004. Spending in the "job safety and other working conditions" category is about $1.6 billion in 2003, increasing by 1.5 percent to $1.7 billion in 2004. Agencies in the "environment" category experienced the largest real spending increases (17.8 percent) to $7.3 billion in 2003, but are budgeted to return close to 2002 levels of $6.0 billion in 2004 (an 18.5 percent decline). Spending in the "energy" category increased by 8.4 percent to reach $759 million in 2003. The current budget request is for a decline of 6.7 percent in 2004 to $719 million.

Appendix Tables A-1 through A-3 provide detail on spending and staffing at agencies within each category and subcategory. Overall, spending at the agencies involved in social regulation increased 13.9 percent in real terms between fiscal years 2002 and 2003. The 2004 budget request anticipates reductions of 7.3 percent for these social regulatory programs.

Leading the increase in the FY 2003 budget were the Transportation Security Administration, with a 28.7 percent inflation-adjusted increase over 2002, and the

Environmental Protection Agency, with a 25.4 percent real increase. Both received increases of about $1 billion in 2003, but are slated for reductions in 2004. TSA's budget request for 2004 is $4.8 billion, down from $5.3 billion. EPA's is also $4.8 billion, down from $6.1 billion.

Figure 3 shows the percentage of the total social regulatory budget allocated to each category of social regulation over the last four decades. After the terrorist attacks of September 11, 2001, spending on regulatory activities related to transportation increased significantly, causing the transportation category to exceed the environment category for the first time since the 1970s. Last year, we noted that the budget request for FY2003 called for giving the Department of Transportation a larger budget ($5.8 billion) for administering federal regulation than EPA ($4.3 billion), for the first time since 1976. In fact, the estimated actual spending for regulatory activities at EPA in 2003 was $6.1 billion, compared to DOT's $2.0 billion. This is due in part to the fact that the Coast Guard, which made up the bulk of DOT's regulatory budget, was transferred to the Department of Homeland Security. It also reflects actual budget increases for EPA that were significantly larger than the budget request.

Figure 3
Distribution of Social Regulation Budget

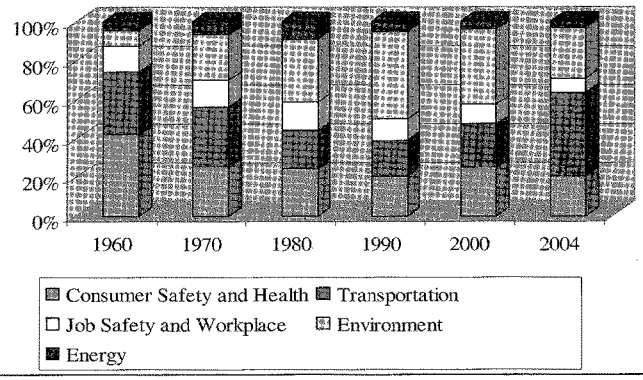


Table 2 provides an overview of changes in personnel for each subcategory. Table A-3 provides staffing detail by agency. Staffing in the "transportation" subcategory saw the largest increase in 2003, due to the newly nationalized workforce of 59,494 at the Transportation Security Administration. Full-time equivalent staff at agencies regulating transportation are budgeted to decline by 4.8 percent in FY 2004, to 83,571. "Consumer safety and health" agencies should see a 7.5 percent increase in staffing (2,279 people) by the end of FY 2003, and are budgeted to increase regulatory staff by another 69 full-time equivalents or 0.2 percent in 2004. Under the FY 2004 budget, the regulatory work force

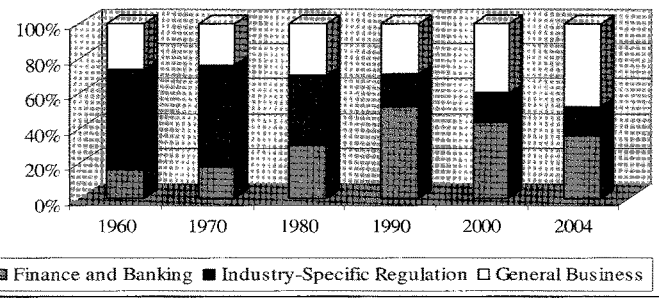
at "job safety and other working conditions" agencies would grow by 1.3 percent in 2004, an increase of 154 full-time staff. This comes after a decline of 29 positions (0.2 percent) in 2003. Agencies regulating "environment" activities are estimated to lose 77 positions in 2003 and are budgeted to add 91 full-time positions, for a 0.4 percent increase in 2004. After staffing increases of 3.9 percent at "energy" agencies in 2003, regulatory staffing faces a 0.4 percent decline in budgeted personnel, or a reduction of 14 full-time equivalents, in 2004.

Economic Regulation

Economic regulatory agencies are divided into three subcategories. The budget for regulatory activity in the "finance and banking" subcategory increased 5.3 percent (after inflation) in 2003 to $2.0 billion. The 2004 budget request calls for a 0.2 percent increase. The budget for "industry-specific regulation" increased at a real rate of 7.4 percent, reaching $0.9 billion in 2003. An additional 1.9 percent increase is included in the 2004 budget. "General business" regulation experienced the largest increase in 2003 (16.1 percent), with a total budget of $2.5 billion. The 2004 budget calls for an additional 4.0 percent real increase.

The Patent and Trademark Office and the Securities and Exchange Commission saw the largest dollar increases in 2003. While the PTO is slated for a reduction in FY 2004, the SEC budget requests an additional $250 million (a 39.6 percent increase) in 2004. (See Table A-1 and A-2 for agency level spending detail.) This large increase reflects the increased attention to corporate accounting and reporting practices in response to recent highly publicized cases and allegations of securities and accounting fraud.

Figure 4
Distribution of Economic Regulation Budget



The percentage of the budget devoted to agencies administering economic regulations has declined since the 1970s. In 1960, 40 percent of federal regulatory spending was for economic programs. In 2004, less than 20 percent will be spent on these programs. The economic deregulation that began in the mid-1970s with deregulation of airlines,

trucking, and other industries continues today. As Figure 4 illustrates, budgets directed at administering industry specific regulations in particular have declined. Since the mid-1980s, these activities have occupied under 5 percent of the total regulatory budget. The "general business" category has grown the most over the last few years, largely due to the large increases in the SEC's budget.

Agency staffing details presented in Table A-3 are consistent with spending patterns. The "finance and banking" agencies expect declines in personnel between 2002 and 2004, and the "general business" category will receive the largest increases in staffing, driven largely by staffing at the SEC.

Conclusion

Spending for regulatory activities in the FY 2004 *Budget of the United States Government* reflects national concerns about homeland security, particularly as it relates to the transportation infrastructure, and the highly publicized securities and accounting scandals of the last few years. In 2003, budget expenditures directed toward regulatory activities represented 1.4 percent of the total federal budget, the highest percentage since 1980. The FY 2004 budget request reflects a slightly lower percentage (1.3 percent) of the total budget directed toward writing, administering, and enforcing regulations.

The largest increases in spending in 2003 were at the newly formed Department of Homeland Security, which enforces regulations through the Coast Guard and the Transportation Security Administration. Both Homeland Security and the Environmental Protection Agency received over $1 billion in additional spending in 2003. The Patent and Trademark Office and the Securities and Exchange Commission also experienced budget increases of over $100 million each in 2003. Of these agencies, only the Coast Guard and SEC are slated for additional increases in FY 2004.

The administrative expenditures of federal regulation will likely reach an all-time high of $30.1 billion by the end of fiscal year 2003. The budget request for 2004 would reduce that amount slightly to $28.9 billion, however, as in years past, Congress may appropriate more than requested. Adjusted for inflation, this represents a real growth of almost 13.2 percent between 2002 and 2003, and a decline of 5.6 percent in 2004. Budget figures for 2002 reveal that spending on regulatory administration and enforcement increased 23.5 percent that year—the highest real increase since 1973.

Staffing at the federal regulatory agencies is expected to peak at 195,284 in 2003 and decline slightly to 192,210 in 2004. Due largely to the new federal staff engaged in airport screening at the Transportation Security Administration, the 2003 peak is 46.9 percent higher than staffing levels in 2002.

Appendix

The Weidenbaum Center at Washington University has monitored trends in federal regulation for 28 years and has compiled 44 years of data on the administrative expenses of federal regulation. In 2002, the Mercatus Center at George Mason University joined the Weidenbaum Center to prepare this annual report on the regulatory administration and enforcement costs embodied in the annual budget of the United States.

New data for this report were drawn from the *Budget of the United States, Fiscal Year 2004* and supporting documents. This budget, also known as "the President's Budget," is presented to Congress approximately seven months prior to the beginning of each fiscal year (e.g. fiscal year 2004 begins October 1, 2003 and ends September 30, 2004). In this report, all references to specific years refer to fiscal years unless otherwise noted.

Budget figures for the 60 regulatory agencies contained in Table A-1 consist of "obligations incurred," the statistical measure in the budget document which is shown in greatest detail. These data are expressed in current dollars, rounded to the nearest million. Table A-2 provides comparable information in real terms (constant 1996 dollars). Because these numbers are rounded to the nearest million, the numbers do not necessarily add to totals.

The data on obligations provide a clear picture of the resources a regulatory agency directs to regulation in a given year. For example, some agencies are funded, partly or totally, by fees collected from businesses and individuals and these fee structures have changed over the years. The obligations are gross of fees collected.

The staffing figures shown in Table A-3 are derived from the full-time equivalent employment numbers for each agency. For example, two employees, each working half time, are counted as one full-time equivalent.

Tables A-4 and A-5 give data from 1960 to 2004 for obligations incurred in current and constant dollars for major categories of regulation. Staffing data from 1970 to 2004 are given in Table A-6. Detailed agency-by-agency data are available and can be obtained by writing to the Weidenbaum Center at Washington University or the Mercatus Center at George Mason University.

Agencies that primarily perform taxation, entitlement, procurement, subsidy, and credit functions are excluded from this report. Examples of these organizations are the Internal Revenue Service, the Social Security Administration, the Department of Defense, the Commodity Credit Corporation, and the Federal Housing Administration.

The notes to the appendix, which follow the appendix tables, give background on organizational changes since the Weidenbaum Center began tracking trends in regulatory budgets and staffing in 1975. Some agencies have been abolished while others have been created. Names of agencies have changed over time. These notes help the reader make sense of name and other changes that have occurred over the years.

Table A-1
Agency Detail of Spending on Federal Regulatory Activities: Current Dollars
(Fiscal Years, Millions of Dollars in "Obligations")

Agency	1960	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
SOCIAL REGULATION										
Consumer Safety and Health										
Consumer Product Safety Commission	n/o	n/o	43	35	52	59	61	64	3.4%	4.9%
Department of Agriculture:										
Animal and Plant Health Inspection Service (1)	69	101	259	423	867	948	1,091	830	15.1%	-23.9%
Food Safety and Inspection Service (2)	n/o	n/o	381	475	734	808	865	899	7.1%	3.9%
Grain Inspection, Packers and Stockyards (3)	n/o	3	63	52	61	67	82	84	22.4%	2.4%
Subtotal	69	104	703	950	1,662	1,823	2,038	1,813	11.8%	-11.0%
Department of Health and Human Services:										
Food and Drug Administration	15	80	334	603	1,239	1,574	1,686	1,748	7.1%	3.7%
Department of Housing and Urban Development:										
Consumer Protection Programs (4)	n/o	n/o	4	6	15	8	15	17	87.5%	13.3%
Department of Justice:										
Drug Enforcement Administration (5)	n/o	2	13	28	74	79	114	119	44.3%	4.4%
Bureau of Alcohol, Tobacco, Firearms, and Explosives (6)	27	50	144	282	616	795	835	875	5.0%	4.8%
Subtotal	27	52	157	310	690	874	949	994	8.6%	4.7%
Department of Homeland Security: (7)										
Alcohol and Tobacco Tax and Trade Bureau	n/o	n/o	n/o	n/o	n/o	74	81	81	9.5%	0.0%
Chemical Safety and Hazard Investigation Board (8)	n/o	n/o	n/o	n/o	8	8	8	9	0.0%	12.5%
Federal Mine Safety and Health Review Commission	n/o	n/o	4	4	6	7	7	8	0.0%	14.3%
TOTAL--Consumer Safety and Health	111	236	1,245	1,908	3,672	4,427	4,845	4,734	9.4%	-2.3%
Transportation (9)										
Department of Homeland Security: (10)										
Coast Guard	45	94	498	909	1,717	2,127	2,751	3,070	29.3%	11.6%
Transportation Security Administration (13)	n/o	n/o	n/o	n/o	n/o	4,080	5,330	4,812	30.6%	-9.7%
Subtotal	45	94	498	909	1,717	6,207	8,081	7,882	30.2%	-2.5%
Department of Transportation:										
Federal Aviation Administration	41	126	281	495	924	1,436	1,146	1,153	-20.2%	0.7%
Federal Highway Administration	n/o	6	20	98	9	16	17	17	6.3%	0.0%
Federal Motor Carrier Safety Administration (11)	n/o	n/o	n/o	n/o	187	367	377	457	2.7%	21.2%
Federal Railroad Administration	n/o	21	85	56	120	157	158	168	0.6%	6.3%
National Highway Traffic Safety Administration	n/o	32	136	142	192	242	256	259	5.8%	1.2%
Surface Transportation Board (12)	n/o	n/o	n/o	n/o	17	18	19	20	5.6%	5.3%
Subtotal	41	185	522	791	1,449	2,236	1,973	2,074	-11.8%	5.1%
National Transportation Safety Board	n/o	5	17	27	73	68	70	71	2.9%	1.4%
TOTAL--Transportation	86	284	1,037	1,727	3,239	8,511	10,124	10,027	19.0%	-1.0%
Job Safety and Other Working Conditions										
Department of Labor:										
Employment Standards Administration (14)	14	37	124	155	232	247	260	252	5.1%	-3.2%
Office of the American Workplace (15)	n/o	12	55	79	n/o	n/o	n/o	n/o	-	-
Employee Benefits Security Administration (16)	n/o	n/o	n/o	n/o	106	118	134	146	13.6%	9.0%
Mine Safety and Health Administration (17)	6	27	144	167	228	254	256	269	0.8%	5.1%
Occupational Safety and Health Admin.	n/o	n/o	191	267	385	446	439	454	-1.6%	3.4%
Subtotal	20	76	514	668	951	1,065	1,089	1,121	2.2%	2.9%

Table A-1 (continued)

Agency Detail of Spending on Federal Regulatory Activities: Current Dollars

(Fiscal Years, Millions of Dollars in "Obligations")

Agency	1960	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Architectural and Transportation Barriers Compliance Board	n/o	n/o	n/o	2	5	5	5	5	0.0%	0.0%
Equal Employment Opportunity Commission	n/o	13	124	185	281	320	311	320	-2.8%	2.9%
National Labor Relations Board	15	39	108	141	205	226	233	243	3.1%	4.3%
Occupational Safety and Health Review Commission	n/o	n/o	7	6	8	8	10	10	25.0%	0.0%
TOTAL--Job Safety and Other Working Conditions	35	128	753	1,002	1,450	1,624	1,648	1,699	1.5%	3.1%
Environment										
Council on Environmental Quality	n/o	n/o	8	1	3	3	3	3	0.0%	0.0%
Department of Agriculture: (18)										
Forest and Rangeland Research	n/o	n/o	n/o	n/o	245	290	276	275	-4.8%	-0.4%
Department of Defense:										
Army Corps of Engineers (19)	1	2	41	64	112	134	148	148	10.4%	0.0%
Department of Interior:										
Fish and Wildlife Service (20)	3	7	68	159	247	283	277	277	-2.1%	0.0%
Office of Surface Mining Reclamation and Enforcement (21)	n/o	n/o	174	346	436	454	359	360	-20.9%	0.3%
U.S. Geological Survey (22)	n/o	n/o	n/o	n/o	135	166	163	169	-1.8%	3.7%
Subtotal	3	7	242	505	818	903	799	806	-11.5%	0.9%
Environmental Protection Agency (23)	17	205	1,360	3,594	4,463	4,758	6,050	4,789	27.2%	-20.8%
TOTAL -- Environment	21	214	1,651	4,164	5,641	6,088	7,276	6,021	19.5%	-17.2%
Energy										
Department of Energy:										
Petroleum Regulation	n/o	n/o	n/o	13	23	34	40	41	17.6%	2.5%
Federal Inspector for the Alaska Natural Gas Pipeline (24)	n/o	n/o	8	n/o	n/o	n/o	n/o	n/o	-	-
Energy Conservation (25)	0	0	77	38	111	103	99	53	-3.9%	-46.5%
Subtotal	n/o	n/o	85	51	134	137	139	94	1.5%	-32.4%
Nuclear Regulatory Commission (26)	12	64	396	434	476	553	620	625	12.1%	0.8%
TOTAL--Energy	12	64	481	485	610	690	759	719	10.0%	-5.3%
TOTAL SOCIAL REGULATION	265	926	5,167	9,286	14,612	21,340	24,652	23,200	15.5%	-5.9%
ECONOMIC REGULATION										
Finance and Banking										
Department of the Treasury:										
Comptroller of the Currency	11	32	113	261	396	417	439	459	5.3%	4.6%
Office of Thrift Supervision	n/o	n/o	n/o	275	156	155	156	160	0.6%	2.6%
Subtotal	11	32	113	536	552	572	595	619	4.0%	4.0%
Farm Credit Administration	2	4	12	36	35	34	38	38	11.8%	0.0%
Federal Deposit Insurance Corporation	13	38	113	495	572	593	643	651	8.4%	1.2%
Federal Housing Finance Board (27)	n/o	n/o	n/o	7	19	23	27	28	17.4%	3.7%
Federal Reserve System (28)										
Federal Reserve Banks (29)	n/o	n/o	86	212	537	471	504	504	7.0%	0.0%
Federal Reserve System Board of Governors	1	5	20	30	78	96	105	105	9.4%	0.0%
Subtotal	1	5	106	242	615	567	609	609	7.4%	0.0%
National Credit Union Administration	3	7	18	46	75	90	96	98	6.7%	2.1%
TOTAL--Finance and Banking	30	86	362	1,362	1,868	1,879	2,008	2,043	6.9%	1.7%

Table A-1 (continued)
Agency Detail of Spending on Federal Regulatory Activities: Current Dollars
(Fiscal Years, Millions of Dollars in "Obligations")

Agency	1960	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Industry-Specific Regulation										
Department of Agriculture:										
Agriculture Marketing Service (30)	53	190	67	160	212	219	249	255	13.7%	2.4%
Department of the Energy:										
Economic Regulatory Administration (31)	n/o	n/o	146	17	2	2	1	1	-50.0%	0.0%
Civil Aeronautics Board (32)	7	11	29	n/o	n/o	n/o	n/o	n/o	-	-
Commodity Futures Trading Commission (33)	1	2	17	39	63	75	80	88	6.7%	10.0%
Federal Communications Commission	11	25	76	108	264	333	372	381	11.7%	10.0%
Federal Energy Regulatory Commission (34)	7	18	68	114	173	191	192	199	0.5%	2.4%
Federal Maritime Commission	n/o	4	11	15	15	16	17	18	6.3%	5.9%
Interstate Commerce Commission (35)	20	27	78	44	n/o	n/o	n/o	n/o	-	-
Renegotiation Board (36)	3	4	n/o	n/o	n/o	n/o	n/o	n/o	-	-
TOTAL--Industry-Specific Regulation	102	281	492	497	729	836	911	942	9.0%	3.4%
General Business										
Cost Accounting Standards Board (37)	n/o	n/o	1	n/o	n/o	n/o	n/o	n/o	-	-
Council on Wage and Price Stability (38)	n/o	n/o	9	n/o	n/o	n/o	n/o	n/o	-	-
Department of Commerce:										
International Trade Administration (39)	3	6	16	20	33	45	51	53	13.3%	3.9%
Bureau of Industry and Security (40)	n/o	n/o	n/o	43	61	68	88	84	29.4%	-4.5%
Patent and Trademark Office	22	49	105	327	895	1,144	1,334	1,203	16.6%	-9.8%
Subtotal	25	55	121	390	989	1,257	1,473	1,340	17.2%	-9.0%
Department of Justice:										
Antitrust Division	4	10	49	48	110	114	138	142	21.1%	2.9%
Federal Election Commission	n/o	n/o	9	15	38	44	45	50	2.3%	11.1%
Federal Trade Commission	7	21	66	70	126	157	184	192	17.2%	4.3%
International Trade Commission (41)	2	4	14	38	47	53	54	58	1.9%	7.4%
Library of Congress:										
Copyright Office	1	3	14	20	35	37	45	49	21.6%	8.9%
Securities and Exchange Commission	8	22	72	162	372	489	594	842	21.5%	41.8%
TOTAL--General Business	47	115	355	743	1,717	2,151	2,533	2,673	17.8%	5.5%
TOTAL ECONOMIC REGULATION	179	482	1,209	2,602	4,314	4,866	5,452	5,658	12.0%	3.8%
GRAND TOTAL	444	1,408	6,376	11,888	18,926	26,206	30,104	28,858	14.9%	-4.1%

Notes:
L = less than $500,000
n/o = agency not operational

(1) through (41): see notes at the end of the Appendix

Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Table A-2

Agency Detail of Spending on Federal Regulatory Activity: Constant 1996 Dollars

(In Millions of Constant 1996 Dollars)

Agency	1960	1970	1980	1990	2000	2002	2003	(Estimated) 2004	% Change 2002-2003	% Change 2003-2004
SOCIAL REGULATION										
Consumer Safety and Health										
Consumer Product Safety Commission	n/o	n/o	75	40	49	53	54	56	1.9%	3.4%
Department of Agriculture:										
Animal and Plant Health Inspection Service (1)	311	348	454	489	811	858	974	730	13.4%	-25.1%
Food Safety and Inspection Service (2)	n/o	n/o	668	549	687	731	772	790	5.5%	2.4%
Grain Inspection, Packers and Stockyards (3)	n/o	10	110	60	57	61	73	74	20.6%	0.9%
Subtotal	311	358	1,232	1,098	1,555	1,650	1,819	1,594	10.2%	-12.4%
Department of Health and Human Services:										
Food and Drug Administration	68	275	585	697	1,159	1,425	1,505	1,537	5.6%	2.1%
Department of Housing and Urban Development:										
Consumer Protection Programs (4)	n/o	n/o	7	7	14	7	13	15	84.8%	11.6%
Department of Justice:										
Drug Enforcement Administration (5)	n/o	7	23	32	69	72	102	105	42.2%	2.8%
Bureau of Alcohol, Tobacco, Firearms, and Explosives (6)	122	172	252	326	576	720	745	769	3.5%	3.2%
Subtotal	122	179	275	358	646	791	847	874	7.0%	3.2%
Department of Homeland Security: (7)										
Alcohol and Tobacco Tax and Trade Bureau	n/o	n/o	n/o	n/o	n/o	67	72	71	7.9%	-1.5%
Chemical Safety and Hazard Investigation Board (8)	n/o	n/o	n/o	n/o	7	7	7	8	-1.4%	-1.4%
Federal Mine Safety and Health Review Commission	n/o	n/o	7	5	6	6	6	7	-1.4%	-1.4%
TOTAL--Consumer Safety and Health	500	812	2,182	2,205	3,435	4,008	4,324	4,161	7.9%	-3.8%
Transportation (9)										
Department of Homeland Security: (10)										
Coast Guard	203	324	873	1,051	1,606	1,925	2,455	2,698	27.5%	9.9%
Transportation Security Administration (13)	n/o	n/o	n/o	n/o	n/o	3,694	4,756	4,230	28.8%	-11.1%
Subtotal	203	324	873	1,051	1,606	5,619	7,211	6,928	28.3%	-3.9%
Department of Transportation:										
Federal Aviation Administration	185	434	493	572	865	1,300	1,023	1,014	-21.3%	-0.8%
Federal Highway Administration	n/o	21	35	113	8	14	15	15	4.7%	-1.5%
Federal Motor Carrier Safety Administration (11)	n/o	n/o	n/o	n/o	175	332	336	402	1.3%	19.4%
Federal Railroad Administration	n/o	72	149	65	112	142	141	148	-0.8%	4.7%
National Highway Traffic Safety Administration	n/o	110	238	164	180	219	228	228	4.3%	-0.3%
Surface Transportation Board (12)	n/o	n/o	n/o	n/o	16	16	17	18	4.0%	3.7%
Subtotal	185	637	915	914	1,356	2,024	1,761	1,824	-13.0%	3.6%
National Transportation Safety Board	n/o	17	30	31	68	62	62	62	1.5%	-0.1%
TOTAL--Transportation	388	978	1,818	1,996	3,030	7,705	9,034	8,814	17.3%	-2.4%
Job Safety and Other Working Conditions										
Department of Labor:										
Employment Standards Administration (14)	63	127	217	179	217	224	232	221	3.6%	-4.7%
Office of the American Workplace (15)	n/o	41	96	91	n/o	n/o	n/o	n/o	-	-
Employee Benefits Security Administration (16)	n/o	n/o	n/o	n/o	99	107	120	128	11.9%	7.3%
Mine Safety and Health Administration (17)	27	93	252	193	213	230	228	236	-0.7%	3.5%
Occupational Safety and Health Admin.	n/o	n/o	335	309	360	404	392	399	-3.0%	1.9%
Subtotal	90	262	901	772	890	964	972	985	0.8%	1.4%

Table A-2 (continued)

Agency Detail of Spending on Federal Regulatory Activity: Constant 1996 Dollars

(In Millions of Constant 1996 Dollars)

Agency	1960	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Architectural and Transportation Barriers Compliance Board	n/o	n/o	n/o	2	5	5	4	4	-1.4%	-1.5%
Equal Employment Opportunity Commission	n/o	45	217	214	263	290	278	281	-4.2%	1.4%
National Labor Relations Board	68	134	189	163	192	205	208	214	1.6%	2.7%
Occupational Safety and Health Review Commission	n/o	n/o	12	7	7	7	9	9	23.2%	-1.5%
TOTAL--Job Safety and Other Working Conditions	157	441	1,320	1,158	1,357	1,471	1,471	1,493	0.0%	1.5%
Environment										
Council on Environmental Quality	n/o	n/o	14	1	3	3	3	3	-1.4%	-1.5%
Department of Agriculture: (18)										
Forest and Rangeland Research	n/o	n/o	n/o	n/o	229	263	246	242	-6.2%	-1.9%
Department of Defense:										
Army Corps of Engineers (19)	5	7	72	74	105	121	132	130	8.9%	-1.5%
Department of Interior:										
Fish and Wildlife Service (20)	13	24	119	184	231	256	247	243	-3.5%	-1.5%
Office of Surface Mining Reclamation and Enforcement (21)	n/o	n/o	305	400	408	411	320	316	-22.1%	-1.2%
U.S. Geological Survey (22)	n/o	n/o	n/o	n/o	126	150	145	149	-3.2%	2.1%
Subtotal	13	24	424	584	765	817	713	709	-12.8%	-0.6%
Environmental Protection Agency (23)	77	706	2,384	4,153	4,175	4,307	5,399	4,210	25.3%	-22.0%
TOTAL -- Environment	95	737	2,894	4,812	5,277	5,511	6,493	5,293	17.8%	-18.5%
Energy										
Department of Energy:										
Petroleum Regulation	n/o	n/o	n/o	15	22	31	36	36	16.0%	1.0%
Federal Inspector for the Alaska Natural Gas Pipeline (24)	n/o	n/o	14	n/o	n/o	n/o	n/o	n/o	-	-
Energy Conservation (25)	0	0	135	44	104	93	88	47	-5.3%	-47.3%
Subtotal	n/o	n/o	149	59	125	124	124	83	0.0%	-33.4%
Nuclear Regulatory Commission (26)	54	220	694	502	445	501	553	549	10.5%	-0.7%
TOTAL--Energy	54	220	843	560	571	625	677	632	8.4%	-6.7%
TOTAL SOCIAL REGULATION	1,194	3,188	9,057	10,732	13,670	19,319	21,999	20,394	13.9%	-7.3%
ECONOMIC REGULATION										
Finance and Banking										
Department of the Treasury:										
Comptroller of the Currency	50	110	198	302	370	378	392	403	3.8%	3.0%
Office of Thrift Supervision	n/o	n/o	n/o	318	146	140	139	141	-0.8%	1.0%
Subtotal	50	110	198	619	516	518	531	544	2.5%	2.5%
Farm Credit Administration	9	14	21	42	33	31	34	33	10.2%	-1.5%
Federal Deposit Insurance Corporation	59	131	198	572	535	537	574	572	6.9%	-0.3%
Federal Housing Finance Board (27)	n/o	n/o	n/o	8	18	21	24	25	15.7%	2.2%
Federal Reserve System (28)										
Federal Reserve Banks (29)	n/o	n/o	151	245	502	426	450	443	5.5%	-1.5%
Federal Reserve System Board of Governors	5	17	35	35	73	87	94	92	7.8%	-1.5%
Subtotal	5	17	186	280	575	513	543	535	5.9%	-1.5%
National Credit Union Administration	14	24	32	53	70	81	86	86	5.1%	0.6%
TOTAL--Finance and Banking	135	296	635	1,574	1,748	1,701	1,792	1,796	5.3%	0.2%

Table A-2 (continued)

Agency Detail of Spending on Federal Regulatory Activity: Constant 1996 Dollars

(In Millions of Constant 1996 Dollars)

Agency	1960	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Industry-Specific Regulation										
Department of Agriculture:										
Agriculture Marketing Service (30)	239	654	117	185	198	198	222	224	12.1%	0.9%
Department of the Energy:										
Economic Regulatory Administration (31)	n/o	n/o	256	20	2	2	1	1	-50.7%	-1.5%
Civil Aeronautics Board (32)	32	38	51	n/o	n/o	n/o	n/o	n/o	-	-
Commodity Futures Trading Commission (33)	5	7	30	45	59	68	71	77	5.1%	8.4%
Federal Communications Commission	50	86	133	125	247	301	332	335	10.1%	0.9%
Federal Energy Regulatory Commission (34)	32	62	119	132	162	173	171	175	-0.9%	2.1%
Federal Maritime Commission	n/o	14	19	17	14	14	15	16	4.7%	4.3%
Interstate Commerce Commission (35)	90	93	137	51	n/o	n/o	n/o	n/o	-	-
Renegotiation Board (36)	14	14	n/o	n/o	n/o	n/o	n/o	n/o	-	-
TOTAL--Industry-Specific Regulation	460	967	862	574	682	757	813	828	7.4%	1.9%
General Business										
Cost Accounting Standards Board (37)	n/o	n/o	2	n/o	n/o	n/o	n/o	n/o	-	-
Council on Wage and Price Stability (38)	n/o	n/o	16	n/o	n/o	n/o	n/o	n/o	-	-
Department of Commerce:										
International Trade Administration (39)	14	21	28	23	31	41	46	47	11.7%	2.4%
Bureau of Industry and Security (40)	n/o	n/o	n/o	50	57	62	79	74	27.6%	-6.0%
Patent and Trademark Office	99	169	184	378	837	1,036	1,190	1,057	14.9%	-11.2%
Subtotal	113	189	212	451	925	1,138	1,314	1,178	15.5%	-10.4%
Department of Justice:										
Antitrust Division	18	34	86	55	103	103	123	125	19.3%	1.4%
Federal Election Commission	n/o	n/o	16	17	36	40	40	44	0.8%	9.5%
Federal Trade Commission	32	72	116	81	118	142	164	169	15.5%	2.8%
International Trade Commission (41)	9	14	25	46	44	48	48	51	0.4%	5.8%
Library of Congress:										
Copyright Office	5	10	25	23	33	33	40	43	19.9%	7.3%
Securities and Exchange Commission	36	76	126	187	348	443	530	740	19.7%	39.6%
TOTAL--General Business	212	396	622	859	1,606	1,947	2,260	2,350	16.1%	4.0%
TOTAL ECONOMIC REGULATION	807	1,659	2,119	3,007	4,036	4,405	4,865	4,974	10.4%	2.2%
GRAND TOTAL	2,001	4,847	11,176	13,739	17,706	23,725	26,864	25,367	13.2%	-5.6%

Notes:
L = less than $500,000
n/o = agency not operational

(1) through (41): see notes at the end of the Appendix

Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Table A-3
Agency Detail of Staffing of Federal Regulatory Activity
(Fiscal Years, Full-time Equivalent Employment)

Agency	1970	1980	1990	2000	2002	2003	(Estimated) 2004	% Change 2002-2003	% Change 2003-2004
SOCIAL REGULATION									
Consumer Safety and Health									
Consumer Product Safety Commission	n/o	978	515	468	462	471	471	1.9%	0.0%
Department of Agriculture:									
Animal and Plant Health Inspection Service (1)	5,635	5,440	5,814	6,468	5,215	5,978	5,407	14.6%	-9.6%
Food Safety and Inspection Service (2)	n/o	12,501	9,433	9,545	9,579	9,680	9,834	1.1%	1.6%
Grain Inspection, Packers and Stockyards (3)	193	2,118	989	750	735	830	830	12.9%	0.0%
Subtotal	5,828	20,059	16,236	16,763	15,529	16,488	16,071	6.2%	-2.5%
Department of Health and Human Services:									
Food and Drug Administration	4,470	8,045	7,764	8,900	8,888	9,818	10,111	10.5%	3.0%
Department of Justice:									
Drug Enforcement Administration (5)	125	256	294	613	568	722	789	27.1%	9.3%
Bureau of Alcohol, Tobacco, Firearms, and Explosives (6)	3,489	3,819	3,873	4,337	4,439	4,647	4,772	4.7%	2.7%
Subtotal	3,614	4,075	4,167	4,950	5,007	5,369	5,561	7.2%	3.6%
Department of Homeland Security: (7)									
Alcohol and Tobacco Tax and Trade Bureau	n/o	n/o	n/o	n/o	559	559	559	0.0%	0.0%
Chemical Safety and Hazard Investigation Board (8)	n/o	n/o	n/o	26	30	38	38	26.7%	0.0%
Federal Mine Safety and Health Review Commission	n/o	85	48	43	38	49	50	28.9%	2.0%
TOTAL--Consumer Safety and Health	13,912	33,242	28,730	31,150	30,513	32,792	32,861	7.5%	0.2%
Transportation (9)									
Department of Homeland Security: (10)									
Coast Guard	7,064	11,423	10,891	16,780	16,016	19,659	19,493	22.7%	-0.8%
Transportation Security Administration (13)	n/o	n/o	n/o	n/o	3,434	59,494	55,156	1632.5%	-7.3%
Subtotal	7,064	11,423	10,891	16,780	19,450	79,153	74,649	307.0%	
Department of Transportation:									
Federal Aviation Administration	6,447	6,251	5,640	6,319	6,569	5,385	5,636	-18.0%	4.7%
Federal Highway Administration	177	239	495	66	127	129	128	1.5%	-0.1%
Federal Motor Carrier Safety Administration (11)	n/o	n/o	n/o	673	864	1,058	1,118	22.5%	5.7%
Federal Railroad Administration	267	607	435	718	754	794	817	5.3%	2.9%
National Highway Traffic Safety Administration	472	917	602	612	661	666	671	0.8%	0.8%
Surface Transportation Board (12)	n/o	n/o	n/o	135	143	145	145	1.4%	0.0%
Subtotal	7,363	8,014	7,172	8,523	9,118	8,176	8,316	-10.3%	4.2%
National Transportation Safety Board	251	387	325	421	424	432	406	1.9%	-6.0%
TOTAL--Transportation	14,678	19,824	18,388	25,724	28,992	87,761	83,571	202.7%	-4.8%
Job Safety and Other Working Conditions									
Department of Labor:									
Employment Standards Administration (14)	1,961	3,372	2,335	2,211	2,211	2,180	2,147	-1.4%	-1.5%
Office of the American Workplace (15)	626	1,330	980	n/o	n/o	n/o	n/o	-	-
Employee Benefits Security Administration (16)	n/o	n/o	n/o	747	848	861	930	1.5%	8.0%
Mine Safety and Health Administration (17)	1,040	3,700	2,679	2,202	2,205	2,264	2,334	2.7%	3.1%
Occupational Safety and Health Admin.	n/o	2,950	2,431	2,160	2,257	2,233	2,236	-1.1%	0.1%
Subtotal	3,627	11,352	8,425	7,320	7,521	7,538	7,647	0.2%	1.4%

Table A-3 (continued)
Agency Detail of Staffing of Federal Regulatory Activity
(Fiscal Years, Full-time Equivalent Employment)

Agency	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Architectural and Transportation Barriers Compliance Board	n/o	n/o	27	30	30	32	32	6.7%	0.0%
Equal Employment Opportunity Commission	637	3,496	2,853	2,852	2,783	2,720	2,765	-2.3%	1.7%
National Labor Relations Board	2,222	2,898	2,227	1,876	1,946	1,952	1,952	0.3%	0.0%
Occupational Safety and Health Review Commission	n/o	148	78	63	60	69	69	15.0%	0.0%
TOTAL--Job Safety and Other Working Conditions	6,486	17,894	13,610	12,141	12,340	12,311	12,465	-0.2%	1.3%
Environment									
Council on Environmental Quality	n/o	49	15	20	19	24	24	26.3%	0.0%
Department of Agriculture: (18)									
Forest and Rangeland Research	n/o	n/o	n/o	2,340	2,494	2,407	2,319	-3.5%	-3.7%
Department of Defense:									
Army Corps of Engineers (19)	n/o	800	1,201	1,354	1,447	1,450	1,450	0.2%	0.0%
Department of Interior:									
Fish and Wildlife Service (20)	432	1,913	2,059	1,848	1,956	1,784	1,791	-8.8%	0.4%
Office of Surface Mining Reclamation and Enforcement (21)	n/o	1,186	1,195	636	617	630	630	2.1%	0.0%
U.S. Geological Survey (22)	n/o	n/o	n/o	1,047	1,201	1,210	1,250	0.7%	3.3%
Subtotal	432	3,099	3,254	3,531	3,774	3,624	3,671	-4.0%	1.3%
Environmental Protection Agency (23)	4,093	13,045	15,587	17,310	17,216	17,368	17,500	0.9%	0.8%
TOTAL -- Environment	4,525	16,993	20,057	24,555	24,950	24,873	24,964	-0.3%	0.4%
Energy									
Department of Energy:									
Petroleum Regulation	n/o	n/o	101	122	155	185	147	19.4%	-20.5%
Federal Inspector for the Alaska Natural Gas Pipeline (24)	n/o	64	1	n/o	n/o	n/o	n/o	-	-
Energy Conservation (25)	0	47	31	66	51	47	26	-7.8%	-44.7%
Subtotal	n/o	111	133	188	206	232	173	12.6%	-25.4%
Nuclear Regulatory Commission (26)	219	3,114	3,160	2,735	2,771	2,862	2,907	3.3%	1.6%
TOTAL--Energy	219	3,225	3,293	2,923	2,977	3,094	3,080	3.9%	-0.5%
TOTAL SOCIAL REGULATION	39,820	91,178	84,078	96,493	99,772	160,831	156,941	61.2%	-2.4%
ECONOMIC REGULATION									
Finance and Banking									
Department of the Treasury:									
Comptroller of the Currency	2,003	3,234	3,216	2,920	2,792	2,813	2,813	0.8%	0.0%
Office of Thrift Supervision	n/o	n/o	3,250	1,254	1,266	1,291	1,291	2.0%	0.0%
Subtotal	2,003	3,234	6,466	4,174	4,058	4,104	4,104	1.1%	0.0%
Farm Credit Administration	222	277	530	287	270	292	290	8.1%	-0.7%
Federal Deposit Insurance Corporation	2,185	3,648	6,005	5,283	4,769	4,509	4,498	-5.5%	-0.2%
Federal Housing Finance Board (27)	n/o	n/o	54	108	112	124	127	10.7%	2.4%
Federal Reserve System (28)									
Federal Reserve Banks (29)	n/o	1,589	2,217	3,050	2,888	2,858	2,858	-1.0%	0.0%
Federal Reserve System Board of Governors	170	333	419	668	815	868	868	6.5%	0.0%
Subtotal	170	1,922	2,636	3,718	3,703	3,726	3,726	0.6%	0.0%
National Credit Union Administration	389	443	662	618	652	638	634	-2.0%	-0.6%
TOTAL--Finance and Banking	4,969	9,524	16,353	14,188	13,451	13,269	13,252	-1.4%	-0.1%

Table A-3 (continued)
Agency Detail of Staffing of Federal Regulatory Activity
(Fiscal Years, Full-time Equivalent Employment)

Agency	1970	1980	1990	2000	2002	(Estimated) 2003	2004	% Change 2002-2003	% Change 2003-2004
Industry-Specific Regulation									
Department of Agriculture:									
Agriculture Marketing Service (30)	12,873	2,147	3,164	2,595	2,666	2,677	2,684	0.4%	0.3%
Department of the Energy:									
Economic Regulatory Administration (31)	n/o	2,255	184	18	11	8	2	-27.3%	-75.0%
Civil Aeronautics Board (32)	658	778	n/o	n/o	n/o	n/o	n/o	-	-
Commodity Futures Trading Commission (33)	166	459	527	556	488	541	489	10.9%	-9.6%
Federal Communications Commission	1,511	2,216	1,734	1,925	1,984	1,987	2,007	0.2%	1.0%
Federal Energy Regulatory Commission (34)	1,095	1,653	1,475	1,216	1,188	1,250	1,250	5.2%	0.0%
Federal Maritime Commission	226	336	229	128	127	132	137	3.9%	3.8%
Interstate Commerce Commission (35)	1,802	2,041	664	n/o	n/o	n/o	n/o	-	-
Renegotiation Board (36)	217	n/o	n/o	n/o	n/o	n/o	n/o	-	-
TOTAL--Industry-Specific Regulation	18,548	11,885	7,977	6,438	6,464	6,595	6,569	2.0%	-0.4%
General Business									
Cost Accounting Standards Board (37)	n/o	21	n/o	n/o	n/o	n/o	n/o	-	-
Council on Wage and Price Stability (38)	n/o	230	n/o	n/o	n/o	n/o	n/o	-	-
Department of Commerce:									
International Trade Administration (39)	247	335	238	215	269	310	330	15.2%	6.5%
Bureau of Industry and Security (40)	n/o	n/o	508	398	358	458	474	27.9%	3.5%
Patent and Trademark Office	2,569	2,660	4,059	6,128	6,593	7,453	7,666	13.0%	2.9%
Subtotal	2,816	2,995	4,805	6,741	7,220	8,221	8,470	13.9%	3.0%
Department of Justice:									
Antitrust Division	544	971	513	748	772	851	851	10.2%	0.0%
Federal Election Commission	n/o	258	241	343	352	362	391	2.8%	8.0%
Federal Trade Commission	1,302	1,719	903	989	1,057	1,080	1,080	2.2%	0.0%
International Trade Commission (41)	245	409	499	357	357	395	395	10.6%	0.0%
Library of Congress:									
Copyright Office	314	598	520	490	490	530	530	8.2%	0.0%
Securities and Exchange Commission	1,388	2,050	2,130	2,841	3,009	3,150	3,731	4.7%	18.4%
TOTAL--General Business	6,609	9,251	9,611	12,509	13,257	14,589	15,448	10.0%	5.9%
TOTAL ECONOMIC REGULATION	30,126	30,660	33,941	33,135	33,172	34,453	35,269	3.9%	2.4%
GRAND TOTAL	69,946	121,838	118,019	129,628	132,944	195,284	192,210	46.9%	-1.6%

Notes:
L = less than $500,000
n/o = agency not operational

(1) through (41): see notes at the end of the Appendix

Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Table A-4
Total Spending on Federal Regulatory Activity: Current Dollars
(Fiscal Years, Millions of Dollars)

Year	Social Regulation	Economic Regulation	Total
1960	265	179	444
1961	324	199	523
1962	368	214	582
1963	432	232	664
1964	474	250	724
1965	485	306	791
1966	528	308	836
1967	614	341	955
1968	691	364	1,055
1969	789	409	1,198
1970	926	482	1,408
1971	1,193	538	1,731
1972	1,578	566	2,144
1973	2,247	480	2,727
1974	2,229	612	2,841
1975	2,703	743	3,446
1976	2,777	821	3,598
1977	3,347	929	4,790
1978	3,861	965	5,542
1979	4,577	1,044	5,621
1980	5,167	1,209	6,376
1981	5,427	1,213	6,640
1982	5,366	1,298	6,664
1983	5,408	1,302	6,710
1984	5,970	1,566	7,536
1985	6,385	1,601	7,986
1986	6,160	1,858	8,018
1987	7,218	1,805	9,023
1988	7,809	2,160	9,969
1989	8,359	2,541	10,900
1990	9,286	2,602	11,888
1991	10,209	2,641	12,850
1992	11,187	2,825	14,012
1993	11,393	3,236	14,629
1994	11,884	3,277	15,161
1995	12,047	3,496	15,543
1996	11,625	3,572	15,197
1997	12,449	3,710	16,159
1998	13,003	3,786	16,789
1999	13,662	4,097	17,759
2000	14,612	4,314	18,926
2001	16,327	4,700	21,027
2002	21,340	4,866	26,206
2003*	24,652	5,452	30,104
2004*	23,200	5,658	28,858

*Estimates

Note: Numbers may not foot to totals due to rounding. Data are based upon obligations incurred.
Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University
Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Table A-5
Total Spending on Federal Regulatory Activity: Constant Dollars
(Fiscal Years, Millions of 1996 Dollars)

Year	Social Regulation	Economic Regulation	Total
1960	1,194	807	2,001
1961	1,443	887	2,330
1962	1,619	939	2,559
1963	1,878	1,010	2,888
1964	2,033	1,069	3,102
1965	2,041	1,287	3,328
1966	2,160	1,260	3,419
1967	2,436	1,354	3,790
1968	2,628	1,383	4,012
1969	2,860	1,484	4,343
1970	3,188	1,659	4,847
1971	3,909	1,763	5,672
1972	4,961	1,779	6,740
1973	6,688	1,429	8,116
1974	6,090	1,672	7,762
1975	6,752	1,856	8,609
1976	6,567	1,941	8,508
1977	7,434	2,064	9,498
1978	8,007	2,001	10,008
1979	8,761	1,998	10,760
1980	9,057	2,119	11,176
1981	8,701	1,945	10,646
1982	8,098	1,959	10,057
1983	7,852	1,891	9,743
1984	8,357	2,192	10,549
1985	8,665	2,173	10,837
1986	8,178	2,467	10,645
1987	9,304	2,327	11,631
1988	9,734	2,693	12,427
1989	10,038	3,052	13,090
1990	10,732	3,007	13,739
1991	11,386	2,946	14,332
1992	12,180	3,076	15,255
1993	12,114	3,441	15,554
1994	12,378	3,413	15,791
1995	12,280	3,564	15,844
1996	11,625	3,572	15,197
1997	12,211	3,639	15,850
1998	12,600	3,669	16,268
1999	13,050	3,913	16,963
2000	13,670	4,036	17,706
2001	14,922	4,295	19,217
2002	19,319	4,405	23,725
2003*	21,999	4,865	26,864
2004*	20,394	4,974	25,367

*Estimates

Note: Numbers may not foot to totals due to rounding. Data are based upon obligations incurred.
Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Table A-6
Total Staffing of Federal Regulatory Activity
(Fiscal Years, Full-time Equivalent Employment)

Year	Social Regulation	Economic Regulation	Total
1970	39,820	30,126	69,946
1971	48,867	31,133	80,000
1972	56,375	29,990	86,365
1973	70,334	23,848	94,182
1974	70,285	25,209	95,494
1975	73,072	29,171	102,243
1976	77,049	30,785	107,834
1977	81,347	27,441	108,788
1978	86,013	29,019	115,032
1979	90,448	29,399	119,847
1980	91,178	30,660	121,838
1981	88,631	28,696	117,327
1982	77,822	28,636	106,458
1983	74,242	27,085	101,327
1984	75,077	26,803	101,880
1985	75,724	26,496	102,220
1986	74,869	27,091	101,960
1987	75,181	26,649	101,830
1988	77,085	27,357	104,442
1989	79,549	31,064	110,613
1990	84,078	33,941	118,019
1991	87,597	33,907	121,504
1992	92,630	35,890	128,520
1993	94,807	37,400	132,207
1994	93,917	36,937	130,854
1995	94,987	36,853	131,840
1996	93,774	34,142	127,916
1997	92,643	32,918	125,561
1998	93,507	33,062	126,569
1999	93,863	33,304	127,167
2000	96,493	33,135	129,628
2001	95,719	32,462	128,181
2002	99,772	33,172	132,944
2003*	160,831	34,453	195,284
2004*	156,941	35,269	192,210

*Estimates

Note: Numbers may not foot to totals due to rounding. Data are based upon obligations incurred.
Source: Weidenbaum Center, Washington University and Mercatus Center at George Mason University. Derived from the *Budget of the United States Government* and related documents, various fiscal years.

Notes to Appendix Tables A-1, A-2, and A-3

1. The 1960-1970 data for the Animal and Plant Health Inspection Service are for the Agricultural Research Service.
2. The Food Safety and Inspection Service was formerly the Food Safety and Quality Service.
3. Budgets for Federal Grain Inspection Service and Packers and Stockyards Administration were merged in 1994.
4. The Consumer Protection Programs of the Department of Housing and Urban Development have been listed under several sources. Data prior to 1975 are for the Office of Interstate Land Sales Registration; the data for 1980 are for the Office of Neighborhoods, Voluntary Associations and Consumer Protection. Staffing figures are not available.
5. Data for the Drug Enforcement Administration prior to 1970 are for the Bureau of Narcotics and Dangerous Drugs.
6. In 2004, the Bureau of Alcohol, Tobacco, and Firearms was divided into two agencies – one within the newly created Department of Homeland Security and one within the Department of Justice. These agencies – Homeland Security's Alcohol and Tobacco Tax and Trade Bureau and Justice's Bureau of Alcohol, Tobacco, Firearms, and Explosives are both listed for consistency. Prior to fiscal year 1973, the Bureau of Alcohol, Tobacco and Firearms was part of the Internal Revenue Service.
7. On January 24, 2003, the law creating the United States Department of Homeland Security came into effect. This is the 15th executive department of the president's Cabinet. It was set up on the wake of the terrorist attacks of September 11, 2001 to lead a comprehensive and unified effort to defend this nation. The Department will analyze threats; guard our borders and airports; safeguard critical infrastructure and coordinate the response of our nation to future emergencies. (This description is based upon the press release "Ridge Sworn In Friday as Secretary of Homeland Security," Remarks by the President at Swearing-In of Tom Ridge, Secretary of the Department of Homeland Security, January 24, 2003.)
8. The Chemical Safety and Hazard Investigation Board did not receive funding in 1996 or 1997. Its responsibilities were allocated to the Environmental Protection Agency and the Occupational Safety and Health Administration for those years. In 1998, this agency began once again to receive funding.
9. Reports prior to 2003 (Regulatory Budget Report 24) included transportation-related agencies in the consumer safety and health category.
10. Coast Guard was moved from the Department of Transportation to the Department of Homeland Security in the fiscal year 2004 budget.
11. In the FY2004 Budget, funding of the Motor Carrier Safety portion of the Federal Motor Carrier Safety Administration was shifted to Motor Carrier Safety Grants. Funding was not requested for the Border Enforcement Program for 2004.

12. The Surface Transportation Board was created on January 1, 1996 as a successor organization to the Interstate Commerce Commission.

13. On November 19, 2001, the Transportation Security Administration was created to protect the Nation's transportation systems to ensure freedom of movement for people and commerce.

14. Data for the Employment Standards Administration are for the Workplace Standards Administration for 1969 and 1970. The 1960-1968 data are for the Wage and Labor Standards Administration.

15. Before the 1995 budget, the Office of the American Workplace was called the Labor Management Services Administration. Labor-management standards, enforcement, and related administrative functions were transferred to the Employment Standards Administration in 1996. The US Dept of Labor's Office of the American Workplace (OAW) was disbanded due to lack of funding in July, 1996.

16. In the 2004 budget, the Pension and Welfare Benefits Administration was renamed the Employee Benefits Security Administration. Prior to the 1993 budget, data for the Pension and Welfare Benefits Administration were part of the Labor Management Services Administration.

17. The 1960-1974 data for the Mine Safety and Health Administration are for the Health and Safety Division of the Bureau of Mines, Department of the Interior; 1975 data are for the Mining Enforcement and Safety Administration, Department of the Interior.

18. In 2000, the Forest & Rangeland Research division of the U.S. Forest Service at the Department of Agriculture began devoting resources to developing and implementing forest-planning regulations.

19. The 1960-1985 cost data for the Army Corps of Engineers were for the Protection of Navigation under the Operation and Maintenance category.

20. In 1995, the Fish and Wildlife's research and development budget was eliminated. Data for R&D after 1994 are listed under the U.S. Geological Survey.

21. The 1990 costs for the Office of Surface Mining Reclamation and Enforcement reflect a major cut in federal support for the abandoned mine reclamation fund. The 1995 spending figures reflect a similar cut.

22. In 1995, the U.S. Geological Survey picked up the research and development formerly done at the Fish and Wildlife Service.

23. Construction grants are excluded from the calculation of the regulatory expenditure and staffing of the Environmental Protection Agency. Before 1970, EPA functions were scattered throughout the budget. Data for this report were taken from these Department of Health, Education and Welfare agencies: 1968-1969, National Air Pollution Control Administration; 1968-1969, Environmental Health Service; 1960-1967, Public Health Service. Data from the Department of the Interior's Federal Water Quality Administration were used for 1968-1969. 1962-1969 data from the Federal Radiation Council were also included.

24. The Office of the Federal Inspector for the Alaska Natural Gas Pipeline was eliminated in 1997.

25. Energy conservations standards are issued by the Department of Energy's Office of Energy Efficiency and Renewable Energy. These data reflect obligations under the non-grant portion of "Building technology, State and community programs."

26. Prior to fiscal year 1974, the Atomic Energy Commission performed the activities of the Nuclear Regulatory Commission.

27. The Federal Housing Finance Board regulates the 12 Federal Home Loan Banks that were created in 1932 to improve the supply of funds to local lenders that, in turn, finance loans for home mortgages.

28. All data for the Federal Reserve System are presented on a calendar-year basis.

29. Data are from the Board of Governors of the Federal Reserve System's *Annual Report: Budget Review*, various years.

30. Agricultural Marketing Service was formerly the Consumer and Marketing Service. Starting with our 2003 report, we include these expenditures in the economic regulatory category.

31. The 1975 data for the Economic Regulatory Administration are for the Federal Energy Administration. Starting with our 2003 report, we include these expenditures in the economic regulation category.

32. The Civil Aeronautics Board was abolished in 1984.

33. The 1970 data for the Commodity Futures Trading Commission are for the Commodity Exchange Authority, Department of Agriculture.

34. The 1970 and 1975 data for the Federal Energy Regulatory Commission are for the Federal Power Commission, the predecessor agency.

35. The Interstate Commerce Commission was abolished in 1996.

36. The Renegotiation Board was abolished in 1979.

37. The Cost Accounting Standards Board was abolished in 1980.

38. The Council on Wage and Price Stability was abolished in 1981.

39. The 1970 data for the International Trade Administration are for International Activities-Export Control; the 1975 data are for the Domestic and International Business Administration.

40. Regulation of both imports and exports was once performed by the International Trade Administration. From 1988 until 2003, the regulation of exports was shown under the Export Administration of the Department of Commerce. In 2004, the Export Administration was renamed the Bureau of Industry and Security of the Department of Commerce.

41. The 1970 data for the International Trade Commission are for the Tariff Commission, the predecessor agency.

SUSAN DUDLEY / DANIEL SIMMONS

EPA dodges a rule

To justify a policy that violates rules under which it is supposed to operate, the Environmental Protection Agency has calculated Americans love fish more when they are swimming freely than when they are on their plates.

The story starts with the EPA proposing regulations to reduce the number of fish killed or injured when water is drawn into large power plants to help with cooling. When EPA conducted its analysis of the costs and benefits, however, it found the rule wouldn't meet the requirements of Executive Order 12866 (originally issued by President Clinton), which says agencies can "adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs."

Apparently, EPA thinks we place a much higher value on a fish swimming free than on one on our plate. EPA's estimates suggest we are willing to pay between $61 and $113 per pound for fish that we don't eat.

In fact, EPA discovered that, on an annual basis, the regulations would cost more than $18 million to save about $80,000 worth of fish.

Undaunted and determined to move forward, EPA decided to get creative in its calculation of benefits. It reasoned that not only do fish have value to those that use them, such as fishermen and consumers, but also what it calls "nonuse" value. In other words, EPA decided people place value on the mere existence of fish. While most people share the feeling that animals should not be needlessly injured, EPA went a step further and put a price tag on Americans' collective caring about fish.

It ran into obstacles, of course, because there is no market value for feeling fondly about fish. When people purchase fish at the market, the price provides a good estimate of how much they value the fish. However, trying to estimate how much they value the fish they didn't buy (and that remain uncaught) is far more difficult and maybe impossible. But that didn't stop EPA from trying.

Since EPA couldn't find any studies that specifically ask people how much they value the existence of uncaught fish, EPA decided that comparing apples to oranges would have to do, and turned to a study that asked people in the ultra-affluent Hamptons, N.Y., how much they value wetlands.

After some heroic statistical gymnastics to convert the value of wetlands to the value of fish, EPA calculated that the annual "nonuse" value of fish that the rule would protect from getting caught in cooling water intakes at power plants is between $14 million and $27 million a year.

To put this in perspective, this is between 175 and 337 times greater than the estimated $80,000 commercial value of the fish saved by the regulation. Delighted that it had satisfied the requirement that benefits outweigh the costs, EPA appears not to have considered the implications of its result.

Apparently, EPA thinks we place a much higher value on a fish swimming free than on one on our plate. EPA's estimates suggest we are willing to pay between $61 and $113 per pound for fish that we don't eat (just to know they are swimming safely) compared to the $1.12 a pound we have revealed we are willing to pay for fish at our neighborhood grocery store.

In 2001, American fishermen caught 9.5 billion pounds of fish, valued at $3.2 billion. Using EPA's analysis, if fishermen hadn't caught these fish and instead had left them swimming freely in the ocean, Americans would be better off by between $500 billion and $1 trillion a year. This translates to each American being willing to pay fishermen between $1,700 and $3,400 every year not to catch fish for our tables.

EPA, it's time for a reality check.

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MERCATUS CENTER
GEORGE MASON UNIVERSITY

REGULATORY STUDIES PROGRAM

Public Interest Comment on

The Environmental Protection Agency's
"Proposed National Pollutant Discharge Elimination System Regulations to Establish Requirements for Cooling Water Intake Structures at Phase II Existing Facilities"[1]

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Environmental Protection Agency's "Proposed National Pollutant Discharge Elimination System Regulations to Establish Requirements for Cooling Water Intake Structures at Phase II Existing Facilities" does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the Agency's proposals on overall consumer welfare.

I. Introduction

In April 2002, EPA proposed a rule establishing national requirements applicable to the location, design, construction, and capacity of cooling water intake structures at existing power producing facilities that withdraw 50 million gallons per day (MGD) or more of water from rivers, streams, lakes, reservoirs, estuaries, oceans, or other waters of the U.S. for cooling purposes.

The proposed requirements, implemented through National Pollutant Discharge Elimination System (NPDES) permits, reflected the best technology available for minimizing adverse environmental impact from the cooling water intake structure based on water body type, and the amount of water withdrawn by a facility. More stringent requirements were proposed for more sensitive or biologically productive the waterbodies.

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[1] Prepared by Daniel Simmons, Research Fellow, and Susan E. Dudley, Senior Research Fellow, Mercatus Center at George Mason University. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

Though EPA provided estimates of the benefits of the proposal (based on a decrease in expected mortality or injury to aquatic organisms that would otherwise be subject to entrainment into cooling water systems or impingement against screens or other devices at the entrance of cooling water intake structures) on March 19, 2003 it supplemented these data with a notice of data availability (NODA).[2]

The NODA suggests that in the North Atlantic Region alone the rule will provide annual benefits of $80,000 a year for commercial fishermen, another $880,000 a year for recreational fishermen, and between $14 million and $27 million a year in nonuse value benefits.[3] In other words, the nonuse values attributed to the fish saved through the proposal are 175 to 335 times greater than the commercial value, and 17 to 32 times greater than the total use (commercial and recreational) value.[4] The implications of these results are implausible.

This comment focuses on the NODA, the methodology EPA relied on for calculating benefits, and the resulting benefits EPA attributes to the proposed rule. Section II examines the calculations and methods EPA used to value nonuse benefits associated with regulation of cooling water intakes. Because the benefit estimates are dominated by nonuse values, Section III attempts to penetrate the reasons for the implausible results by examining the concept of nonuse values and the use of contingent valuation surveys to estimate them. Section IV concludes this comment and makes recommendations. Appendix I evaluates the proposal and NODA against the Regulatory Studies Program Checklist.

II. EPA's Estimation of Nonuse Values of Impinged and Entrained Fish

In the proposed rule published on April 9, 2002, EPA used a "50 percent rule" to estimate the nonuse value of fish impinged or entrained by cooling intakes (the 50 percent rule estimates the nonuse value as 50 percent of the use value). However, in response to comments, EPA presents new values for nonuse benefits in this NODA based on a "benefits transfer" approach.[5] As noted above, benefits transfer is "the practice of transferring existing estimates of non-market values from the context of study to a new context."[6] In this case, the existing study EPA used is a contingent valuation (CV) survey conducted of the value of eelgrass and wetlands in the Peconic Estuary on the East End of Long Island.

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[2] National Pollutant Discharge Elimination System—Proposed Regulations to Establish Requirements for Cooling Water Intake Structures at Phase II Existing Facilities; Notice of Data Availability, 68 Fed. Reg. at 13,522 (Mar. 19, 2003).

[3] 68 Fed. Reg. at 13,578.

[4] The valuation of recreational benefits appears to overestimate the benefits of recreational fishing. However, this analysis is only concerned with the nonuse benefits.

[5] 68 Fed. Reg. at 13,544.

[6] Office of Management and Budget, Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations, 68 Fed. Reg. 5,491, at 5,520 (Feb. 3, 2003).

This comment focuses on the nonuse value estimates provided in the NODA. The NODA also provides estimates of the benefits to commercial fishing and recreational fishing attributable to the proposed rule. While recreational fishing values are not as readily measured as commercial fishing values, which rely on direct market prices, they are more reliably estimated from indirect methods than nonuse values. We do not address EPA's estimates of recreational benefits here.

A. A Lack of Understanding of the Role of Prices

The first problem in the NODA does not recognize the role of prices. For example, in calculating the value of fish lost to impingement and entrainment, EPA uses a measure it describes as "total yield" and "production foregone." "Total yield" is an estimate of "direct losses of harvested species as well as the yield of harvested species that is lost due to losses of forage species."[7] "Production forgone" is estimated by using "trophic structure and trophic transfer efficiency to estimate the harvested species that is lost because of the loss of forage species to impingement and entrainment."[8] While it is not clear how EPA uses "total yield," and "production foregone" in the calculations, it is clear that assigning prices to these metrics is problematic.

Prices are not static values that reflect only the value of the good in question. Rather, they are dynamic values that change as people's perceptions change about the value of the inputs to the good, the scarcity of the good, and the value of substitutes to that good. By assigning a price to either "total yield" or "production foregone," EPA conflates the value of the good (the fish), with the value of the inputs to the good (the forage fish). While this alone would not invalidate the study, these types of problems are compounded throughout the analysis, resulting in a nonuse value for fish that has no basis in the real world.

B. Benefit Transfer Approach

Any benefits transfer approach rests on a number of assumptions and estimates, and EPA's study is no different. The first assumption is that the values from the Peconic Estuary survey of preservation/restoration of eelgrass and wetlands can be transferred to provide useful information about the valuation of fish.[9] This assumption alone is questionable.

The Peconic study was a contingent choice survey conducted "to estimate the relative preferences of residents and second homeowners" on the East End of Long Island.[10] The study asked respondents to choose between bundles of "goods" comprising "physical, environmental, aesthetic, and/or monetary dimensions."[11] One problem with transferring

[7] 68 Fed. Reg. at 13,554.
[8] 68 Fed. Reg. at 13,546.
[9] 68 Fed. Reg. at 13,568.
[10] Lynne Tudor, et. la, *Memo to the* 316*(b) Record, Estimating the Total and Nonuse Value of Fish, Based on Habitat Values for Coastal Wetlands* at 7 (Mar. 12, 2003).
[11] *Id.*

the results from this study is that the contingent choice survey estimated a value for habitat. In the NODA, EPA used the estimating of the values of habitat as a way of valuing how much people value fish. However, if there is a nonuse value for the fish impinged and entrained in cooling intakes, that value is for the fish themselves, not for the habitat the fish live in. EPA's study is a study of nonuse benefits about fish that get entrained and impinged. The relevant value is the nonuse value of the fish, not the habitat.

The EPA's approach estimates the amount of wetland that could hypothetically produce the habitat services necessary for the fish hypothetically impinged or entrained, and then uses information from people's hypothetical willingness to pay for the fish production services of that habitat. Each hypothetical estimate further detaches the final estimate from any mooring connected with actual values. Each estimate, assumption, and hypothetical weakens the explanatory power of the final valuation.

In the NODA, EPA "solicits comments on whether [this] benefits transfer approach provides a more comprehensive value that address all impingement and entrainment losses."[12] Due to the number of assumptions and hypotheticals involved in this approach, there is little reason to believe that the approach provides more or less of a comprehensive value of impingement and entrainment losses than the arbitrary 50 percent method. The real question is if the benefit transfer approach as applied here provides any information at all.

C. The Peconic Study

To develop willingness-to-pay (WTP) nonuse values, the NODA relies on "Measuring Public Values and Priorities for Natural Resources: An Application to the Peconic Estuary System," a dissertation paper by Marisa J. Mazzotta. This paper is not available online in the EPA's docket, and we were unable to find it online at all. Since we do not have a copy of the study[13] we assume it is not peer reviewed.

Many questions are raised by the study. The first and most obvious is that the study was conducted in the area surrounding Peconic Estuary: Southhold, Riverhead, Southampton, Easthampton, and Shelter Island.[14] These areas are in Suffolk County, New York. Median household income in Suffolk County $65,288, while the median household income in the rest of New York is $43,393.[15] Not only is the Peconic Estuary more wealthy, "the study found that the survey sample population was better educated and had higher incomes that the population of the area."[16] This forced the study's author to adjust

[12] 68 Fed. Reg. at 13,568.

[13] As of May 29, 2003, EPA has not responded to an email request for the paper.

[14] Lynne Tudor, et. la, *Memo to the 316(b) Record, Estimating the Total and Nonuse Value of Fish, Based on Habitat Values for Coastal Wetlands* at 7 (Mar. 12, 2003).

[15] U.S. Census Bureau, *Suffolk County, New York*, at http://quickfacts.census.gov/qfd/states/36/36103.html (last visited May 28, 2003).

[16] *Memo to the 316(b) Record*, at 8.

the values "to be representative of the general population of the East End in terms of education and income."[17] It is not known how the study's author would know and understand the relative preferences of the survey respondents compared to the general population. Also the study's author had to estimate and adjust for people who lived in the area year-round, compared to seasonal residents.[18] It is also not known how the study's author could know and understand the relative preferences between year-round residents and seasonal residents to produce.

Another problem with the Peconic study is that, from the information we have, the survey did not ask how much respondents were willing to pay, but rather if each household on the East End of Long Island should pay either $0 for habitat or $50. There are several problems with this for EPA's purposes. First, it is not a measure of stated WTP, but rather a response to a binary question regarding what others should pay. Second, respondents have no expectation that they will actually be asked to pay the $50 as a result of their response. Third, though the EPA claims the Peconic study provides marginal cost information, individuals were not asked about the marginal cost of habitat, but rather whether they thought that each household should pay a certain amount for a certain amount of wetland.[19] Inferences of people's marginal preferences may be possible in economics text books, but it is far more difficult, and maybe impossible to derive a valid demand function from people's responses to a survey of this design.

To use the information from the Peconic study, EPA adjusted the values estimated for wetlands because the wetlands values "reflect all ecological services provided by the wetlands, not just fish and shellfish habitat."[20] To do this, EPA used another stated preference study to estimate the value people assign to the ecological services for fish and shellfish habitat provided by wetlands.[21] Put in other way, EPA had to conduct benefits transfer within another benefits transfer to arrive at values for its study.

In the NODA, EPA requests comment on its methodology of assigning a share of WTP to "fish production services" for each habitat type.[22] As noted above, there are so many estimates, including estimates within estimates within estimates, it is questionable that any useful value could be derived from this analysis. The real question is, "Is there a connection between these hypothetical values and any values in the real world?" There is no reason to believe that there is a connection. In fact, as will be shown in the next section, because the values in EPA's analysis are so detached from people's actual preference, they provide no useful information.

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[17] *Id.*

[18] *Id.*

[19] *See id.* at 9.

[20] *Id.* at 10.

[21] *Id.*

[22] 68 Fed. Reg. at 13,750.

D. EPA's Estimates are Implausible

After numerous estimates, assumptions, and extrapolations, EPA concludes that in the North Atlantic region, the annual nonuse value of fish lost from impingement and entrainment is between $76 million and $140 million a year.[23] This is in stark contrast to commercial fishing's estimated losses of a mere $282,339 per year.[24] In other words the annual value lost nonuse benefits from impingement and entrainment in the North Atlantic is 270 to 500 times greater than the lost benefits to commercial users.[25] To evaluate the validity of these estimates, these numbers need some context.

One way to compare the validity of these estimates is to evaluate them on a per pound basis. According to table X-6, X-7, X-8, and X-9, the total yield per year in the North Atlantic region lost to impingement and entrainment is 1.24 million pounds of fish. This translates to a nonuse value of between $61 and $113 per pound. In comparison, the estimated commercial losses are only $1.12 per pound. This means that EPA estimates the nonuse value of fish to be 54 to 100 times greater than their commercial value. The implication of this is that fish are worth 54 to 100 times more to people if they are left in the water than if a commercial fisherman catches them for human consumption.

This gigantic discrepancy between the estimated nonuse value of the fish and the commercial (or consumption) value begs the question, "why do we still have commercial fishing?" If Americans really value knowing that fish are swimming free so much more than they value eating fish, why do we pay commercial fishermen to catch them for our consumption? If the values EPA produced are truly people's "willingness to pay" for the nonuse value they place on the fish, then why don't people organize, raise money, and buy out the fishermen? Obviously there are some organizing costs to such an endeavor, but the possible societal benefits are enormous. In fact, the societal benefits are so enormous that EPA's estimate of nonuse value could be overstated by an entire order of magnitude, and nonuse values would still dwarf use values. If nonuse values were anywhere near the estimate the EPA provides, we have to assume that environmental groups would organize to collect money and buy out commercial fishing.

To further put the EPA's estimate in perspective, according to the National Marine Fisheries service, in 2001, commercial fishermen landed 9.5 billion pounds of fish. The value of these fish is $3.3 billion. Applying the same benefits transfer approach EPA used here to all fish taken by commercial fisherman, the nonuse value of the 9.5 billion pounds of fish landed may be worth between $580 billion and $1 trillion. Therefore, according to the EPA's logic and estimates, commercial fishing costs the nation between $500 billion and $1 trillion a year – almost 5 to 10 percent of GDP!

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[23] 68 Fed. Reg. at 13,577. EPA estimates that a portion of these losses would be avoided with the proposed rule, resulting in benefits of between $14 million and $27 million per year.

[24] 68 Fed. Reg. at 13,558.

[25] *See* 68 Fed. Reg. at 13,577, table X-44.

III. Nonuse Values, Contingent Valuation, and Benefits Transfer

This section attempts to address how EPA could derive such implausible results from its analysis. It examines the nature of nonuse values, and the use of contingent valuation methods to measure them. It also briefly addresses the appropriate use of benefit transfer methods.

A. The nature of nonuse values

"Nonuse" values are alleged to derive from the mere existence of something; in this case, common species of fish. Some economists view nonuse values as a form of externality that must be addressed by government action, while others question their existence.[26] There are several conceptual problems inherent in nonuse values.[27] First, it can be difficult to distinguish true nonuse values from values that do involve the use or potential use of a resource, particularly unique resources, such as the Grand Canyon or Alaskan wilderness, which are often used to illustrate the concept of nonuse values. Though you may not currently visit the Grand Canyon, you may place a value on its continued existence in pristine condition so that your children or grandchildren can enjoy it ("bequest value"), so you could visit it if you chose to ("option value") or so you can see photographs and nature videos of it ("indirect use value").[28] These are all values that derive from potential or indirect use, and are not true nonuse values.

Weikard,[29] for example, distinguishes real nonuse values from these other values based on potential use and altruism, and attempts a theoretical proof to show that individuals would not be willing to sacrifice use values to receive nonuse values. He argues that the concept of nonuse or existence value is inconsistent with generally accepted economic principles.

Boudreaux, Meiners & Zywicki raise related concerns, though they do not deny the existence of nonuse values.

> "Although everyone experiences subjective utility gains and losses that do not correspond to market money values, the fact that subjective utility exists in humans does not justify government policy geared to that dimension. Of course, government policy and the law, if they are to serve

[26] University of Southern California's "National Ocean Economics Project" provides information and links to research on non-market values of environmental amenities. http://ahf331b.usc.edu/nonmarket.html. Last accessed 4/4/03.

[27] Hans-Peter Weikard, "The Existence Value Does Not Exist and Nonuse Values are Useless." Paper prepared for the annual meeting of the European Public Choice Society, 2002. http://polis.unipmn.it/epcs/papers/weikard.pdf. Last accessed 4/4/03.

[28] This classification of option and bequest values as use values is consistent with other authors, including the U.K. Department for Transport, Local Government and the Regions *Economic Valuation with Stated Preference Techniques: Summary Guide.* http://www.dtlr.gov.uk/about/economics/05.htm. Last accessed 4/4/03.

[29] Weikard, *op cit.*

> useful social functions, must be geared to measures of human welfare. But because subjective utility is unmeasurable, government cannot be charged with the task of maximizing utility." (p. 793)

This recognition that nonuse values reflect subjective utility gains and are therefore not measurable or comparable across individuals is important. Though generally discussed in the context of environmental amenities, nonuse values exist for innumerable things. Some individuals may gain nonuse values from the knowledge that the Alaskan wilderness is untouched by oil drilling, while others may gain nonuse values from the knowledge that oil wells exist to provide jobs for Alaskan workers and national security. Some individuals may assign nonuse values to knowing people attend church regularly, while others may gain nonuse values from knowing others engage in hedonistic behavior. The question then becomes, if nonuse values are to be included in government decisions, on whose values should government reallocation of resources be based?

B. Contingent Valuation

Since there is no market in incremental changes in subjective individual utility, proponents of including nonuse values in government decision calculus turn to stated preference or "contingent valuation" (CV) surveys. Recent draft guidelines for regulatory analysis prepared by the Office of Management and Budget raise concerns about CV surveys, noting "the reliance of these methods on stated preferences regarding hypothetical scenarios and the complexities of the goods being valued by this technique raise issues about its accuracy in estimating willingness to pay compared to methods based on (indirect) revealed preferences."[30]

Despite concerns about its accuracy, the draft guidelines conclude that CV may be the only method available to estimate "nonuse" values, and do not dismiss CV as a tool. Instead, they state that "value estimates derived from contingent-valuation studies require greater analytical care than studies based on observable behavior," and proceed to enumerate "best practices" for conducting CV. The best practices for conducting CV surveys address sampling, survey instrument design, transparency and replicability of results.

However, Boudreaux *et al* show that the practical problems of CV cannot be resolved with better surveys because the technique itself is conceptually flawed.

> The questionable results [recognized by OMB and others] are merely the manifestation of greater underlying and incurable problems that render contingent valuation studies generally—and attempts to discern existence value particularly—useless and unreliable. The problem confronting designers of contingent valuation studies is at the conceptual and theoretical level, not at the merely practical level of implementation.

[30] Office of Management and Budget, Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations, 68 Fed. Reg. at 5,491 (Feb. 3, 2003).

> Contingent valuation studies are inconsistent with the fundamental principles of economic choice under conditions of scarcity and budget constraints and rest on a superficial understanding of the role played by dollar prices in a dynamic economy. (p. 776)

Values emerge, not as conscious, intentional decisions, but as the unintended and undesigned results of decentralized market activity. People do not have a single value for an environmental amenity, but rather schedules of different dollar figures dependent upon a nearly infinite variety of variables. As a result, Boudreaux *et al* conclude that stated market values are not acceptable surrogates for market prices.

Kahneman, Ritov, and Schkade have also examined CV methods and results to understand what stated preferences actually express.[31] They find that willingness to pay estimates derived from CV studies, though denominated in dollars, "are better viewed as expressions of attitudes than as indications of economic preferences," and that "the anomalies of CV are inevitable manifestations of known characteristics of attitudes and attitude expressions." (p. 204) They find that stated preferences derived from CV studies are analogous to juries' punitive damage awards, and are not consistent with economists' rational models.

Both jury awards and CV results seem to reveal a prescriptive notion of what should be, divorced from actual behavior or revealed preferences. But how much weight should these prescriptive notions carry in designing government policy?

Boudreaux *et. al.* point out,

> In market transactions, we can assume that all individual trades increase individual utility, because the occurrence of the trade itself suggests that the individual values the good received more highly than the good surrendered. Thus, it is only through the process of actual exchange of one good for another that we can know for sure that an individual values one option over another… Divorced from the discipline of making actual choices, the hypothetical choices presented by contingent valuation have little value. (p. 785)

Kahneman *et al* and Boudreaux *et al,* through very different paths, reach the conclusion that stated preferences divorced from any expectation of actually having to pay the stated values, are not accurate proxies for revealed economic preferences. The similarities Kahneman *et al* find between jurors and CV respondents suggests that, like jurors determining civil damage awards, CV respondents view the values they assign as imposing costs on someone other than themselves. They know they will never have to pay the values they profess to place on different amenities. Thus, these responses do not comply with the key concept of opportunity cost articulated in the guidelines – they do

[31] Daniel Kahneman, Ilana Ritov, and David Schkade, "Economic Preferences or Attitude Expressions?: An Analysis of Dollar Responses to Public Issues," in *Journal of Risk and Uncertainty,* 19:1-3; 203-235 (1999).

not "measure what individuals are willing to forgo to enjoy a particular benefit." Indeed, it strikes us as unrealistic to think that individuals would give up more than a small amount of income or other use value in exchange for a nonuse value. Indeed, as discussed above, the implications of the NODA—that nonuse values of the common fish saved from harm by the proposal dwarf the commercial or recreational value of the fish—is completely implausible. It is equally unrealistic to assume that it is in society's interests to pursue government policies that would divert society's scarce resources based on these subjective, stated preferences.

C. Benefits transfer

In its draft guidelines, OMB recognizes that it is not always possible to conduct an original study to estimate non-market benefits attributable to regulatory activity. It notes that although "benefit transfer," a method that applies existing estimates to a new context, "offers a quick, low cost approach for establishing values for goods and attributes of goods, you should consider it as a last resort option. Several studies have documented difficulties in applying benefit transfer methods."[32] The draft guidelines go on to list the conditions under which benefit transfer is appropriate and when it is not.

We have endorsed the draft guidelines on this point.[33] However, as discussed above, EPA's use of the benefit transfer method in this case, relying on a survey of willingness to pay for wetlands habitat to measure the value of fish in open waters, appears to defy most if not all of the conditions set forth in the draft guidelines.

IV. Conclusions and Recommendations

EPA's efforts to place values on the nonuse benefits attributable to reducing fish losses due to entrainment and impingement at power facility cooling water intakes illustrates the problems with attempting to capture subjective utility measures in policy decisions. EPA estimates that the commercial value (or value to American consumers) of the proposed regulations is $80,000 per year. It estimates the recreational fishing value at another $880,000 per year. In contrast, it values the nonuse benefits of the proposed regulations at between $14,170,000 and 26,870,000. On a per-pound basis, the nonuse values of the common fish examined in the NODA are 54 to 100 times greater than actual use values. This is implausible.

EPA's results suggest that every fish consumed actually costs Americans much more in nonuse values than it provides in consumption value. As noted above, the implication of this result is that Americans could experience benefits of between $500 billion and $1 trillion per year, simply by not eating fish. Preferences revealed by the fact that Americans do eat fish shows the impossibility of the benefit estimates presented in the NODA.

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[32] 68 Fed. Reg. at 5,520.

[33] See Mercatus Center Public Interest Comment on OMB's Draft Guidelines for Regulatory Analysis, May 2003. Available at http://www.mercatus.org/article.php/314.html.

Relying on stated preferences regarding hypothetical scenarios is widely recognized to be less reliable than relying on methods based on revealed preferences. In this NODA, EPA compounds the problems inherent in stated preference surveys by attempting to transfer the results of a CV study designed to value wetland habitat to estimate the benefits of common fish species. EPA appears to have gotten caught up in the complicated exercise of adjusting, extrapolating, and transferring, and not stopped to conduct a reality check on the plausibility of the results.

EPA should reconsider its approach to estimating benefits for this rule. The values attributable to commercial fishing (and corresponding consumption) are observable through market transactions and should be included. The values associated with recreational fishing are less easy to estimate, because they involve assumptions about the relationship between number of fish and recreational enjoyment, however, with care they should also be included. The nonuse values of the fish, however, involve subjective utility changes and are not measurable or comparable across individuals. While individuals may experience subjective utility gains from knowing that fish are not entrained or impinged, this does not justify regulation that imposes real opportunity costs. If forced to actually pay for the costs of regulation, it is simply implausible that people would be willing to give up a significant amount of private economic goods in exchange for pure nonuse value of fish.[34]

[34] Boudreaux *et al* defer to Adam Smith, who illustrated the concept two centuries ago with a hypothetical earthquake in China that killed millions. While a European would express sincere regrets about the plight of the dead, his concern would pale in comparison to a comparatively trivial misfortune of his own. Adam Smith, *The Theory of Moral Sentiments*, referenced in Boudreaux *et al.* (p. 774).

APPENDIX I
RSP CHECKLIST

Element	Agency Approach	RSP Comments
1. Has the agency identified a significant market failure?	**N/A**	EPA does not address the issue of market failure in this NODA.
2. Has the agency identified an appropriate federal role?	**N/A**	
3. Has the agency examined alternative approaches?	**N/A**	This NODA examines benefits from an alternative already proposed by EPA.
4. Does the agency attempt to maximize net benefits?	This NODA attempts to justify costs of $18 million by estimating large values for nonuse benefits. **Grade: F**	Net benefits are not maximized when the analysis that estimates the benefits is fundamentally flawed. The proposed rule arguably will produce $80,000 a year in benefits to commercial fishermen. In the North Atlantic Region, the value of commercial fish is the only value estimated that has any tie to an actually measurable market value. Yet the rule will cost $18 million.

Element	Agency Approach	RSP Comments
5. Does the proposal have a strong scientific or technical basis?	EPA relies on what appears to be a non-peer reviewed study that was designed to measure something very different from the values it attempts to quantify. **Grade: F**	EPA's estimate that the annual nonuse value of the fish lost to impingement and entrainment in the North Atlantic Region alone is $76 to $140 million is derived through too many estimates, assumptions, and extrapolations to have any basis to values in the real world.
6. Are distributional effects clearly understood?	**N/A**	
7. Are individual choices and property impacts understood?	The NODA concludes that nonuse value of fish exceed the consumption value by 54 to 100 times. **Grade: F**	EPA's results reveal that it has not considered the role of individual choice. If the true benefits lost to impingement and entrainment were even close to the amount the NODA suggests, we would expect private conservation organizations to organize and remediate the problem. That fact that they do not suggests that EPA's analysis completely misapprehends individual choice. The analysis also appears flawed because EPA does not understand the role of prices in an economy.

REGULATORY STUDIES PROGRAM

THE COSTS AND BENEFITS OF REGULATION AND GUIDELINES FOR REGULATORY ANALYSIS

Comments on OMB's 6th Report to Congress

May 2003

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THE COSTS AND BENEFITS OF REGULATION AND GUIDELINES FOR REGULATORY ANALYSIS

Comments on OMB's 6th Report to Congress

OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulation (RSP 2003-11, April 29, 2003)
by Susan E. Dudley and Brian F. Mannix

OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulation: Precautionary Aspects (RSP 2003-14, May 5, 2003)
by Jonathan H. Adler and Daniel R. Simmons

OMB's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements (RSP 2003-13, May 5, 2003)
by Susan E. Dudley and Brian F. Mannix

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THE COSTS AND BENEFITS OF REGULATION AND GUIDELINES FOR REGULATORY ANALYSIS

Comments on OMB's 6th Report to Congress

Preface

Regulations impose a hidden tax on Americans, a tax that ultimately falls on individuals—consumers, workers, entrepreneurs, investors, taxpayers, and citizens—and affects the quality of their lives. In order for the Legislative and Executive branches to understand better the effects of regulations on society, a sober and rigorous analysis of regulatory costs and benefits is vital.

The Office of Information and Regulatory Affairs in the Office of Management and Budget is charged with (1) overseeing regulatory policy and reviewing draft regulations under Executive Order 12866, (2) reviewing agency collection of information under the Paperwork Reduction Act, and (3) reporting annually on the costs and benefits of federal regulation pursuant to Section 624 of the FY2001 Treasury and General Government Appropriations Act. Its draft "2003 Report to Congress on the Costs and Benefits of Federal Regulations" not only provides estimates of the annual costs and benefits of federal regulations, but requests public comment on a number of areas, including the role of precaution in risk policy and regulation. An appendix to the report contains draft guidelines to agencies for analyzing regulations, on which OMB also seeks comment. When issued in final form, these documents will have a significant impact on both public understanding of the impact of existing regulation and the development of new regulatory policy.

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason is dedicated to advancing knowledge of regulations and their impacts on society. As part of its mission, RSP produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. Due to the importance of the draft report and guidelines, and the issues they raise, RSP filed three separate comments on different aspects of the OMB draft. These three comments, reproduced in this volume, do not represent the views of any particular affected party or special interest group, but are designed to protect the interests of American citizens.

In the first comment in this volume, Mercatus Senior Research Fellows Susan Dudley and Brian Mannix critique the draft report, respond to OMB's specific questions, and provide recommendations for improving future reports. They find that the benefit and cost data presented in the 2003 draft report are inconsistent and fragmentary and may not offer the American public an accurate picture of the benefits and costs of regulation. Moreover, because OMB simply reports and sums up agency estimates, the resulting total cost and benefit estimates are not based on a consistent and objective review of available information. The authors recommend that OMB (1) hold agencies accountable for analysis that complies with its regulatory analysis guidelines, (2) report benefits and costs honestly and without deliberate bias, and include a "report card" for agency analyses that highlights their strengths and weaknesses, (3) continue to build its regulation-by-regulation database of the costs and benefits of regulations issued before 1992, and (4) attempt to estimate the real costs associated with regulations that effect large "transfers" from one group to another.

In the second comment in this volume, Jonathan Adler, Assistant Professor at Case Western Reserve University School of Law, and Mercatus Research Fellow Daniel Simmons address OMB's request for information on "current risk assessment and management practices in federal agencies, with an emphasis on the role of precaution in risk policy and regulation." They examine the role of precaution in current

federal activities and argue that, while precaution has a place in federal policy, reliance on the precautionary principle is unlikely to improve federal risk management efforts. They illustrate with real examples that reliance on the precautionary principle as it is typically formulated produces unintended consequences that undermine government efforts to enhance social welfare. They urge regulators to reject precaution in risk assessment, and instead to allow objective, unbiased estimates of risk to inform policymakers and the public.

Issuing clear analytical guidelines, and holding agencies accountable for complying with them, is an important step toward regulatory reform. The third comment, by Susan Dudley and Brian Mannix, examines in detail the draft guidelines for regulatory analysis offered as an appendix to the report. The authors find that while many aspects of the draft guidelines are sound, they should focus more on the comparative analysis of market failure and regulatory failure, and not simply rely on the results of benefit-cost analysis to justify regulatory interventions. They also raise concerns regarding the guidelines' recommendation for the use of non-market "contingent valuation" benefits and non-market "ethical" discount rates. These recommendations cannot be defended and would undermine the care and detail embodied in the rest of the guidelines. Taken together, they amount to a license to: "Imagine some benefits. Imagine they go on forever. . . ." The authors urge OMB to leave the current (2000) guidelines in place while it revises the draft guidelines to address these concerns and make it clear that contingent valuation surveys and unrealistic discount rates will not be accepted.

More information on regulations and the hidden tax they impose is available from the Mercatus Center at George Mason University.

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May 2003

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Public Interest Comment on

Office of Management and Budget's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulation[1]

Abstract

In its sixth Report to Congress on the Costs and Benefits of Federal Regulations, the Office of Management and Budget misses an opportunity to provide government policymakers and the public a better understanding of the impact of federal regulations. We strongly support efforts by OMB and the respective agencies to assess regulatory costs and benefits, and are encouraged by OMB's extension of its regulation-by-regulation estimates back to 1992. However, the data as presented are still inconsistent and fragmentary and may not offer the American public an accurate picture of the benefits and costs of regulation. As illustrated in this comment with rules Mercatus scholars have studied, individual estimates are not made in accordance with the Administration's Guidelines. Moreover OMB simply reports and sums up agency estimates, so that total cost and benefit estimates are not based on a consistent and objective review of available information.

Holding agencies accountable for basing policy on sound regulatory analysis grounded in accepted scientific and economic principles is an important step. The revised guidelines for the conduct of regulatory analysis and the format of accounting statements, presented in draft as Appendix C of the draft report should support this, though we note here and in more detail in comments on those guidelines that some aspects of the guidelines may undermine the ability of regulators to ensure their initiatives do more good than harm.

Regulations impose a hidden tax on Americans, a tax that ultimately falls on individuals—consumers, workers, entrepreneurs, investors, taxpayers, and citizens—and affects the quality of their lives. In order for the Legislative and Executive branches to understand better the effects of regulations on society, a sober and rigorous analysis of regulatory costs and benefits is vital. We therefore urge OMB to continue this process and include the refinements to the annual report and guidelines that we have suggested.

[1] Prepared by Susan E. Dudley and Brian F. Mannix, Mercatus Center, George Mason University. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

Public Interest Comment on
OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulation

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of regulations and their impacts on society. As part of its mission, RSP produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. OMB's sixth Report to Congress on the Costs and Benefits of Federal Regulations offers an important opportunity for government policymakers and the public to gain a better understanding of the impact of federal regulations. RSP's comments on this report do not represent the views of any particular affected party or special interest group, but are designed to protect the interests of American citizens.

After an introductory section that discusses the importance of regulatory oversight and regulatory accounting, this comment evaluates and critiques OMB's estimates of the costs and benefits of federal regulation. Section II.A addresses OMB's estimates of the total costs of regulation issued over the last decade, Section II.B examines OMB estimates of this year's "major" rules, and Section II.C offers recommendations for improving the benefit-cost estimates. Section III responds briefly to OMB's request for comments on (1) guidelines for regulatory analysis, (2) analysis and management of emerging risks, and (3) improving analysis of regulations to protect homeland security. More detailed critiques of the regulatory analysis guidelines and emerging risks are provided in separate comments. Section IV concludes the comments.

I. The importance of regulatory oversight

In our previous comments on OMB draft reports to Congress, we discussed the importance of regulatory oversight, and the regulatory accounting process Congress initiated when it required these annual reports. The federal government has two principal mechanisms by which it diverts resources away from private sector uses towards government-mandated goals: taxation (and subsequent spending) and regulation. While tax revenues are measured, tracked through the federal budget, and subjected to Congressional oversight and public scrutiny, there is no corresponding mechanism for keeping track of the costs of regulation. Since the costs of regulation are not paid directly, as taxes are, Americans don't know what this hidden tax actually amounts to each year. This annual report represents a good opportunity to improve regulatory transparency not only by increasing awareness of the magnitude of the hidden regulatory tax, but also by increasing the accountability of regulators to American people.

It is important to recognize that *all* of the regulatory burden ultimately falls on individuals—consumers, workers, entrepreneurs, investors, taxpayers, citizens, and children—and affects the quality of their lives. Businesses (and governments too, for that matter) are merely intermediaries and cannot "absorb" the real costs of regulation. People bear the burden of this hidden regulatory tax.

We continue to support OIRA's renewed attention to the principles embedded in Executive Order 12866, issued by President Clinton in September 1993. We also commend the increased transparency OIRA has brought to the executive oversight process under President Bush. As we noted in previous comments, while openness and public debate are essential to the process of rulemaking and its oversight; internal communication, coordination, and deliberation are also essential for the Executive branch to operate effectively. To this end, the regulatory analysis guidelines included as Appendix C to the 2003 report should prove valuable at facilitating greater coordination and bringing improved analytical vigor to the regulatory process. We comment on specific aspects of those guidelines in section III.A below, and in more detail in separate comments.

OMB's report shows that, despite renewed efforts, compliance with sound regulatory principles remains uneven. Major regulations are not supported by sound regulatory analysis, yet OMB continues to report agency estimates without standardizing assumptions and methodologies. To truly meet the goals of increased transparency and accountability, OMB should, at a minimum, identify the different assumptions

and methods underlying the different agency estimates and the effect they have on the resulting overall estimates.

II. The Costs and Benefits of Federal Regulations

A. Estimates of the Total Costs and Benefits of Regulations Reviewed by OMB

The costs of regulations are a tax on American citizens, but unlike taxes, they are not accounted for in any systematic way. That is why Congress, through Section 624 of the FY2001 Treasury and General Government Appropriations Act, asked OMB to report each year "an estimate of the total annual costs and benefits (including quantifiable and nonquantifiable effects) of Federal rules and paperwork, to the extent feasible:

(A) in the aggregate;

(B) by agency and agency program; and

(C) by major rule."

There are admittedly numerous methodological and conceptual obstacles to developing reliable estimates of the total costs and benefits of regulation. However, OMB is in the best position to develop such estimates. We are encouraged that OMB has extended its estimate of total benefits and costs by including estimates of the impacts of rules issued between October 1992 and March 1995, as well as major rules issued between October 2001 and September 2002. As a result, OMB's estimates of total regulatory costs and benefits now cover the major regulations issued over the last ten years. These estimates, however, still suffer from serious shortcomings.

1. OMB continues to report estimates prepared by agencies without independent analysis.

OMB's reported estimates are based, as in previous years, on agency estimates of the costs and benefits of regulations. OMB caveats these estimates by saying:

> "We have not made any changes to agency monetized estimates other than connecting them to annual equivalents. Any comparison or aggregation across rules should also consider a number of factors that our presentation does not address. To the extent that agencies have adopted different methodologies—for example, different monetized values for effects, different baselines in terms of the regulations and controls already in place, different treatments of uncertainty—these differences remain embedded in [the total benefit and cost table]. While we have relied in many instances on agency practices in monetizing costs and benefits, our citation of or reliance on agency data in this report should not be taken as an endorsement of all the varied methodologies used to derive benefits and cost estimates.[2]

Aside from this caveat, OMB offers no independent assessment of the quality or usefulness of agency analyses, and correspondingly, the estimates presented in this report. There is little value added in simply compiling the unverified representations of agency management. Such an approach would be unthinkable when dealing with budget expenditures; OMB should make an effort to impose some discipline on agencies' estimates of regulatory expenditures.

We have suggested in previous comments that OMB's reports to Congress should provide more detailed information about the assumptions underlying the benefit and cost estimates of the individual regulations that comprise the aggregate figures. OMB is in a unique position to provide some useful analysis; it has access to agency analyses, interagency discussions, and public comments on individual rules. In the

[2] Draft 2003 report, p. 8.

course of its own reviews of significant regulations under Executive Order 12866, OMB analysts identify strengths and weaknesses of the methodologies agencies use to estimate benefits and costs. At a minimum, it should include those observations in this report in the form of a "report card" that highlights strengths and weakness of each analysis. OMB could present a table, along the lines of that produced in its 1988 Regulatory Program, that summarizes how each regulatory analysis addressed key criteria.[3]

2. The total benefit estimate is influenced heavily by four EPA rules.

OMB reports estimated annual benefits of regulation over the ten-year period (October 1992-September 2002) of between $135 billion and $218 billion. These benefits are much higher (4-5 times) than estimated costs, which OMB reports to be between $38 billion and $44 billion. However, the OMB report notes that EPA estimates of the benefits of four rules – all of which derive benefits from reducing particular matter (PM) emissions – contribute a substantial fraction of the aggregate benefits. EPA estimates, and OMB reports, benefits ranging from $96 billion to $113 billion per year attributable to PM reductions provided by these four rules; that is more than half of the benefits of all regulations combined.

As reported by OMB, EPA estimates that the benefits of reducing PM exceed the costs ($8 to $8.8 billion per year) by a factor of 12 or 13. In a footnote, OMB summarizes the uncertainties associated with benefits attributed to PM reductions, and many commentators have questioned the methodology EPA uses to derive these high benefits. Indeed, in our comments on OMB's 2001 report to Congress[4], we highlighted problems with EPA's estimates of these benefits, including (1) an unrealistic baseline, (2) uncertainties in the magnitude and causation of effects, (3) improper accounting for latency of effects, and (4) exaggerated valuation of health benefits.

The fact that the benefits reported by OMB are so dominated by the questionable analytical approach used to value reductions in one pollutant illustrates the problem with relying uncritically on agency estimates.[5]

The Congress needs an accurate picture of the benefits and costs of regulation; not only to evaluate the performance of existing regulatory programs, but also to make important decisions about future legislation. On its web page for the Clear Skies initiative, EPA continues to promote a highly questionable estimate of benefits based on the same flawed analysis of the health effects of PM, claiming that: "The monetized benefits of Clear Skies would total approximately $96 billion annually by 2020, substantially outweighing the annual costs of $6.5 billion."[6] On further reading, one learns that $93 billion of this is from an estimate of health effects, that an alternative estimate of these same health effects in only $11 billion, and (in a footnote) that even the $11 billion may be too high.

It is understandable that agencies try to portray their programs and initiatives in the best possible light. Because health-benefits estimation is subject to considerable uncertainty, there is typically a wide margin between what an agency thinks is "best" for public relations and what a statistician would define as a "best estimate" for scientific purposes. OMB must work to eliminate these biases, which have a disturbing tendency to persist and "bioaccumulate," even as caveats and footnotes tend to disappear.

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[3] U.S. Office of Management and Budget, *Regulatory Program of the United States Government*, April 1, 1987-March 31, 1989, pp. xv-xvii.

[4] Available at: http://www.mercatus.org/article.php/69.html.

[5] The cost estimates may have similar problems. In a Mercatus Center working paper, Garry Vaughn, PhD finds that EPA's cost estimates for air quality rules are understated by a factor of 4 or more. EPA's Section 812 report on the costs of clean air regulations between 1970 and 1990 estimates present value costs of $523 billion, while Vaughn found costs were more likely to be close to $2.4 trillion (both estimates in 1990 dollars).

[6] See http://www.epa.gov/air/clearskies/benefits.html , accessed April 28, 2003.

3. Other estimates of costs and benefits are questionable.

In Table 3 of the report, OMB presents estimated benefits and costs of regulations by selected programs and agencies. Regulations directed at energy efficiency and renewable energy are reported to produce benefits nearly twice the costs. (The benefits range from $4.7 to $4.8 billion compared to costs of $2.5 billion.) However, such a result is inconsistent with economic principles. Energy efficiency regulations restrict consumer choice by forcing consumers to purchase more energy-efficient appliances than they would choose in the absence of federal restrictions. While DOE consistently estimates net benefits from these standards, its analysis derives those benefits by substituting DOE-selected discount rates for consumer discount rates and preferences. In the absence of a significant market failure (which DOE does not identify to justify its regulations), it is implausible that restricting consumer choices will increase net benefits.

4. Costs and benefits of rules issued before 1992 could significantly increase total estimates.

OMB suggests that "the total costs and benefits of all Federal rules now in effect (major and non-major, including those adopted more than 10 years ago) could easily be a factor of ten or more larger than the sum of the costs and benefits" it reports. It recommends more research "to provide a stronger analytic foundation for comprehensive estimates of total costs and benefits by agency and program."[7]

We concur. However, several recent analyses may offer the foundation OMB seeks. Probably the most dependable estimate of the total costs of regulation is presented in a recent report for the Small Business Administration, by Professors Mark Crain and Thomas Hopkins. They estimate that Americans spent $843 billion in 2000 to comply with federal regulations.[8] This suggests that OMB's factor of 10 estimate (indicating total costs between $380 and $438 billion per year) may understate the actual costs.

In September 2001, the Mercatus Center released a working paper on the costs of workplace regulation.[9] Based on a careful review of available literature, including academic studies, agency regulatory impact analyses, and private sector analyses on the costs associated with 25 major statutory and executive provisions, the study conservatively estimates that workplace regulations cost at least $91 billion per year in 2000 dollars. In contrast, OMB's estimate of the costs of labor regulations issued since 1992 is slightly over 1 billion per year.

B. Estimates of Benefits and Costs of this Year's "Major" Rules

Table 4 of OMB's report presents information on each of the "major rules" issued in final form between October 1, 2001 and September 30, 2002. This table illustrates the range of approaches and the degree of analytical rigor used by agencies in estimating the benefits and costs of economically significant rules pursuant to E.O. 12866. Of the 31 economically significant rules reviewed by OMB and included in this report, OMB classifies the vast majority (25) as "transfers," i.e., they simply shift money from one segment of society to another. OMB reports neither costs nor benefits for transfer rules. Of the remaining six "social regulations," issuing agencies estimated benefits for five, and costs for only three. Thus, of the 31 major rules issued during fiscal year 2002, OMB presents costs for only three, and benefits for only five.

These statistics highlight several problems with relying solely on information reported by agencies.

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[7] Draft 2003 report, p. 7.

[8] W. Mark Crain and Thomas D. Hopkins, *The Impact of Regulatory Costs on Small Firms*, Office of Advocacy, U. S. Small Business Administration, RFP No. SBAHQ-00-R-0027.

[9] Joseph M. Johnson, *A Review and Synthesis of the Cost of Workplace Regulations*, Mercatus Center at George Mason University, Working Paper Series, September 2001.

1. The most obvious is the lack of information on the impacts (costs and benefits) of the major rules issued last year. By definition, an economically significant or major rule has an annual impact of $100,000,000 or more,[10] yet costs are presented for less than ten percent of these rules.
2. There are real costs associated with regulations that effect large "transfers" from one group to another. OMB should investigate and report these costs.
3. For 2 of the rules, agencies report only expected benefits, not expected costs, which is likely to overstate any net benefit estimate

Scholars in the Regulatory Studies Program of the Mercatus Center at George Mason University have commented on 3 of the 6 regulations summarized in Table 4. These comments raised questions about the benefit and cost estimates developed in the draft Regulatory Impact Analyses and relied on in OMB's table, and are summarized below.[11]

1. DOE's Energy Conservation Standards for Central Air Conditioners and Heat Pumps[12]

DOE's benefit estimates are based almost exclusively on cost savings to the average consumer estimated using unrealistic discount rate assumptions, without adequately considering either different usage patterns, or the value consumers place on reliability, performance (especially dehumidification), or esthetics. The standards would require consumers in northern states to purchase high-cost air conditioners, and residents of southern states to purchase high-cost heat pumps, even though they would not likely recoup those up-front costs in lower energy bills over the life of the unit. DOE's static comparison of up-front costs to operating costs also ignores the fact that once the initial investment is made, lower operating costs will encourage more usage of the unit, leading to increased energy use (less conservation). Since air-conditioning usage is highly elastic, forcing consumers to use higher efficiency units may increase energy consumption instead of decreasing it. Rather than providing net benefits of almost $2 billion per year, as estimated by DOE and reported by OMB, these standards will likely impose net cost on consumers.

2. EPA's Rule to Control Emissions from Nonroad Large Spark-Ignition Engines and Recreational Vehicles[13]

EPA's analysis supporting this rule did not show that nationwide standards will be effective at meeting air quality in the urban regions that are out of attainment, but instead justified the rule on cost-per-emitted-ton measures that do not inform policy makers as to whether the restrictions will actually contribute to air quality goals. EPA also justified the stricter emission standards on alleged fuel cost savings to purchasers of these vehicles without recognizing that purchasers value other qualities that would have to be forfeited in these machines.

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[10] E.O. 12866 (available at: http://www.whitehouse.gov/omb/inforeg/eo12866.pdf) defines a significant regulatory action as one that "is likely to result in a rule that may:

(1) Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;
(2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
(3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
(4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive order.

[11] For a complete list of regulations on which scholars at the Mercatus Center have commented, go to www.Mercatus.org and click on Regulatory Studies.

[12] Available at the Mercatus web site: http://www.mercatus.org/research/RSP200113.htm.

[13] Available at the Mercatus web site: http://www.mercatus.org/research/RSP200116.htm.

Instead of economic costs, the Agency estimated the engineering costs that producers would face in modifying engine designs and developing new technologies needed to meet the emission standards. Our review of EPA's analysis also revealed an inconsistent and inappropriate treatment of research and development costs, flawed "learning curve" treatment of variable costs, and a flawed treatment of fixed costs.

3. DOT Light Truck Average Fuel Economy Standards[14]

The Department of Transportation was restricted from analyzing the costs and benefits of CAFE standards for model year 2004, so the OMB report includes no estimates for this rule. However, NHTSA's economic model supporting its CAFE standards for 2005-2007 shows large net benefits to consumers even if markets are assumed to operate perfectly, i.e., without counting any externalities. We know this must be false, because the fundamental premise of benefit-cost analysis is that all benefits and costs must be valued according to the consumers' own preferences. Any regulatory constraint that forces consumers away from their preferred choices must have negative net benefits. NHTSA's results prove that its model must be wrong.

The model year 2004 standards are thus likely to impose net costs on consumers. Errors like this should not be incorporated into OMB's report uncritically.

C. Recommendations for Improving Total Benefit-Cost Estimates

1. OMB should hold agencies accountable for analysis that complies with its economic analysis guidelines.

OMB's guidelines for regulatory analysis reflect generally accepted principles for evaluating the impacts of regulation. In the course of E.O. 12866 review, it should hold agencies accountable for following the guidelines.

2. The report should present OMB's objective estimates of the benefits and costs of individual regulatory actions.

In many cases agencies are required by law to issue regulations whose costs exceed the benefits—although the agencies are understandably reluctant to say so. Nonetheless, in its report to Congress, OMB should report benefits and costs honestly and without deliberate bias. OMB should report best (i.e., expected value) estimates of aggregate benefits and costs, in addition to ranges. OMB should identify in a concise but comprehensive manner variations in agency methodologies used to estimate benefits and costs of individual regulations. It should present a "report card" for agency analyses that highlights their strengths and weaknesses.

3. OMB should continue to build its regulation-by-regulation database of the costs and benefits of regulations issued before 1992.

The report recognizes that "the total costs and benefits of all Federal rules now in effect (major and non-major, including those adopted more than 10 years ago) could easily be a factor of ten or more larger than the sum of the costs and benefits" it reports. OMB should be commended for providing estimates for a ten-year period in this report. It is in the best position to continue to extend its estimates to include costs and benefits of regulations issued before 1992.

4. OMB should attempt to estimate the dead-weight loss associated with "transfer rules"

There are real costs associated with regulations that effect large "transfers" from one group to another. At the very least, OMB should estimate the deadweight loss associated with the transfer (as it has done in

[14] Comments on the light truck CAFÉ standards for 2005 are available at: http://www.mercatus.org/article.php/208.html.

previous years' reports). OMB has estimated the "excess burden of taxation" at 25 percent of revenues. It would be surprising if transfers effected by regulation had a deadweight loss any less than that. In addition, regulations that transfer wealth are typically the product of lobbying and other rent-seeking behavior on the part of the beneficiaries. Such rent-seeking will dissipate the benefits, so that costs assumed to be transfers may in fact represent real resource costs.[15] OMB should investigate and report these costs.

III. Recommendations for Reform

In this report, OMB has taken a different approach to eliciting recommendations for reform, as required by Congress. It asks for comment on (1) draft guidelines for regulatory analysis, (2) approaches for analyzing and managing emerging risks, and (3) improving the analysis of regulations related to homeland security. We address these briefly below. In separate comments, we provide a more detailed review and critique of the draft Guidelines for Regulatory Analysis.

A. Regulatory Analysis Guidelines

As recommended above, developing clear analytical guidelines, and holding agencies accountable for complying with them, would be an important step toward regulatory reform. Appendix C of the draft 2003 report presents draft guidelines for regulatory analysis. The draft revises guidelines first issued during the Reagan administration in 1988, and then revised by the Clinton administration in 1996 and 2000.[16]

The draft guidelines provide more detailed guidance than its predecessors in several key areas, including the conduct of cost-effectiveness analysis as well as benefit-cost analysis, and treatment of uncertainty using formal probabilistic analysis. It is also refreshing that they encourage agencies to be transparent in their analysis and assumptions so that reviewers can understand and reproduce results. The guidelines should ensure greater consistency across agency analyses, and should facilitate more accurate annual reporting of regulatory costs and benefits as required by Congress.

Despite these good qualities, the draft also takes some curious turns that seem inconsistent with an administration philosophy that embraces markets and limited government. For example, the draft is arguably less demanding than either the Reagan or Clinton guidelines in its requirement that, before considering regulatory intervention into private markets, an agency must first identify a significant market failure (why the private sector can't address the issues without regulation). The new guidelines cite "other possible justifications" for regulatory action, including "promoting privacy and personal freedom." It provides no example of when regulation (which, almost by definition, *restricts* personal freedoms) would be necessary to *promote* personal freedom.

The draft also suggests "harmonization of U.S. and international rules may require a strong Federal regulatory role." What this means is unclear. Would the new guidelines endorse restrictions on promising new therapeutic or agricultural products to "harmonize" with European Union members who resist biotechnology techniques? U.S. foreign policy ought to stress our objective of exporting freedom, not importing government regulations—particularly regulations that lack any economic rationale apart from "everybody does it."

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[15] Gordon Tullock. "The Welfare Costs of Tariffs, Monopolies and Theft" *Western Economic Journal*, 5, pp. 224-232. (1967).

[16] The 1996 guidelines were not called guidelines but "Best Practices."

1. Discounting inter-generational effects

The draft guidelines venture into some controversial areas. On "ethical grounds," yet without any economic or empirical rationale, it advocates applying discount rates as low as one percent for measuring long-term (inter-generational) benefits and costs.

OMB refers to a conference volume published by Resources for the Future[17] as justification for annual discount rates as low as 1 percent. Yet, a careful review of the papers in this volume does not offer clear support for a low intergenerational discount rate. As discussed more fully in our companion comment on OMB's guidance, as many of the papers in the volume offer evidence that a low rate would be *inappropriate*. Most of the authors who expressed concern that the results of traditional discounting violate ethical intuition were unable to defend making decisions based on an arbitrarily low discount rate.

We believe it is a mistake to vest the discount rate with moral significance. It is simply a price, formed by the interaction of supply and demand and strongly influenced by the state of technology. It should reflect the opportunity cost of the investment, or the foregone benefits of other projects not undertaken as a result of a mandated government expenditure, which could have provided value for future as well as current generations.

In comments on a paper in the volume, Jerome Rothenberg notes that abatement (of future problems, like climate change) takes two forms: prevention or adaptation. A subset of adaptation "is to make provision for a general subsidizing of those [future] generations in terms of overall productivity—in effect, a reimbursement to them for sustaining unmitigated climatic damages." Thus, the opportunity cost of preventive abatement actions is the lost productivity of adaptation/reimbursement investments, which can be approximated by market rates of return on capital.[18]

Looking hundreds of years into the future is difficult; so let's examine a low-discount-rate approach by looking to the past. If we could go back in time, would we really ask our (relatively poorer) ancestors to set their money aside at a one percent return for our benefit? Indeed, would we even be better off if they had done so? They would have had to forsake many higher return investments to make this "investment in the future" and as a result, our standard of living would likely be lower today, even with the "inheritance" they left us invested at a one percent rate.

As OMB recognizes, rates of return that are required for private investments are already much higher than those routinely accepted by government agencies, in part because of the burden of taxation. This distortion will be exacerbated if government agencies are permitted to justify proposals that return benefits of only one percent, and do that only after decades or centuries pass. Such low-value government-mandated projects will displace ever greater amounts of private investment, raising the question of how the CEA can forecast long-term economic growth in excess of one percent annually, when it is so willing to displace the high-value private investment that drives economic growth.

2. Use of contingent valuation surveys for estimating non-use values

The draft, like the Clinton guidelines before it, supports the use of the controversial benefit-valuation technique known as contingent valuation (CV). Noting that CV may be the only method available to estimate "non-use" values, the guidelines attempt to address its problems by enumerating "best practices" for conducting CV. But, as Boudreaux, Meiners & Zywicki[19] show, the practical problems of CV cannot be resolved with better surveys because the technique itself is conceptually flawed. CV studies rest on the

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[17] Paul R. Portney and John P. Weyant (eds.), *Discounting and Intergenerational Equity,* Washington, D.C.: Resources for the Future, 1999.

[18] Rothenberg also notes that when investments come at the expense of investment and consumption, a social discount rate, rather than the private cost of capital, is appropriate (p. 107).

[19] Donald J. Boudreaux, Roger E. Meiners and Todd J. Zywicki. "Talk is Cheap: The Existence Value Fallacy," *Environmental Law.* Northwestern School of Law of Lewis and Clark College. Vol. 29, No. 4 (1999).

assumption that values are absolute and static, when in reality they are relative and dynamic, formed by the interaction of market forces.

Kahneman, Ritov, and Schkade find that willingness to pay estimates derived from CV studies, though denominated in dollars, "are better viewed as expressions of attitudes than as indications of economic preferences," and that "the anomalies of CV are inevitable manifestations of known characteristics of attitudes and attitude expressions."[20] They find that stated preferences derived from CV studies are analogous to juries' punitive damage awards, and are not consistent with economists' rational models.

Both jury awards and CV results seem to reveal a normative notion of what should be, divorced from actual behavior or revealed preferences. But how much weight should these prescriptive notions carry in designing government policy? Boudreaux *et. al.* point out,

> In market transactions, we can assume that all individual trades increase individual utility, because the occurrence of the trade itself suggest that the individual values the good received more highly than the good surrendered. Thus, it is only through the process of actual exchange of one good for another that we can know for sure that an individual values one option over another... Divorced from the discipline of making actual choices, the hypothetical choices presented by contingent valuation have little value.[21]

Kahneman *et al* and Boudreaux *et al,* through very different paths, reach the conclusion that stated preferences divorced from any expectation of actually having to pay the stated values, are not accurate proxies for revealed economic preferences. The similarities Kahneman *et al* find between jurors and CV respondents suggests that, like jurors determining civil damage awards, CV respondents view the values they assign as imposing costs on someone other than themselves. They know they will never have to pay the values they profess to place on different amenities. Indeed, it strikes us as unrealistic to think that individuals would give up more than a small amount of income or other use value in exchange for a non-use value. It is equally unrealistic to assume that it is in society's interests to pursue government policies that would divert society's scarce resources based on these subjective, stated preferences.

B. Analysis and Management of Emerging Risks

The report notes that "US regulators rely on various science-based precautionary approaches in assessing potential hazards and taking protective actions." "For purposes of collecting and analyzing current risk assessment and management practices in federal agencies, with an emphasis on the role of precaution in risk policy and regulation, the Administration has formed an Interagency Work Group on Risk Management,"[22] and requests comment on several questions, which we address below.[23]

Before we address the specific questions however, a brief introduction to the concept of "precaution" in risk policy and regulation is in order. The essence of OMB's question is how should regulators behave when there exists uncertainty about the likelihood or magnitude of potential harm associated with human action. Some advocate the "precautionary principle" as the guiding principle for policies directed at public health and the environment. There is no widely endorsed definition of the precautionary principle, but one that is often cited is the January 1998 Wingspread Statement on the Precautionary Principle:

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[20] Daniel Kahneman, Ilana Ritov, and David Schkade, "Economic Preferences or Attitude Expressions?: An Analysis of Dollar Responses to Public Issues," in *Journal of Risk and Uncertainty,* 19:1-3; 203-235 (1999).
[21] Boudreaux, *et. al., Op. Cit.* p. 785.
[22] 2003 draft p. 19.
[23] In separate comments on this draft report, other Mercatus scholars provide additional feedback on this issue.

> When an activity raises threats of harm to human health or the environment, precautionary measures should be taken even if some cause-and-effect relationships are not fully established scientifically.[24]

Variations on this principle have appeared in several international environmental agreements and declarations and have been used to justify international controls or bans on various technologies.[25] Concerned that the "burden of scientific proof has posed a monumental barrier in the campaign to protect health and the environment,"[26] proponents turn to the precautionary principle to avoid having to justify decisions based on available evidence, but instead based on a "better safe than sorry" approach.

The problem with this approach is that it does not recognize that inaction, as well as action, bears risks. Sunstein points out that "risks of one kind or another are on all sides of regulatory choices, and it is therefore impossible, in most real-world cases, to avoid running afoul of the principle.[27]

In his book, *The Precautionary Principle: A Critical Appraisal of Environmental Risk Assessment*, Indur Goklany[28] shows that the current use of the precautionary principle is flawed in that it focuses simplistically on potential dangers associated with new technologies and ignores the very real risks that could be mitigated by those technologies. For example, advocates of applying the precautionary principle to new genetically modified organisms interpret it as requiring that a new substance not be introduced "unless you have proof it will do no harm to the environment."[29] This approach would apply precaution only to the unknown risks a new technology might introduce, without regard to the benefits to health or the environment that will be foregone if it is banned.

Goklany proposes an alternative approach to "precaution" in policy making that considers the risks of inaction as well as the risks of action. While we do not endorse all aspects of Goklany's formulation of a precautionary principle, we highly recommend his thoughtful book to OMB and the task force. He offers a set of criteria on which to construct a precautionary framework:

1. The *public health criterion* suggests that threats to human health take precedence over threats to the environment.
2. The *immediacy criterion* requires that more immediate threats be given priority over threats that could occur later.
3. The *uncertainty criterion* calls for threats that are more certain to take precedence over less certain threats.
4. The *expectation-value criterion* says that for threats that are equally certain, the one with the higher expected value should receive greater weight.
5. The *adaptation criterion* states that "if technologies are available to cope with, or adapt to, the adverse consequences of an impact, then that impact can be discounted to the extent that the threat can be nullified."

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[24] Wingspread Statement: A Common Sense Way to Protect Public Health & the Environment, Prepared by the Science & Environmental Health Network, January 25, 1998 <<http://www.sehn.org/wing.html>>

[25] For example, Principle 15 of the Rio Declaration (UN 1992:10), Convention on Biological Diversity, Article 3.3 of the U.N. Framework Convention on Climate Change (UNFCC, 1992). See Goklany 2001 for a discussion of these declarations.

[26] Joel Tickner, Carolyn Raffensperger, and Nancy Myers. *The Precautionary Principle In Action: A Handbook*, First Edition. Science and Environmental Health Network. (1998) Available at http://www.sehn.org/rtfdocs/handbook-rtf.rtf

[27] Cass Sunstein, "The Paralyzing Principle." *Regulation* Vol. 25, No. 4 (Winter 2002-2003) Cato Institute. Available at www.regulationmagazine.com.

[28] The Cato Institute, 2001.

[29] Goklany, quoting Leggett of Greenpeace, p. 2.

6. The *irreversibility criterion* requires that greater priority be given to outcomes that are irreversible, or likely to be more persistent.[30]

Rather than using these criteria one at a time, as Goklany suggests, we find them very useful factors to consider when conducting benefit-cost analysis. Examining the benefits and costs of different policy options with these criteria in mind would help policy makers balance the risk of accepting new products or technologies too quickly and without complete information against the risks of delaying or foregoing new products or technologies.

We now turn to the specific questions posed by OMB in the draft report.

1. Ways in which "precaution" is embedded in current risk assessment procedures through "conservative" assumptions in estimation of risk, or through explicit "protective" measures in management decisions as required by statutory requirements as well as agency judgments. [31]

Precaution is embedded in current risk assessment procedures, particularly those directed at human health risk assessments, but such precaution may harm, rather than protect, public health. Risk assessments based on animal studies, in particular, present policy makers with only the high end of the range of possible risk outcomes. This is a problem because when agencies focus their efforts on regulating insignificant risks, they may forsake more significant risks, or inadvertently create even greater risks.

Most estimates of human risk from exposure to a substance come from extrapolating risks from animal studies, or from studies of human populations exposed to very high doses of the substance. This raises difficult questions, including how to treat differences between species (e.g., rats and humans) and how to extrapolate the effects of very high doses to the relatively low exposure levels encountered by Americans. Currently, the assumptions used to make these extrapolations are very cautious, resulting in exaggerated estimates of risk. Generally, the risk estimates derived from these conservative assumptions are treated as expected values, rather than upper bounds, leaving regulators poorly informed about how effective regulation will be.

2. Examples of approaches in human and ecological risk assessment and management methods addressed by US regulatory agencies (e.g., consumer product safety, drug approval, pesticide registration, protection of endangered species) which appear unbalanced. [32]

As discussed above, risk assessments methods in the U.S. systematically overstate estimated risks. EPA's regulation limiting arsenic in drinking water to 10 ug/l, for example, likely overstates the risk to exposures in the U.S. significantly.

- The 10 ug/L standard was based largely on Taiwan studies which linked long-term exposure to arsenic levels that are 10 times higher than the current U.S. standard to increased risk of lung and bladder cancers.
- These study populations differ in important ways from the U.S. population, for example they had a higher incidence of smoking and poorer nutrition. By ignoring these differences, EPA likely overstated by a significant amount the risk of arsenic ingestion in the U.S.
- The assumption of a linear dose-response function to extrapolate effects at 500 ug/L down to levels of 50 ug/L, 20 ug/L and 10 ug/L is not consistent with either National Academy of Science (NAS) findings or available evidence on the mode of action for arsenic-associated cancers and is likely to overstate risk at low doses.

[30] Goklany pp 9-10.
[31] 2003 draft p. 20.
[32] 2003 draft p. 20.

- EPA improperly discounted an epidemiological study of Latter Day Saints in Utah (Lewis et al., 2000), which found no statistical evidence linking the amount of arsenic ingested in drinking water with elevated risks of bladder or lung cancer.[33]

The Food and Drug Administration's new drug and devise approval process is another example where precaution can imperil Americans' health. According to one medical doctor who studies FDA policy, "the average number of clinical trials performed on an average drug increased from 30 in the early 1980s to 68 during 1994-95, while the average number of patients in clinical trials for each drug more than tripled. Furthermore, the average time required for clinical trials of a new drug increased from 85 to 92 months from the first half of the 1990s to the second half."[34] The time and cost involved in bringing a new drug to the market prevents new life-saving treatments from reaching people who need them and ends up costing lives.

Another commentator illustrated this problem with the 15 years FDA took to approve an artificial valve, which significantly reduces embolism risk. Approved by the FDA in 2001, the valve had been available since 1986 or earlier in Italy, Germany, France, Switzerland, and Japan. "Given the fact that approximately 16,000 heart valve recipients per year in the U.S. experience bleeding complications, many of them fatal, the Omnicarbon valve offers major life-saving benefits—benefits which were denied to the American public due to the FDA's 15-year delay."[35]

3. How the US balances precautionary approaches to health, safety and environmental risks with other interests such as economic growth and technological innovation.[36]

In 1983[37] the National Academy of Sciences codified the process by which regulators should quantitatively evaluate risks and make policies to reduce those risks. It suggested separating the process into two parts: risk assessment and risk management. *Risk assessment* is a purely scientific process that measures the risk of an activity. For example, risk assessment could estimate the risk of contracting cancer from exposure to a certain chemical over a certain length of time. Risk assessment cannot tell whether that risk is too high, or what should be done about it. That decision is made in the risk management phase. *Risk management* takes scientific risk assessment information and combines it with other information, such as the cost and feasibility of reducing risks, to determine what action to take.

This appears to us to be a sound process. It relies on most-likely estimates of risk based on available scientific evidence, and explicitly considers tradeoffs of different actions. Unfortunately, as discussed above, the results of the risk assessment phase tend to be systematically biased, which confounds the risk assessment/risk management division. Because of that systematic bias, uncertain risks are likely to be weighed more heavily than more certain risks of harm.[38] Whatever its merits, precaution is a risk-*management* technique, and there is no place for it in risk *assessments*.

C. Analysis of Regulations Related to Homeland Security

OMB observes that it expects a significant number of homeland-security proposals in the future and requests comment on how best to evaluate their benefits and costs. OMB is asking important questions.

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[33] Robert S. Raucher, PhD Comment on EPA's Proposed National Primary Drinking Water Standards: Arsenic, Mercatus Center at George Mason University, RSP 2000-18. http://www.mercatus.org/article.php/87.html.

[34] Henry Miller. "Strong Bush Prescription Needed to Cure an Overactive FDA" Guest Op-Ed *Findlaw.com.* January 12, 2001.

[35] Competitive Enterprise Institute. "CEI Criticizes FDA Delay In Approving New Heart Valve." June 27, 2001.

[36] 2003 draft p. 20.

[37] National Academy of Sciences. *Risk Assessment in the Federal Government: Managing the Process.* Washington, DC: National Academy Press. 1983.

[38] See "The Perils of Prudence" by Albert Nichols and Richard Zeckhauser, *Regulation* Nov/Dec 1986 for a discussion of how deliberately bias risk assessments can backfire.

The nation suffered a massive blow after the attacks of September 11, 2001. Much like the pattern Higgs describes in *Crisis and Leviathan*,[39] the nation has responded emotionally, and political priorities have changed. New government machinery has been designed and installed, and older programs have been expanded. Unlike past ratchet-like responses that led to a larger federal establishment and expenditures, the new ratchet will likely be built only partly of larger employment levels and increased expenditures of tax money. Regulation will form the other, and perhaps most significant, part.[40] Thus, it is essential that OMB continue to fulfill its functions under Executive Order 12866 to ensure these new regulations are truly in the public interest.

D. Other Recommendations

In future reports, OMB should consider expanding its interpretation of "recommendations for reform." Several commentators have suggested the development of a regulatory budget, and that is part of the rationale for this annual report to Congress on the Benefits and Costs of Federal Regulations. What other changes in regulatory procedures might provide more accountability to the public? For example, Supreme Court Justice Stephen Breyer once suggested that agency-issued regulations should not have the force of law until enacted into law by the Congress. Others have suggested that some regulatory standards could be developed as recommendations by federal agencies, to be enacted by state legislatures. The Toxic Substances Control Act of 1976 asked the EPA to consider whether the government should compensate individuals for the costs imposed by EPA's regulatory programs.[41] It would be useful for OIRA to assemble a catalog of ideas for generic regulatory reform, including some that have been tried in other nations, and begin a public discussion of their merits and weaknesses. Even if some of the ideas seem impractical, such a discussion would help advance our understanding of the nature of government regulation and the pathologies that afflict it.

IV. Conclusions

We strongly support efforts by OMB and the respective agencies to assess regulatory costs and benefits, and are encouraged by OMB's extension of its regulation-by-regulation estimates back to 1992. However, the data as presented are still inconsistent and fragmentary and may not offer the American public an accurate picture of the benefits and costs of regulation. As illustrated above with rules Mercatus scholars have studied, individual estimates are not made in accordance with the Administration's Guidelines. Moreover total cost and benefit estimates are not based on a consistent and objective review of available information.

Holding agencies accountable for basing policy on sound regulatory analysis grounded in accepted scientific and economic principles is an important step. The revised guidelines for the conduct of regulatory analysis and the format of accounting statements, presented in draft as Appendix C of the draft report should support this, though we note here and in more detail in comments on those guidelines that some aspects of the guidelines may undermine the ability of regulators to ensure their initiatives do more good than harm.

Regulations impose a hidden tax on Americans, a tax that ultimately falls on individuals—consumers, workers, entrepreneurs, investors, taxpayers, and citizens—and affects the quality of their lives. In order for the Legislative and Executive branches to understand better the effects of regulations on society, a sober and rigorous analysis of regulatory costs and benefits is vital. We therefore urge OMB to continue this process and include the refinements to the annual report and guidelines that we have suggested.

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[39] Robert Higgs. *Crisis and Leviathan: Critical Episodes in the Growth of American Government.* Oxford: Oxford University Press. 1987.

[40] Susan Dudley & Bruce Yandle. *Is 9/11 a Crisis to be followed by a Leviathan?* Mercatus Center at George Mason University (2002) Available at: http://www.mercatus.org/article.php/52.html.

[41] Section 25(a).

MERCATUS CENTER
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REGULATORY STUDIES PROGRAM

Public Interest Comment on

Office of Management and Budget's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations: Precautionary Aspects[1]

Abstract

In its sixth Report to Congress on the Costs and Benefits of Federal Regulations, the Office of Management and Budget explains that the Administration has formed an "Interagency Work Group on Risk Management." To assist in the Work Group's efforts, the Draft Report requests information on "current risk assessment and management practices in federal agencies, with an emphasis on the role of precaution in risk policy and regulation."

The essence of OMB's request is: How should regulators act when uncertainty exists about the likelihood or magnitude of potential harm associated with human action? In response to this question, some advocate reliance on the precautionary principle. While precaution has a place in federal policy, reliance on the precautionary principle would not improve federal risk management efforts. To the contrary, reliance on the precautionary principle as it is typically formulated would, in all likelihood, produce unintended consequences that undermine government efforts to enhance social welfare.

This comments argues that risks should be examined in a two-part process: risk *assessment* and risk *management.* Risk assessments should focus on developing the most accurate possible assessment of potential risks. To achieve this, the most probable assumptions should be used, not those that are the most conservative. *Risk management* takes scientific risk assessment information and combines it with other information, such as the cost and feasibility of reducing risks, to determine what action to take.

When precaution is used in risk assessment, the risks of new technologies and products are overstated, causing regulators to unduly concentrate on new products while ignoring older, and possibly more significant risks. Overcautious risk management also does not necessarily promote safety and regulators need to be aware that even the most well-intentioned precautionary measures can have terrible results. This comment gives several examples of precautionary risk assessments creating unintended side effects, such as the Food and Drug Administration delaying life-saving drugs, and the Fish and Wildlife Service harming fish in an effort to save them.

[1] Prepared by Jonathan H. Adler, Assistant Professor at Case Western Reserve University School of Law and Daniel Simmons, Research Fellow, Regulatory Studies Program. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

Public Interest Comment on

Office of Management and Budget's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations: Precautionary Aspects

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic and legal scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the Agency's proposals on overall consumer welfare.

In OMB's Draft Report to Congress on the Costs and Benefits of Federal Regulations, the Administration explains that it has formed an "Interagency Work Group on Risk Management."[2] To assist in the Work Group's efforts, the Draft Report requests information on "current risk assessment and management practices in federal agencies, with an emphasis on the role of precaution in risk policy and regulation."[3]

The essence of OMB's request is: How should regulators act when uncertainty exists about the likelihood or magnitude of potential harm associated with human action? In response to this question, some advocate reliance on the precautionary principle. While precaution has a place in federal policy, reliance on the precautionary principle would not improve federal risk management efforts. To the contrary, reliance on the precautionary principle as it is typically formulated would, in all likelihood, produce unintended consequences that undermine government efforts to enhance social welfare.

I. Precaution as a Guiding Principle for Regulatory Policy

While there is no widely endorsed definition of the precautionary principle a widely cited formulation is the "Wingspread Consensus Statement," a document drafted by several dozen environmental activists in January 1998.[4] Under the Wingspread formulation: "When an activity raises threats of harm to human health or environment, precautionary measures should be taken even if some cause and effect relationships are not fully established scientifically."[5] The precautionary principle appeals to the common sense idea that "it is better to be safe than sorry." At its core, the precautionary principle embodies "the belief that society should seek to avoid environmental damage by careful forward planning, blocking the flow of potentially harmful activities."[6]

Simple safety measures, such as wearing a seatbelt or motorcycle helmet, can greatly reduce the risk of substantial harm at relatively modest cost. In many instances preventing harm can be easier and less costly than repairing damage after the fact. While the precautionary principle appeals to conventional notions of "safety" and "taking care," as typically formulated, it calls for more drastic measures than the adoption of cost-effective safety measures.

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[2] Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations, 68 Fed. Reg. 5492, 5499 (2003).

[3] *Id.*

[4] Signatories of the statement included representatives of Greenpeace, Physicians for Social Responsibility, the W. Alton Jones Foundation, the Silicon Valley Toxics Coalition, and the Indigenous Environmental Network, among others.

[5] The Wingspread Statement is reprinted in Appendix A, *Protecting Public Health & The Environment*, pp. 353–55.

[6] Joel Tickner, Carolyn Raffensperger, and Nancy Myers, *The Precautionary Principle in Action: A Handbook* (Science and Environmental Health Network, 1999), p. 3.

Rather, the precautionary principle calls for a presumption that government action is necessary to address every potential risk that could arise from technological advance or productive economic activity. The principle is premised on the idea that all technologies and chemical substances are dangerous until proven safe. Drastic changes in regulatory policy are therefore required. In the words of its proponents, "new principles for conducting human affairs are necessary" as it is time to "adopt a precautionary approach to *all human endeavors*."[7]

As applied in the environmental context, this means that it is better to err on the side of regulating or controlling new technologies than to risk new or unforeseen problems; "decision makers should act in advance of scientific certainty to protect the environment (and with it, the well-being of future generations) from incurring harm."[8] In this sense, the precautionary principle establishes a default rule for regulating new innovations, irrespective of the relative risk that they actually pose to human health or the environment. At its extreme, the principle calls for the elimination of substances that are not proven safe: "the precautionary principle calls for the prohibition of the release of substances which might cause harm to the environment *even if insufficient or inadequate proof exists regarding the causal link*."[9]

On the one hand, this aspect of the precautionary principle does not call for much. Scientific certainty is rare, and few environmental regulations would exist if absolute scientific certainty were required before their imposition. Rather, policy makers traditionally consider the weight of the evidence for or against a given causal relationship, and the costs involved with implementing a particular policy. In some cases, such as the link between cigarettes and lung cancer, the causal connection is easy to identify. In other cases, such as a postulated connection between water chlorination and the incidence of bladder cancer, the connection is more suspect, and the costs of reducing the risk are substantial. Most environmental laws nonetheless authorize regulation of potentially dangerous substances or activities with less-than absolute proof or quantification of environmental risk.

On the other hand, by emphasizing the need to act in the face of scientific uncertainty, before there is clear evidence of scientific harm, the precautionary principle lowers the threshold for what is considered reliable evidence of a potential effect. "Better safe than sorry" can be used to call for regulatory measures when there is little, if any, evidence of an actual health or environmental impact. After all, it is impossible to disprove the existence of risk. There is no evidence that even a single individual has suffered a negative reaction from the consumption of genetically engineered food.[10] Yet proponents of the precautionary principle call for moratoria on the development and marketing of such products because such risks are "possible" and have yet to be *un*proven.

A related, corollary to the precautionary principle is a shift in the burden of proof for new technologies and inventions. Government agencies would not be required to demonstrate that a technology poses a likely risk. Rather, "the proponent of an activity, rather than the public, should bear the burden of proof"

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[7] The Wingspread Statement on the Precautionary Principle, reprinted in Appendix A, *Protecting Public Health & The Environment*, Carolyn Raffensperger and Joel Tickner, eds. (Washington, DC: Island Press, 1999), pp. 353-55.

[8] Andrew Jordan and Timothy O'Riordan, "The Precautionary Principle in Contemporary Environmental Policy and Politics," in *Protecting Public Health and the Environment*, p. 23.

[9] P. Horsman of Greenpeace quoted in Jordan and O'Riordan, p. 25.

[10] *See* C.S. Prakash, Feeding a World of Six Billion, AGBIOFORUM, Summer/Fall 1999 (quoting David Aaron of the U.S Commerce Department); see also COMMITTEE ON GENETICALLY MODIFIED PEST-PROTECTED PLANTS, BOARD ON AGRICULTURAL AND NATURAL RESOURCES, NATIONAL RESEARCH COUNCIL, GENETICALLY MODIFIED PEST- PROTECTED PLANTS (2000) (finding that genetically engineered crops are safe and that they do not pose any greater health or environmental risk than plants produced through traditional breeding practices); Paarlberg, supra note 20, at 21 ("There is no credible evidence of a food safety risk linked to any GM food currently on the market in Europe."); Tim Beardsley, Rules of the Game, SCI. AMER., Apr. 2000, at 42 (noting that "no harm from a GMO crop has ever been demonstrated").

of demonstrating that it is risk free.[11] Greenpeace's Jeremy Leggett explains: "the modus operandi we would like to see is: 'Do not admit a substance unless you have proof that it will do no harm to the environment.'"[12] The World Charter for Nature incorporates this position, holding that "where potential adverse effects are not fully understood, the activities should not proceed."[13]

Applied in even a mild formulation, the reverse onus idea will dramatically retard the development of new technologies. As precautionary principle advocate Joel Tickner acknowledges, the principle "establishes a type of 'speed bump,' which creates bottlenecks in the development process" to slow down the introduction of new technologies.[14] If this reverse onus were applied in a more rigorous fashion, it could stop the flow of new innovations altogether. "The truth of the matter is that whoever has the burden of proof loses," contends Boston University bioethicist George Annas.[15]

Application of the principle to existing technologies, such as various industrial chemicals, would require eliminating thousands of substances from economic use. Proving that a new technology or product will cause no harm requires proving a negative, something that science cannot do. "It is not possible to prove something is harmless, any more than it is possible to prove that there are no fairies at the bottom of one's garden."[16] The scientific process can test the robustness of a given hypothesis—substance X will cause cancer in mice or substance Y disrupts amphibian reproduction—but it cannot *prove* that a given substance is risk-free. Substance X might not cause rodent tumors, but it could always cause something else. For this reason, scientists fear that the precautionary principle could "block the development of any technology if there is the slightest theoretical possibility of harm."[17] Indeed, "taken literally, the directive would be: 'Don't do anything.'"[18]

"Not doing anything," however, may also be contrary to the precautionary principle. When the precautionary principle counsels regulators to take precautionary measures with respect to new harms, that counsel only considers one half of the equation. New technologies create not only new risks, but also new benefits.[19] By doing nothing, society is deprived of the benefits of new technologies, including harms and deaths that society could otherwise avoid. This begs the question, what is more precautionary, keeping the status quo, or forgoing preventable deaths. As Cass Sunstein argues, the problem is not that the precautionary principle "provides no guidance… but that it forbids all courses of action, including inaction."[20]

Another corollary to the precautionary principle that is equally problematic is that the consideration of a given technology or environmental decision must "involve an examination of the full range of alternatives, including no action."[21] Taken literally, this corollary calls for paralysis by analysis. It is

[11] Jordan and O'Riordan, *supra* note 7, p. 354.

[12] Quoted in Julian Morris, "Defining the Precautionary Principle," in *Rethinking Risk and the Precautionary Principle*, Julian Morris ed. (Oxford, UK: Butterworth Heinemann, 2000), p. 4.

[13] United Nations General Assembly, *1982 World Charter for Nature*.

[14] Joel A. Tickner, "A Map Toward Precautionary Decision Making," in *Protecting Public Health*.

[15] Quoted in Ronald Bailey, "Precautionary Tale," *Reason*, April 1999.

[16] Morris, *supra* note 10, p. 10.

[17] Soren Holm & John Harris, "Precautionary Principle Stifles Discovery," *Nature*, vol. 400 (1999), p. 398.

[18] Christopher D. Stone, "Is There a Precautionary Principle?" *Environmental Law Reporter*, vol. 31, (July 2001), p. 10790.

[19] AARON WILDAVSKY, SEARCHING FOR SAFETY 39–58 (1988) (arguing that accepting risks may increase safety and that the guiding criterion should be "net benefits" not "no harm").

[20] Cass R. Sunstein, *The Paralyzing Principle*, REGULATION, Winter 2002–2003, at 33.

[21] The Wingspread Statement, quoted in Appendix A, p. 354.

simply impossible to consider the "full range" of alternatives.[22] Some advocates of the precautionary principle suggest that this corollary would merely require a consideration of likely or possible alternatives as a part of the decision-making process, much like federal agencies in the United States must consider alternatives to proposed actions when undergoing Environmental Impact Statements under the National Environmental Policy Act. Thus, before a company could introduce a new pesticide, a regulatory agency would need to consider alternative means of controlling the target pest and whether the pest needs to be controlled at all. Even in this more mild form, the additional burden placed upon new technologies could be substantial, while doing little to improve public health or environmental protection. If existing alternatives were adequate, it is unlikely that a new product would be purchased in the marketplace. Substituting government regulators' tastes and preferences for market forces will create monopolies and hinder innovation, both of which harm individuals.

II. Precautionary Principle in Practice

In this section we respond to three questions posed in the Draft Report:

1. Ways is in which "precaution" is embedded in current risk assessment procedures
2. Examples of unbalanced approaches in human and ecological risk assessment and management methods by U.S. regulatory agencies
3. How the U.S. balances precautionary approaches to health and safety and environmental risks with other interest such as economic growth and technological innovation

Though the precautionary principle has not been explicitly embraced as U.S. policy, many regulatory and other policy actions reflect a precautionary approach to potential risks. We discuss five such policies. The first three—new drug approval, pesticide regulation, and environmental risk assessment—have been recognized elsewhere as embodying precautionary approaches. The latter two—water flow and forest planning—are less obvious examples of the influence of precaution in policy making.[23]

A. Drug Lag

Perhaps the most prominent example of the harm caused by an unbalanced approach to human risk assessment is "drug lag"—the delay in approval of potentially life-saving medicines and treatments. The Food and Drug Administration (FDA) must approve new pharmaceuticals and medical devices before they may be used or prescribed. The purpose of FDA approval is to ensure that only "safe and effective" drugs approved. In a precautionary fashion, the FDA seeks to prevent the release of an unsafe drug. Delaying the availability of potentially life-saving treatment, however, poses risks of its own. In the simplest terms, if a new drug or medical treatment will start saving lives once it is approved, then the longer it takes for the government to approve the drug, the more likely it is that people will die awaiting treatment.[24]

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[22] Even under NEPA agencies do not need to consider every possible alternative, thus the onus of the precautionary principle would be would than under NEPA and even NEPA's analysis are already very burdensome. The Administration is considering reducing the analysis requirements to combat the problem of Forest Health. *See* Healthy Forests: An Initiative for Wildfire Prevention and Stronger Communities (2002).

[23] For other examples of the problems with the precautionary principles in an international setting, *see* Jonathan H. Alder, *More Sorry Than Safe: Assessing the Precautionary Principle and the Proposed International Biosafety Protocol*, 35 TEXAS INT'L L.J. 173 (2000); Jonathan H. Adler, *The Cartagena Protocol And Biological Diversity; Biosafe Or Bio-Sorry*, 12 GEO. INT'L ENVTL. L. REV. 761 (2000).

[24] Sam Kazman, "Deadly Overcaution: FDA's Drug Approval Process," *Journal of Regulation and Social Costs*, September 1990, p. 35.

This is not merely a theoretical concern. Consider the example of Misoprostol, a drug that prevents gastric ulcers.[25] Misoprostol was developed in the early 1980s, and was first approved in some nations in 1985. The FDA, however, did not approve use of Misoprostol until 1988. Even though the drug was already available in several dozen foreign countries, the FDA subjected Misoprostol to a nine-and-one-half month review. At the time, between 10,000 and 20,000 people died from gastric ulcers per year. Therefore, had Misoprostol been approved more rapidly, it could have saved as many as 8,000 to 15,000 lives. In other words, FDA's delay cost lives, just as surely as does the approval and use of unsafe treatments. Thus, precautionary regulation by the FDA does not always enhance protection of public health.

B. Pesticides

Another example of an unbalanced approach to risk assessment is pesticide regulation. As with the drug lag, it is not clear that more government regulation of chemical pesticides always makes people safer. In some cases, restrictions on the use of a pesticide can expose people to other risks, such as disease, or result in the use of more harmful substitutes. Ethylene dibromide (EDB), for example, was a powerful fungicide used to prevent the growth of molds on grain and other foods. Molds produce some of the most potent carcinogens found in nature, such as aflatoxin.[26] Yet EDB was also deemed a potential carcinogen, and was banned by the U.S. Environmental Protection Agency (EPA). The ban was a precautionary measure, yet the EPA did not consider whether the risk of EDB was greater or less than that posed by aflatoxin. Moreover, EDB was replaced with fungicides that had to be applied in greater quantities, increasing the risk for exposed workers.[27] Thus, the EDB ban may have, on net, *increased* risks to human health.

Among the chemicals targeted for elimination by advocates of the precautionary principle is DDT. Once widely used for mosquito control, DDT was banned in most developed nations due to concerns that its widespread use interfered with the reproduction of several bird species, including the bald eagle. In the years after World War II, DDT became the ultimate weapon in the battle against malaria. In Ceylon (now Sri Lanka), DDT spraying reduced the number of malaria cases from approximately three million in 1946 to approximately 7,300 in only a decade. By 1964, there were only 29 recorded malaria cases on the island nation.[28] In India, malaria cases dropped from an estimated 75 million in 1951 to approximately 50,000 by 1961.[29] In industrialized nations, DDT helped eliminate malaria completely.[30]

Evidence that DDT contributed to egg-shell thinning in some bird species, and fears that it could harm people as well, led to a ban on DDT in the United States in 1972. Other developed countries followed soon thereafter, and many developing countries restricted its use.[31] At the time, there was concern—though little evidence—that DDT might pose a risk to public health. Rachel Carson's *Silent Spring* and media alarmism contributed to fears that DDT use was poisoning America's children. Foreshadowing

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[25] *See id.* at 47-48.

[26] George M. Gray and John D. Graham, "Regulating Pesticides," in *Risk versus Risk: Tradeoffs in Protecting Health and the Environment*, John D. Graham and Jonathan Baert Weiner eds. (Cambridge: Harvard University Press, 1995), pp. 186-87.

[27] Cross, "Paradoxical Perils," pp. 875-76.

[28] Richard Tren and Roger Bate, *Malaria and the DDT Story* (London: Institute of Economic Affairs, 2001), pp. 36-37.

[29] *Id.*, p. 37.

[30] *See* Indur M. Goklany, *The Precautionary Principle* 18–27 (2001).

[31] Some argue that the development of resistance to DDT by mosquitoes led to a reduction in DDT use in developing nations. DDT, however, remained effective at mosquito control even after some resistance was developed. *See id.* at 46-47.

later precautionary appeals for chemical phase-outs, then-EPA administrator William Ruckleshaus argued that DDT was "a warning that man may be exposing himself to a substance that may ultimately have a serious effect on his health."[32] Solid evidence of DDT's health risks never materialized, however. A few animal studies suggest some risk, but epidemiological and other research have been inconclusive, producing no more than "weak evidence of harm to human health."[33] Indeed, Harvard University's Amir Attaran notes that "The scientific literature does not contain even one peer-reviewed, independently replicated study linking DDT exposures to any adverse health outcome" in humans.[34]

Continuing concerns about potential human health effects of DDT led to the pesticide's inclusion on a proposed list of "persistent organic pollutants" to be completely phased out under an international agreement sponsored by the United Nations Environment Program. During the negotiations, however, the complete elimination of DDT was reconsidered. Although DDT is virtually synonymous with industrial pollution in western nations, it is known as a life-saving compound in much of the developing world. DDT is still used in nearly two dozen countries for malaria control, and for good reason.

> DDT remains one of the few affordable, effective tools against the mosquitoes that transmit malaria, a plague that sickens at least 300 million and kills over one million, mainly children, in economically underdeveloped areas of the tropics each year. Such a toll is scarcely comprehensible. To visualize it, imagine filling seven Boeing 747s with children, and then crashing them, every day.[35]

The phaseout of DDT before the development of a suitable, cost-effective alternative would condemn millions of people in the developing world to malaria infection and potential death. Application of the precautionary principle to DDT, and eliminating it on the basis of speculative concerns that it *might* harm human health, would leave much of the world far less safe than it is today. The use of DDT may yet be shown to cause health problems in humans; in many developing countries, doing without DDT will definitely cause health problems for millions. As two malaria researchers observe, "DDT has saved countless millions of lives, while Greenpeace struggles to find some evidence that it harms mankind."[36]

C. Consumer Product Safety Commission and Arsenic

Another example of an unbalanced approach to human and ecological risk assessment is the recent briefing package assembled by the staff of the Consumer Product Safety Commission (CPSC) to analyze a petition to ban wood treated with chromated copper arsenate (CCA).[37] CCA is the most commonly used preservative in the pressure treatment of wood.[38] In 2001, CCA was used in 98 percent of the pressure-treated wood produced for residential uses.[39] On May 22, 2001, two environmental groups, arguing that

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[32] Quoted in ibid., p. 46.

[33] Amir Attaran, et al., "Balancing Risks on the Backs of the Poor," *Nature Medicine*, Vol. 6, no. 7 (July 2000), pp. 729–31.

[34] Quoted in Ronald Bailey, "Green's vs. the World's Poor," *Reason Online*, November 29, 2000, available at http://www.reason.com/hod/rb112900.html.

[35] Attaran, "Balancing Risks," p. 729.

[36] Tren and Bate, *supra* note 25, p. 60.

[37] Petition HP 01-3 Requesting a Ban of Chromated Copper Arsenate (CCA)-Treated Wood in Playground Equipment, 68 Fed. Reg. 7,510 (Feb. 14, 2003). The petition is available at http://www.healthybuilding.net/pdf/petition.pdf (last visited Mar. 24, 2003). A more complete analysis of the CPSC's Briefing Materials is Daniel R. Simmons, *Public Interest Comment on the Consumer Product Safety Commission's Briefing Package Prepared to Evaluate a Request to Ban Chromated Copper Arsenate in Playground Equipment*, available at http://www.mercatus.org/article.php/224.html (last visited Apr. 25, 2003).

[38] CPSC BRIEFING PACKAGE at 5.

[39] *Id.*

new studies indicate that arsenic was more dangerous than previously thought, filed a petition with the CPSC to ban CCA-treated wood for used in playgrounds.

In response, CPSC staff assembled briefing materials for the Commission to evaluate the petition. These briefing materials estimate that a child who plays on playground structures made of CCA-treated wood has an increased risk of 2 to 100 per million of developing lung or bladder cancer.[40] The briefing package relies on a number of unrealistic assumptions to estimate that children exposed to CCA-treated playground equipment face an increased risk of cancer. First of all, the briefing package does not provide evidence that arsenic is actually carcinogenic at low doses.

In drawing their conclusion that arsenic is carcinogenic at high doses, CPSC staff cites studies from Taiwan, Chile, and Argentina that show what high doses of arsenic in water could contribute to increased risks of cancer. There are a number of reasons these studies are not conclusive. For example, the Taiwanese studies treated everyone within the same city as being exposed to the same amount of arsenic.[41] However, arsenic concentrations varied greatly from well to well. It is possible that the people who drank from the wells with chronic levels of arsenic are the only ones who developed cancer and people who drank from other wells within the same study did not develop cancer. By lumping people with very different exposure rates, the studies probably overestimated the risks of cancer. Another reason that the studies may not be comparable to the United States, and especially to children, is because the members of the Taiwanese cohorts had higher incidents of smoking and poorer nutrition.[42]

Even assuming that arsenic is carcinogenic at the levels found in drinking water in Taiwan, that does not necessarily mean that arsenic is carcinogenic at the levels children come in contact with by playing on structures made of CCA-treated wood. To calculate the risks of small doses of arsenic exposure, CPSC staff chose a linear dose-response curve. Instead of relying on any studies that indicate a linear dose-response curve was appropriate, they explained they chose a linear dose-response curve, in the "absence of data that the shape of the dose-response at low doses is not linear.[43] However, the National Research Council expert panel believes, based on the evidence on the mode of action for arsenic-associated cancers, that the dose-response function is more likely to be sublinear—meaning that the linear extrapolation used by the CPSC significantly overstates the expected risk at low doses.[44]

While CPSC staff relied on questionable studies from other countries and chose a dose-response curve that likely overstates the expected risks of low doses of arsenic exposure, they also discounted some of the most applicable studies on arsenic exposure. The only studies on arsenic in drinking water in the United States do not show a link between arsenic in drinking water and increased cancer rates. To justify excluding one of these studies conducted in Utah, CPSC staff argues "this cohort differed from the larger population in important ways."[45] Specifically, the "cohort was rural and belong to a religion with strict lifestyles rules."[46]

The members of the cohort studied were mostly members of the Church of Jesus Christ of Latter-day Saints, and as a result, most did not drink alcohol, coffee, tea, and most did not smoke. CPSC staff points

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[40] *Id.* at 1.

[41] KENNETH G. BROWN, COMMENTS ON CPSC'S ANALYSIS OF CANCER RISK TO CHILDREN FROM CONTACT WITH CCA-TREATED WOOD PRODUCTS 4 (2003).

[42] ROBERT RAUCHER, PUBLIC INTEREST COMMENT ON EPA'S NATIONAL PRIMARY DRINKING WATER REGULATIONS; ARSENIC RULE, REGULATORY STUDIES PROGRAM, MERCATUS CENTER, GEORGE MASON UNIVERSITY (2000).

[43] CPSC BRIEFING PACKAGE AT 315. They further argue that "data do not exist that elucidate the mechanism of arsenic-induced carcinogenicity or define a non-linear effect, and that linear extrapolation at low doses is appropriate in this case." *Id.*

[44] *See* National Research Council, Arsenic in Drinking Water (1999).

[45] CPSC BRIEFING PACKAGE AT 90.

[46] *Id. at* 90.

out this fact as if this were a confounding factor. However, it is likely the dietary habits of the members of the cohort actually reduced the confounding influence of other possible causes of cancer, making it easier to discern any influence elevated levels of arsenic could have in incidents of cancer.

Thus, CPSC staff first approving cites studies that are of questionable application to the situation of children in the United States. Second, they discount any studies that tend to prove them wrong (and which happen to be the only studies conducted in the United States, and also happen to be on people who have a diet similar to children since children don't often smoke or drink). Third, after discounting any contrary evidence, CPSC staff argues, "[t]hus, there is no convincing evidence that arsenic does not cause cancer at relatively low exposures."[47] Given the evidence presented by CPSC staff, it is easier to draw the conclusion that "there is no convincing evidence that arsenic causes cancer at relatively low exposures."

In the CPSC staff's risk assessment it seems that they erred on the side of caution whenever faced with a choice. As a result, they arrive at a result for which there is no scientific support.

D. Klamath Basin

In 2001, a drought coupled with over-committed water resources lead to a confrontation between irrigators in the Klamath Basin and the federal government. The Bureau of Reclamation (BOR) manages the Klamath Basin Project in Oregon and California. The operation of the project affects a number of endangered species, including the Lost River sucker, the shortnose sucker, and the coho salmon. The suckers are managed by the Fish and Wildlife Service (FWS), while the salmon (because it is an anadromous fish) is managed by the National Marine Fisheries Service (NMFS). Under section 7 of the Endangered Species Act, all federal agencies must consult the FWS or the NMFS to ensure that the agency's actions are "not likely to jeopardize the continued existence of any endangered species or threatened species or result in the destruction or adverse modification" of the species critical habitat.[48]

Under the requirements of section 7, the BOR submitted a biological assessment of its proposed operation of the Klamath Basin Project and its likely effects on the suckers. On April 6, 2001, the FWS released its report on the biological assessment that found that the BOR's proposed operation of the Klamath Basin project would jeopardize the continued existence of the endangered suckers.[49] To avoid jeopardizing the continued existence of the suckers, the FWS proposed "reasonable and prudent alternatives" (RPA) for the operation of the Klamath Project.[50] Among other things the RPAs called for the BOR to maintain higher lake levels than the BOR called for in its assessment.

Because the operation of the Klamath Project would also affect the coho salmon in the Klamath River, the NMFS also reviewed the BOR's biological assessment. Like the FWS, the NMFS's biological opinion found that the BOR's proposed plan would jeopardize the continued existence of the coho salmon.[51] The NMFS proposed RPAs which called for higher water flows in the Klamath River to protect the coho salmon.

During 2001, as the drought progressed, it became impossible for the BOR to fulfill the requirements of the FWS's and NMFS's RPAs as well as provide water to the farmers who used the Klamath Project

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[47] *Id. at* 89.

[48] ESA §7.

[49] Fish and Wildlife Service, Biological/Conference Opinion Regarding the Effects of Operation of the Bureau of Reclamation's Klamath Project on the Endangered Lost Ricer Sucker (*Deltistes luxatus*), Endangered Shortnose Sucker (*Chasmistes brevirostris*), Threatened Bald Eagle (*Haliaeetus leucocepahalus*), ad Proposed Critical Habitat for the Lost River/Shortnose Suckers i (Apr. 2001) (available at http://www.mp.usbr.gov/kbao/esa/34_final_sucker_bo_4_06_01.pdf).

[50] *Id.* at 144.

[51] National Marine Fisheries Service, Biological Opinion: Ongoing Klamath Project Operations (Apr. 2001) (available at http://www.mp.usbr.gov/kbao/esa/38_cohobo_4_6-01.pdf).

water to irrigate their crops. As a result, on April 6, the BOR stopped water deliveries to the irrigators. With no irrigation water, the farmers' crops withered and died. Some estimate the economic lost was over $150 million.[52]

Because of the severe economic consequences, coupled with allegations the FWS and NMFS used poor science in their decision-making, the National Research Council (NRC) of the National Academy of Sciences reviewed the scientific validity of the FWS's and NMFS's biological opinions. The NRC found that there was "no sound scientific basis" for maintaining lake levels as high as the FWS's RPAs called for.[53] The NRC also "did not find clear scientific or technical support for increased minimum flows in the Klamath River."[54] Worse the NRC found that the increased flows that the NMFS called for could actually be lethal for the coho because the water would be too hot.[55] In other words, the two reasonable and prudent alternatives, which cost the irrigators the irrigation waters during 2001, were found not to be supported by sound scientific evidence.

One reason why the both the FWS and NMFS would write biological opinions not supported by the scientific evidence is that scientists' were following the precautionary principle. The Endangered Species Act is a good example of a statute that, while it does not mention the precautionary principle by name, nevertheless follows much of the spirit of the precautionary principle. For example, the *TVA v. Hill*,[56] the Supreme Court held that "it was the intent of Congress in enacting this statute to halt and reverse the trend toward species extinction, whatever the cost."[57] Furthermore, the Supreme Court found that Congress had made it "abundantly clear that the balance has been struck in favor of affording endangered species the highest of priorities, thereby adopting a policy that it described as 'institutionalized caution.'"[58]

Because the scientists were operating under the "whatever the cost" mandate of the Endangered Species Act, they took actions they thought would be best for the species, at literally, whatever the cost. While there was "no sound scientific basis for recommending" keeping the lake levels high,[59] the FWS biologist must have assumed that they would err on the side of caution and recommend high lake levels. Because, as the NRC pointed out, there was no conclusive evidence between sucker mortality and lake levels,[60] the FWS biologists must have reasoned that because of the lack of certainty, they would take the course of action that makes the most intuitive sense—suckers needs water to survive, if there isn't enough water the suckers will die, therefore, more water should give the fish a better chance to survive. The NRC's review of the data explained that there is no scientific evidence to support a position of higher or lower lake levels. Because the Endangered Species Act does not weigh the costs of these decisions, the biologists, when faced with uncertainty, try to be cautious, whether or not there is any scientific evidence for that decision.

One of the problems with the precautionary principle is laid bare by the NMFS's decision to keep higher minimum flows in the Klamath River. Like the FWS biologists, the NMFS's biologists had to make a

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[52] Ron Hathaway, Klamath Water Allocation Background. In "Water Allocation in the Klamath Basin: An Assessment of Natural Resource, Economic, Social, and Institutional Issues" 14 (Dec. 2001)

[53] NATIONAL ACADEMY OF SCIENCES, COMMITTEE ON ENDANGERED AND THREATENED FISHES IN THE KLAMATH RIVER BASIN, INTERIM REPORT ON ENDANGERED AND THREATENED FISHES IN THE KLAMATH RIVER BASIN 4 (2002).

[54] *Id.* at 5.

[55] *Id.*

[56] 437 U.S. 153 (1978).

[57] *Id.* at 184.

[58] *Id.* at 194.

[59] NATIONAL ACADEMY OF SCIENCES, COMMITTEE ON ENDANGERED AND THREATENED FISHES IN THE KLAMATH RIVER BASIN, INTERIM REPORT ON ENDANGERED AND THREATENED FISHES IN THE KLAMATH RIVER BASIN 4 (2002).

[60] *Id.* at 4–5.

decision when there was a lack of scientific information. Also like the FWS biologists, they also made the decision which made the most intuitive sense—since salmon need water to survive, more water in the river will help the salmon live. As the NRC found, however, "there were no scientific or technical support for increased minimum flows in the Klamath River."[61] Worse, the NMFS apparent attempt to take the cautious approach to protecting the coho salmon could have resulted in more salmon dying. According to the NRC report, the additional water to maintain minimum flows in the river would come from reservoirs and "this water could equal or exceed the lethal temperatures for coho salmon during the warmest months."[62] Thus, in an attempt to be cautions in evaluating the risks of lower versus higher water flows, the NMFS in taking a cautious approach, likely made it more difficult for the coho to survive.

This example demonstrates the problems of making decisions when there is a lack of scientific information. Taking apparently precautionary measures turned out not to be precautionary at all. The seemingly precautionary measures provided no benefits for the suckers, it likely harmed the coho salmon, and it cost the area about Klamath Falls, Oregon well over $100 million.

E. Forest Planning

As noted above, a corollary to the precautionary principle is that the consideration of an environmental decision must "involve an examination of the full range of alternatives, including no action."[63] Taken literally, this corollary calls for paralysis by analysis. That is the current situation in our nation's national forests.

A precautionary approach to forest management does not improve forest management. To the contrary, it can undermine forest management goals. According to the Administration, 190 million acres of public lands are at increased risk of catastrophic wildfire;[64] tens of millions of acres of forestlands are threatened by insects and diseases;[65] and invasive species are rapidly spreading, endangering forest, rangelands, and riparian areas.[66] These costs must be weighed against the potential environmental consequences of policies designed to reduce fuel loads in national forests.

Fires are an important and necessary part of many forest ecosystems, but when forests become too dense, forest fires that would otherwise be beneficial or benign become destructive and damaging. Because of fire suppression[67] and a lack of anthropogenic fire ignition,[68] many of our forests are denser than in the past. In some places, such as some ponderosa pine forests, the "forests are 15 times more dense than they were a century ago."[69] Coupling dense, unhealthy forests with drought conditions in much of the West means that when fires start they frequently become holocaust fires killing large stands of trees, damaging fisheries, destroying endangered species habitat, and sterilizing the soil.[70]

While almost everyone agrees that the forest health is a problem and thinning should occur on much of the national forest, very little work is getting done on the ground. A major stumbling block is that the forest planning and environmental review process requires so much analysis. Some of the important

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[61] *Id.* at 5.

[62] *Id.* at

[63] The Wingspread Statement on the Precautionary Principle.

[64] Healthy Forests: An Initiative for Wildfire Prevention and Stronger Communities 1 (2002).

[65] Forest Service, *The Process Predicament* 5 (2002).

[66] *Id.*

[67] *Id.*

[68] *See* STEPHEN PYNE, FIRE IN AMERICA: A CULTURAL HISTORY OF WILDLAND AND RURAL FIRE (1997).

[69] Healthy Forests: An Initiative for Wildfire Prevention and Stronger Communities 4 (2002).

[70] *Id.* at 4–6.

function of forest planning is to look at alternatives and to analyze risks. The National Forest Management Act (NFMA) arose out of concerns the Forest Service was too focused on cutting trees, and was blind to the environmental consequences of its actions.[71] In other words, the Forest Service seemed only concerned with the benefits of cutting trees without considering the ecological risks of those decisions. As a result, NFMA increases the public participation requirements in forest planning to make sure that risks of decision made in the forest were properly assessed.[72] However, the problem is that the identification and planning for the management of the risks has grown so cumbersome, very little work on the ground occurs. According to the Administration:

- It can take six months to prepare environmental planning documents for even routine prescribed fire treatments. More complicated projects can take two years or longer.
- Timber sales to achieve fuels reduction and forest health objectives, consistent with forest health management plans, can take two to four years to prepare and complete.
- A study commissioned by the Forest Service in 2001 found that project decisions by the agency involve as many as 800 individual requirements and over 100 points where various laws and required processes interact. The study concluded that "the process interaction between laws is extremely complex" making the project planning process "highly susceptible to recursion/interruption and even non-completion."
- Forest Service officials have estimated that planning and assessment activities consume 40 percent of total work at national forests—at a cost of more than $250 million per year.[73]
- Between January 2001 and July 2002, 48 percent of all Forest Service mechanical fuels reduction projects were appealed. In north Idaho and Montana, 100 percent of the mechanical fuel reductions projects were appealed.[74]

How does the Forest Service manage ecological risks in the forest? The answer far too often is that the Forest Service plans to manage risks, but does not take any on-the-ground actions. They are experiencing analysis paralysis because of the incredibly complex planning requirements, coupled with litigation over forest plans. Frequently it seems that more thought is put into managing the risks of litigation than in managing the ecological risks of actions in forest.

While some forest planning is necessary, forest plans require such extensive consideration of alternatives—including alternatives that will not be implemented—that the complexity creates analysis paralysis. By requiring forest plans to have a full range of alternatives, very little work can be achieved on the ground. The problem in the forest is that waiting to take action means that more forest burn in catastrophic forest fire instead of being restored to more natural conditions. In the name of planning and protecting the forest through plans, millions of acres of forest are sacrificed to catastrophic forest fires every year.[75] This example illustrates that even the more mild form of the precautionary principle, that which primarily calls for consideration of the full range of potential alternative actions, can frustrate efforts to enhance environmental protection.

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[71] *See* George C. Coggin et al., FEDERAL PUBLIC LAND AND RESOURCES LAW 713–16 (2001).

[72] *See* NFMA §6.

[73] Healthy Forests: An Initiative for Wildfire Prevention and Stronger Communities 13 (2002).

[74] *Id.* at 14.

[75] According to the National Interagency Fire Center 6.9 million acres burned in wildland fires in 2002. http://www.nifc.gov/stats/wildlandfirestats.html While not all of the fires were catastrophic, many were.

In fact, in some of the efforts to improve forest health, such as the Administration's "Healthy Forest Initiative"[76] as well as in legislation currently before Congress,[77] one of the ways that they are trying to get more work done on the ground is by limiting the amount of alternatives that need to be considered by agencies.

F. Biased Toward Precaution

In any decision involving uncertainty, there is the possibility of what statisticians call Type I or Type II errors. In regulatory terms, a Type I error occurs when a good outcome (e.g., life-saving drug) is incorrectly rejected, and a Type II error occurs when a bad outcome (e.g., a new drug that has negative effects) is allowed. Predictably, precautionary agencies are much more reluctant to make Type II errors, because victims of new products with unexpected negative side effects (like the diet drug Phen-Fen) are identifiable. Regulators become the subjects of hearings before Congress and appear in news stories.[78] As former FDA Commissioner Schmidt describes:

> [I]n all of FDA's history, I am unable to find a single instance where a congressional committee investigated the failure of the FDA to approve a new drug. But the times when hearings have been held to criticize our approval of new drugs have been so frequent that we aren't able to count them.... The message to the FDA staff could not be clearer. Whenever a controversy over a new drug is resolved by its approval, the agency and the individuals involved likely will be investigated. Whenever such a drug is disapproved, no inquiry will be made. The congressional pressure for our negative action on new drug applications is, therefore, intense.[79]

Type I errors are not identifiable, in part because the dead do not speak. We cannot identify with certainty which people died solely because they were not able to get drugs like Misoprostol. The victims of Type I errors are the silent victims of malaria who die because DDT isn't readily available. These victims are not readily represented in the policy-making process—they do not appear at Congressional hearings, participate in notice-and-comment rulemakings, or appear on the evening news. But such victims are no less real than those who may be harmed by a dangerous new technology.

Agencies have substantial incentive to take actions for which they can claim credit. This is because agencies try to increase their budgets by convincing legislators and the public that their services are absolutely essential.[80] One good way for an agency to prove its worth is to protect the public from new and deadly risks or from new, and unproven drugs.

Thus, to avoid committing Type II errors and thereby allowing harmful activities to occur, agencies are understandably cautious in their decision-making. This precautionary bias is embedded in agency risk assessments, regardless of any agency procedures or statutory requirements.

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[76] *See* The Healthy Forest Initiative, at http://www.whitehouse.gov/infocus/healthyforests/ (last visited May 5, 2003).

[77] *See* H.R. 1904 (108th Congress).

[78] Peter Huber describes this precautionary approach in what he called "gatekeeper" activities. (1983) "Exorcists vs. gatekeepers in risk regulation." *Regulation* 7: 23-32

[79] A. Schmidt, "The FDA Today: Critics, Congress, and Consumerism," speech to National Press Club, (Washington, D.C., Oct. 29, 1974), cited in Aaron Wildavsky, *Searching for Safety* p. 224 (1988).

[80] William C. Mitchell & Randy T. Simmons, *Beyond Politics* p. 61 (1994).

[81] A. Schmidt, "The FDA Today: Critics, Congress, and Consumerism," speech to National Press Club, (Washington, D.C., Oct. 29, 1974), cited in Aaron Wildavsky, *Searching for Safety* p. 224 (1988).

[82] William C. Mitchell & Randy T. Simmons, *Beyond Politics* p. 61 (1994).

G. Wealthier Is Healthier—Richer Is Cleaner

A particular problem with a precautionary bias is that it retards economic growth and technological progress. Economic growth and technological progress have been a tremendous boon to both human health and environmental protection. Efforts to limit such progress are likely to be counterproductive. Regulatory measures that stifle innovation and suppress economic growth will deprive individuals of the resources necessary to improve their quality of life, and deny societies the ability to make investments that protect people and their environs.

The rise of industrial society has coincided with a massive explosion of wealth and health that is unprecedented in the history of human civilization. For centuries average life expectancy hovered in the twenties and thirties. U.S. life expectancy in 1900 was only 47. Today, in developed nations life expectancy is nearly 80.[83] Infant and maternal mortality plummeted over this same period, as have the incidence and mortality of typhoid, diptheria, tuberculosis, and other lethal diseases. [84] These positive trends are largely the result of increased wealth, and the benefits such wealth brings. Higher economic growth and aggregate wealth strongly correlate with reduced mortality and morbidity.[85] This should be no surprise as the accumulation of wealth is necessary to fund medical research, support markets for advanced life-saving technologies, and build infrastructure necessary for better food distribution, and so on. In a phrase, "richer is safer and poorer is sicker."[86]

Cancer rates are often blamed on environmental exposures to chemicals and other synthetic substances. Were this so, one would expect cancer rates to increase with the proliferation of synthetic chemicals in our food supply and environs. This has not been the case. The most recent report of the National Cancer Institute shows that overall incidence and death rates for cancer are also declining.[87] Even lung cancer incidence, largely the result of smoking, has begun to decline.[88] Simply put, "[t]he common belief that there is an epidemic of death from cancer in developed countries is a myth, except for the effects of tobacco. . . . For most non-smokers, the health benefits of modern society outweigh the new hazards."[89] In short, "the Western world is a remarkably healthy place to live."[90]

Economic progress is no less essential for environmental protection than for protection of public health. Environmental protection is a good and, like all goods, it must be purchased. Wealth is required to finance environmental improvements, from the purification of drinking water to invention and installation of low-emission technologies. Not only are wealthier communities healthier than poorer communities, on average, they tend to be more concerned about protecting environmental values as well. Wealthier societies have both the means and the desire to address a wider array of environmental concerns.[91]

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[83] See, e.g., Nicholas Eberstadt, Population, Food and Income, in The True State of the Planet (Ronald Bailey ed., 1995).

[84] *Id.*

[85] See, for example, Susan L. Ettner, "New Evidence on the Relationship Between Income and Health," 15 *Journal of Health Economics*, vol 15 (1996), p. 67; John D. Graham, et al., "Poorer is Riskier," *Risk Analysis*, vol. 12, no. 3 (1992), p. 333-37; Ralph L. Keeney, "Mortality Risks Induced by Economic Expenditures," *Risk Analysis*, vol. 10, no. 1 (1990), pp. 147-59.

[86] Aaron Wildavsky, *Searching for Safety* 58 (1988).

[87] Holly L. Howe, et al., "Annual Report to the Nation on the Status of Cancer (1973 Through 1998), Featuring Cancers With Recent Increasing Trends, *Journal of the National Cancer Institute*, Vol. 93, No. 11, June 6, 2001.

[88] *Id.*

[89] Richard Peto, et al., *Mortality from Smoking in Developed Countries, 1950-2000*, (Oxford: Oxford University Press, 1994).

[90] *Id.*

[91] *See* Seth W. Norton, "Property Rights, the Environment and Economic Well-Being", in *Who Owns the Environment?* Peter J. Hill & Roger E. Meiners eds. (Lanham, MD: Rowman & Littlefield, 1998), pp. 37, 45.

Pollution, while still a serious environmental problem in much of the world, is not the mortal threat to human survival it once was. At the dawn of the 20th century, soot and smoke permeated cities, sometimes to lethal effect. In 1948, a four-day weather inversion in Donora, Pennsylvania, blanketed the town with pollution from local factories, killing eighteen people.[92] Over the past several decades, pollution levels in wealthy, industrialized societies have declined, particularly in the case of those emissions for which the health impacts are most severe.[93] "Countries undergo an environmental transition as they become wealthier and reach a point at which they start getting cleaner."[94] This occurs first with particularly acute environmental concerns, such as access to safe drinking water and sanitation services. As affluence increases, so does the attention paid to conventional pollution concerns, such as fecal coliform bacteria and urban air quality.[95]

There is no doubt that chemicals pose risks. Indeed, some of the chemicals and other technologies targeted by advocates of the precautionary principle can cause problems if misused. Yet it is notable that the proliferation of these technologies has coincided with the greatest explosion of prosperity and longevity in human history. If modern society were as risky as precautionary principle advocates suggest, this should not be the case.

III. Conclusions and Recommendations

In evaluating the role of precaution, the Work Group should review the 1983 National Academy of Sciences report that spelled out the process by which regulators should quantitatively evaluate risks and make policies to reduce those risks. It suggested separating the process into two parts: risk assessment and risk management. *Risk assessment* is a purely scientific process that measures the risk of an activity. For example, risk assessment could estimate the risk of contracting cancer from exposure to a certain chemical over a certain length of time. Risk assessment does not evaluate whether a risk is too high, or what should be done about it. That decision is made in the risk management phase. *Risk management* takes scientific risk assessment information and combines it with other information, such as the cost and feasibility of reducing risks, to determine what action to take.[96]

Risk assessments should focus on developing the most accurate possible assessment of potential risks. To achieve this, the most probable assumptions should be used, not those that are the most conservative. Reliance on the most probable assumptions does not mean that risk assessments should avoid uncertainty. To the contrary, risk assessments typically involve an element of uncertainty. Rather than addressing this uncertainty by systematically biasing the risk assessments in a particular direction, it would be preferable to make the level of uncertainty explicit in the risk assessment. Therefore, where risks are uncertain, risk assessments should characterize the extent of the uncertainty and provide bounded estimates. Uncertainty in risk assessment does not justify the incorporation of precautionary standards in risk assessments.

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[92] Cited in Indur Goklany, "Richer Is Cleaner," in *The True State of the Planet*, R. Bailey, ed. (New York: The Free Press, 1995), p. 347.

[93] See, generally, *id.* See also, Indur Goklany, *Clearing the Air: The Real Story of the War On Air Pollution* (Washington, D.C.: Cato Institute, 1999).

[94] Goklany, "Richer Is Cleaner," pp. 339, 341.

[95] Goklany observes that while the "environmental transition" for drinking water and sanitation occurs "almost immediately as the level of affluence increases above subsistence," the transition appears to occur at approximately $1,375 per capita for fecal coliform and $3,280 and $3670 per capita for urban particulate matter and sulfur dioxide concentrations respectively. *Id.* at 342. For a fuller treatment of the correlation between affluence and air quality, see Goklany, *Clearing the Air.*

[96] *See* Mercatus Center Public Interest Comment on OMB's 2003 Benefit Cost Report, RSP 2003-11 (available at www.mercatus.org).

There are many problems with precautionary risk assessments. First, an overly cautious risk assessment systematically overstates risks. The overstatement of risk is frequently cited as the expected value of the risk, and not for what it really is—the upper bound of a risk assessment. Thus, when an agency engages in risk management based on overstated risk assessments, they tend to focus their regulatory efforts on new risks, while ignoring older, but more significant risks.

Second, overestimating risks leads regulators to over-regulate new activities, thus forcing society to forgo the new benefits of a new activity or technology. The risks of change must be weighed against the risk of stagnation. In every case, "[t]he empirical question is whether the health [and environmental] gains from the regulation of the substances involved are greater or lesser than the health [and environmental] costs of the regulation."[97] As human history shows, economic growth and technological progress makes the world safer. Economic growth and technological progress are only possible through accepting new risk. Retarding these engines of change only retards societies' ability to make the world safer.

Third, another problem with a precautionary risk assessment occurs because eventual risk management decisions often involve trade-offs between different risks. Biasing risk assessments in one direction will produce risk management policies that are consistently biased in the same direction. This is unlikely to maximize social welfare or provide for the greatest protection of human health.

Overestimating risk in a risk assessment can predetermine the outcome of risk management. As a result, those who conduct the risk assessment can effectively dictate policy choices for agencies by producing risk assessments that only allows for certain limited forms of risk management.

Finally, when assessing the risks of new technologies or regulated activities, it is important to also assess the benefits of such activities, particularly the potential benefits to human health and environmental protection. Here again, uncertainty is not an excuse for excluding the consideration of certain potential impacts, nor is it an excuse for systematically biasing the assessments in one particular direction.

Agencies have strong incentives to be very cautious in their risk management. Coupling precaution in risk assessment with cautious risk management leads agencies to over-regulate and deny society of the safety improvements that come from new activities and technologies. Overregulation led to the FDA's delay in the approval of Misoprostol, causing needless suffering for ulcer sufferers. Malaria kills three thousand children a day,[98] but DDT, the most effective pesticide in fighting the spread of malaria, is banned in many countries because of regulatory over-cautiousness. In the Klamath Basin, over-cautiousness cost the region over a $150 million without aiding either suckers or the salmon (and may have harmed the salmon). As the example of the national forests show, being overly cautious in the management of forests can lead to the very conditions agencies seek to avoid.

In sum, regulators need to be aware that even the most well-intentioned precautionary measures can have terrible results.[99] The precautionary principle's threat to technological progress is itself a threat to public health and environmental protection. In the name of precaution, agencies should avoid the precautionary principle.

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[97] Aaron Wildavsky, *But Is It True?* (1995), p. 428.

[98] World Health Organization, *Malaria is alive and well and killing more than 3000 African children every day* (Press Release) available at http://www.who.int/mediacentre/releases/2003/pr33/en/ (last visited May 3, 2003).

[99] *See, e.g.*, Frank B. Cross, Paradoxical Perils of the Precautionary Principle, 53 WASH. & LEE L. REV. 851 (1996). STEPHEN BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 22 (1993); Edward W. Warren & Gary E. Merchant, "More Good Than Harm": A First Principle for Environmental Agencies and Reviewing Courts, 20 ECOLOGY L.Q. 379, 390 (1993).

MERCATUS CENTER
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REGULATORY STUDIES PROGRAM

Public Interest Comment on

The Office of Management and Budget's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements[1]

Abstract

Issuing clear analytical guidelines, and holding agencies accountable for complying with them, is an important step toward regulatory reform. Many aspects of the draft guidelines are sound. However, the circular should be more demanding of agencies' initial justifications of regulatory action. It should stress the comparative analysis of market failure and regulatory failure, and not simply rely on the results of benefit-cost analysis to justify regulatory interventions. This is necessary to avoid the "Planner's Paradox"—the tendency of planned solutions to appear superior to unplanned market solutions in any forecasting model or benefit-cost analysis.

The circular's guidance for estimating benefits and costs has some serious flaws, particularly its recommendation for the use of non-market "contingent valuation" benefits and non-market "ethical" discount rates. These recommendations cannot be defended and would undermine the care and detail embodied in the rest of the guidelines. Taken together, they amount to a license to: "Imagine some benefits. Imagine they go on forever. . . ." If these techniques are permitted, then economic analysis will lose its capacity to impose scientific rigor on regulatory decisions. The guidelines should also recognize that regulatory transfer payments impose real costs on society and develop recommendations to account for the associated dead-weight losses.

OMB should leave the current (2000) guidelines in place while it revises the draft guidelines to address these concerns and make it clear that contingent valuation surveys and unrealistic discount rates will not be accepted.

[1] Prepared by Senior Research Fellows, Susan E. Dudley and Brian F. Mannix. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

Public Interest Comment on

The Office of Management and Budget's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Office of Management and Budget's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of these proposals on overall consumer welfare.

I. Introduction

In Appendix C of its 2003 Draft Report to Congress on the Costs and Benefits of Federal Regulation, the Office of Management and Budget (OMB) presents a draft circular that will provide "guidance to federal agencies on the development of regulatory analysis as required under Executive Order No. 12866 and a variety of related authorities," as well as "guidance to agencies on the regulatory accounting statements that are required under the Regulatory Right-to-Know Act."

If finalized, these guidelines would update and replace guidelines first issued in 1988 by the Reagan Administration and later revised in 1996 and 2000 by the Clinton Administration. These comments follow the general outline of the guidelines themselves. We first address the issue of why regulatory action is needed, and then discuss the guidelines' treatment of how to evaluate alternatives and what analytical approaches to use. Section V of these comments examines in detail the circular's guidance with respect to estimating the benefits and costs of regulation, and raises serious concerns about some of the recommended techniques. Section VI briefly reviews the format for agencies' annual accounting statements on the benefits and costs of regulations issued during a year, and Section VII concludes the comment with recommendations for improvement.

II. Why Regulatory Action is Needed

The circular instructs federal agencies that "before proceeding with a regulatory action, you must demonstrate that the proposed action is necessary." (68 FR 5514) It goes on to clarify that, "this means that you should try to explain whether the action is intended to address a significant market failure or to meet some other compelling public need such as improving governmental processes or promoting distributional fairness, privacy, or personal freedom." (68 FR 5514)

A. Market failures or other social purpose

While the draft circular is careful to say that, when correcting a significant market failure, "you should show that a government intervention is likely to do more good than harm;" it appears less demanding of "other justifications." (68 FR 5514)

Moreover, the "other justifications" for regulation are unclear. OMB should clarify, in particular, what it means by "promoting privacy and personal freedom," since regulation is more commonly viewed as restricting personal freedoms. If this phrase refers to specific circumstances, the guidelines should be more direct, and should also recognize explicitly that promoting freedom for one group likely restricts the freedom of another, and should provide guidance as to how to address those tradeoffs.

In the introduction to the guidance (68 FR 5513), the circular explains why analysis of proposed regulatory actions is needed. While this explanation is important, it focuses exclusively on examining

benefits and costs without explicitly discussing the importance of examining whether there is any reason to believe that regulatory action will be superior to market outcomes. In the absence of a market failure—and one that is plausibly larger than the well-known and unavoidable regulatory failures—there is no reason even to undertake a benefit-cost analysis.

One reason this threshold step is important is the "Planner's Paradox"—the tendency of planned solutions to appear superior to unplanned market solutions in any forecasting model or benefit-cost analysis. This is because both the plan (the proposed regulation) and the supporting analysis are prepared with the same set of data, assumptions, biases, and understandings of the way the world works. Indeed, the planned solution is generally designed to "fix" the problems identified in the analysis; therefore the analysis will necessarily make the plan look better than the alternative. All of the problems with the planned solution—the data, assumptions, biases, and understandings that turn out to be wrong—are invisible to the analyst.

An example of the Planner's Paradox is the analysis of appliance efficiency standards issued by the Energy Department.[2] DOE calculates what the "optimum" appliance looks like, and compares it to what consumers actually buy. It attributes the difference, not to errors on the part of the analyst, but to errors on the part of the consumer! Even without any market failure, the benefit-cost analysis appears to demonstrate that DOE knows what is best for the consumer. The underlying reason is that, simply by undertaking a benefit-cost analysis, the Department *assumes* that it knows what is best. In fact, however, the government is simply substituting its own preferences for consumers' preferences. We know that this should produce negative net benefits (because consumers are the best judges of their own welfare), but the analysis shows otherwise because it is so difficult for an agency to separate the analysis from its own policy choices.[3]

The Planner's Paradox is related to the Winner's Curse, a well-known affliction of offshore oil leases and other auctions. Given a limited data set and wide uncertainty about the value of a particular oil lease, the highest bidder is likely to be one that has been overly optimistic and has erred on the high side in estimating its value. Since oil leases are awarded to the highest bidder, the winner is likely to lose money on the lease; hence, the winner's curse. But markets correct for this problem. Sophisticated bidders learn to discount their own analysis and correct for the effect of the winner's curse (and unsophisticated bidders eventually disappear). In government regulation, however, no such correction ever takes place. Agencies continue to fall into the Planner's Paradox and make overly optimistic assumptions about their own ability to forecast the future.

For this reason OMB's guidance needs to stress the comparative analysis of market failure and regulatory failure, and not simply rely on the results of benefit-cost analysis to justify regulatory interventions. And OMB, in its general guidance and in its review of regulatory analyses, should make efforts to penetrate false assurances that are inherent in the planner's analysis of his own plan.

B. Inadequate or asymmetric information

The draft guidelines provide a careful discussion of possible "market failures" that could justify regulatory intervention in private decisions. The discussion of inadequate or asymmetric information, however, should include more caveats about the dangers of regulating based on "inadequate information."

[2] The phrase, "Planner's Paradox," was coined by one of us, Brian Mannix, at OIRA when reviewing an early analysis of DOE's appliance efficiency standards in the early 1980's.

[3] Also see the Mercatus Center's Public Interest Comments on appliance efficiency standards (clothes washers and air conditioners, 2000) and CAFE standards (2003), available at www.Mercatus.org and www.RegRadar.org.

Information is never perfect or symmetrical, and the draft does recognize this.[4] However, previous guidelines were more explicit in observing that "attempts to regulate information are as likely to make things worse as to make them better."[5] Why does this draft reduce this emphasis?

The draft circular also states:

> In the case of uncertain information about low-probability high-consequence events, markets may underreact or overreact depending on the rules-of-thumb and other mental assumptions that people use to cope with difficult issues. Regulators should be aware of such mental quirks and not adopt policies based on a misunderstanding of the underlying reality.

OMB should provide support for this statement. There is academic literature that supports the notion that individuals sometimes behave in ways that an observer might call "irrational."[6] Surveys of stated preferences, or rankings of risk priorities, for example, often do not reflect expert evaluations of risks, and furthermore are internally inconsistent. However, it is not clear that *markets* underreact or overreact, as the draft paragraph suggests. Rather, markets tend to correct for irrational individual behavior. Indeed, what may appear to be irrational may actually reflect a difference in individual tastes and preferences or tolerance for risk. For example, if one potential home buyer is concerned about a low-probability high-consequence event like another terrorist attack in Washington, DC, she may choose not to purchase a home in the city. Other buyers may make a different choice. If enough buyers are concerned, the price of homes in Washington may decline, while the price of homes in more remote suburbs may increase. Because this market outcome is based upon the collective wisdom of all potential buyers and sellers with varying preferences, it is not realistic to assume that regulators have better information as to buyer and seller preferences and demands. In contrast to markets, regulators tend to exaggerate people's misconceptions about risks.[7]

It is well established that markets can aggregate information and individual judgments to produce an outcome that is superior to what any individual could arrive at; in contrast, regulated solutions choose a few people to make a decision and impose their judgment on everyone else, under penalty of law. Such regulated solutions prevent people from exercise their own judgments to satisfy individual tastes. If individuals are subject to "mental quirks" and "misunderstanding of the underlying reality," that argues strongly for rejecting a regulatory intervention in favor of a market solution. Too often, federal regulators simply assume they know more than everyone else, and try to pass off that assumption as an "information asymmetry."

C. Regulation at the federal level

The draft circular requires agencies to show that regulation at the federal level is the best way to solve a problem, but does not provide clear enough guidelines. The circular should make clear that regulation at

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[4] For a good discussion of the optimal level of information in product markets, see Beales, Craswell, and Salop, "The Efficient Regulation of Consumer Information," *Journal of Law and Economics,* vol. XXIV (December 1981). (In particular, see pages 503, 533-534.)

[5] Regulatory Impact Analysis Guidelines, 1988. Available in annual *Regulatory Program of the United States Government*, various years.

[6] For example, see Kip Viscusi. "Alarmist Decisions with Divergent Risk Information," *The Economic Journal*, 107 (November 1997) 1657-1670 and Daniel Kahneman, Ilana Ritov, and David Schkade, "Economic Preferences or Attitude Expressions?: An Analysis of Dollar Responses to Public Issues," in *Journal of Risk and Uncertainty,* 19:1-3; 203-235 (1999).

[7] U.S. Environmental Protection Agency. *Unfinished Business: A Comparative Assessment of Environmental Problems.* February 1987. EPA ranked its regulated activities according to the risks they posed to human health and the environment. It found that the activities that commanded the largest share of federal resources and public dollars were not the ones that posed the greatest risk. On the other hand, it turned out that the allocation of resources tracked public perception of risks very well.

the federal level is appropriate where (1) rights of national citizenship or (2) considerations of interstate commerce are involved. It should state clearly that "because demands among localities for different governmental services differ and because competition among governmental units for taxpayers and citizens may encourage efficient regulation, the smallest unit of government capable of correcting the market failure should be chosen."[8]

Judgments about when the federal interest justifies preemption of state and local authority are generally made in Congress. Absent a clear statement by Congress, however, OMB should be very reluctant to permit a regulatory agency to use a federal administrative proceeding to preempt the prerogatives of the states.

The circular also suggests that

> The role of federal regulation in facilitating U.S. participation in global markets should also be considered. Harmonization of U.S. and international rules may require a strong Federal regulatory role. Concerns that new U.S. rules could act as non-tariff barriers to imported goods should be evaluated carefully. (68 FR 5515)

The last sentence in the quote above is correct; agencies, and OMB, should evaluate carefully whether proposed rules would constitute a non-tariff trade barrier. This evaluation should not simply focus on fairness to foreign producers and the effect on U.S. trade policy, however; the primary consideration should be on the potential harm to U.S. consumers.

In both cases—proposed rules that erect potential barriers to trade, and those that claim to promote trade through "harmonization"—there is a danger that the underlying motivation for the regulation is anti-competitive. Agencies and OMB should examine such proposals in the same skeptical light that it applies to economic regulation.[9]

In general, harmonization is a weak justification for mandatory rules. If harmonization is worth achieving, it can often be done with voluntary standards. And even harmonized legal standards need not be federal; the Uniform Commercial Code is a venerable example of harmonized state laws. Furthermore, harmonization is not necessarily beneficial to the United States. Harmonizing to the wrong standards can hurt consumers. For example, would the new guidelines endorse restrictions on promising new therapeutic or agricultural products in order to "harmonize" with European Union members who resist modern biotechnology methods? U.S. foreign policy ought to stress our objective of exporting freedom, not importing government regulations—particularly regulations that lack an economic rationale apart from "everybody does it."

D. Presumption against economic regulation

The circular correctly requires a "particularly demanding burden of proof" to support "economic regulation" – those that regulate the price, quantity or quality of a product, or entry and exit in an industry. Long experience has established that economic regulation, usually justified as a remedy for natural monopoly and as a protection for consumers, in practice does more to suppress competition and to harm consumers.

The guidelines could go further and point out that economic regulation sometimes masquerades as environmental, health, and safety regulation. Statutes that require registration or pre-market approval for products may serve a health and safety purpose, but they also can be abused to create market power. For example, the EPA's recent announcement that manufacturers of chromated copper arsenate wood preservatives have agreed to cancel this product's registration under FIFRA should raise questions about

[8] Regulatory Impact Analysis Guidelines (1988).

[9] See next section.

motivation.[10] What was the status of patent protection on this product? What alternatives are available? Are they patented, and, if so, to whom do the patents belong? This kind of competitive analysis should be included in a benefit-cost analysis of regulations, even when they do not appear to be economic regulations.

III. Alternative Approaches to Consider

The guidance correctly directs agencies to evaluate alternative means of achieving regulatory goals, and it lists types of actions to be considered. This is a key element of sound rulemaking, and a genuine evaluation of practical alternatives is often lacking in agency analyses. Beyond estimating costs and benefits for different degrees of stringency, regulations are rarely supported by a thoughtful review of alternatives such as different requirements for different geographic regions, provision of information rather than mandates, or market-oriented solutions.

For example, the Forest Service in its 2000 rules aimed at conserving roadless forest areas, failed to consider alternatives that would have met conservation goals with lower environmental risks and economic costs. One such alternative would be to prohibit permanent roads but allow low-impact temporary roads needed for forest health or ecosystem restoration. Such roads could be closed when no longer needed, thus minimizing economic and environmental costs.[11]

The aggregate cost-effectiveness analysis supporting EPA's Tier 2 vehicle and gasoline rule issued in 1999 hid important information on the cost-effectiveness of individual components of the proposal. Our analysis of the cost-effectiveness of different components of the rule reveal that more targeted approaches to meeting the ozone NAAQS would be superior to EPA's approach.[12] The menu of alternatives for analysis should always include such unbundled options and a "marginal analysis" of the important policy parameters, so that bad decisions do not get bundled with good ones.

IV. Analytical Approaches

The draft circular directs agencies to support major rulemakings with both benefit-cost analysis (BCA) and cost-effectiveness analysis (CEA) wherever possible. For major rulemakings for which the primary benefits are improved public health and safety, it places a priority on a CEA, while encouraging a BCA as well, "to the extent that valid monetary values can be assigned to the expected health and safety outcomes." (68 FR 5516) For all other rulemakings it emphasizes a BCA.

While CEA can help sort among alternatives, it cannot be used to justify a regulation in the first place. Indeed, by admitting that the government cannot place a value on the regulation's objective (lives, wetlands, etc.), the use of CEA should be a signal that relying on the market may be superior to the various regulated alternatives. Markets do not have trouble making such tradeoffs. Instead of choosing among a list of second-best alternatives, an agency should look for ways to rely on property rights, freedom, and individual choice. When citizens can make their own decisions, the government avoids the problem of choosing what values to impose on them.

The circular recognizes that measuring incremental benefits and costs of different regulatory actions (with a BCA) can help choose the right level of regulation to maximize societal net benefits and that CEA is more suitable to comparing regulatory actions with the same primary outcome (e.g., life-years saved or

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[10] See Mercatus Center Public Interest Comment on the Consumer Product Safety Commission's proposal at http://www.mercatus.org/article.php/224.html (2003).

[11] See Mercatus Center Public Interest Comment on Forest Service Roadless Area Proposal. Available at http://www.mercatus.org/article.php/91.html (2000).

[12] See The Mercatus Center's Public Interest Comments EPA's Tier 2 Standards for Vehicle Emissions and Gasoline Sulfur Content,. Available at http://www.mercatus.org/article.php/113.html (1999).

acres of wetlands protected). It warns, correctly, however that CEA can be misleading when the "'effectiveness' measure does not weight appropriately the consequences of each of the alternatives." (68 FR 5516) For example, as we commented on EPA's Tier 2 vehicle emissions and low-sulfur gasoline rules, the use of tons of pollutants in the denominator of EPA's cost-effectiveness calculation was inappropriate, because tons of NOx and NMHC removed was not a good proxy for the risk of concern (health risks from human exposure to high ozone concentrations in non-attainment areas during peak ozone periods).[13]

It notes that "it is difficult for OMB to draw meaningful cost-effectiveness comparisons between rulemakings that employ different cost-effectiveness measurements," and directs agencies to "provide OMB with the underlying data, including mortality and morbidity data, the age distribution of the affected population, and the severity and duration of disease conditions or trauma." (68 FR 5517) Agencies should not only provide this information to OMB, but should make it readily available as part of the electronic rulemaking docket, so that the public can also evaluate the proposal and the analysis supporting it.

The guidelines state that "regulatory analysis should provide a separate description of distributional effects (i.e., how both benefits and costs are distributed among sub-populations of particular concern) so that decisionmakers can properly consider them along with the effects on economic efficiency." (68 FR 5517) Basing regulatory decisions on averages can mislead policy makers. For example, the Department of Energy bases energy efficiency standards on a benefit-cost analysis of "average" consumers. Its analysis supporting its 2001 air conditioner and heat pump standards estimated that the average consumer would save $45 over the life of the more efficient air conditioning or heat pump unit. A review of the distributional impacts of the rule reveals however, that most consumers would lose money once the standard was imposed. Low-income consumers would be harmed the most, particularly those in climates where heat pumps or air conditioners are not intensively used throughout the year.[14]

V. Identifying and Measuring Benefits and Costs

The guidelines discuss in detail the recommended analytical approaches for preparing benefit and costs estimates, as required by Executive Order 12866 and by statute. In general, these reflect accepted principles and analytical techniques. Agency adherence to most aspects of these guidelines would significantly improve the quality of regulation and the net benefits provided by regulatory activity. In this section, we briefly review the recommendations that are generally accepted (but not always followed in regulatory analyses) and then focus more detailed discussion on a few areas that are more controversial.

A. In most areas, the guidelines express generally accepted principles for regulatory analysis

Setting the appropriate baseline from which to examine incremental costs of alternative approaches is important. In our comments on EPA's arsenic in drinking water regulations, we showed that an incremental approach to examining the costs and benefits of different levels of stringency suggested a very different policy approach than the one that emerged from EPA's total cost approach. (EPA estimated the net benefit of each standard from the current baseline, but not from the next less stringent option, and thus missed the insight that intermediate level standards produced significantly greater incremental net benefits than the selected option.)[15]

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[13] *Ibid.*

[14] See the Mercatus Center's Public Interest Comments on energy efficiency standards for air conditioners at http://www.mercatus.org/article.php/81.html (2000) and http://www.mercatus.org/article.php/68.html (2001).

[15] See The Mercatus Center's Public Interest Comments on arsenic in drinking water standards at: http://www.mercatus.org/article.php/87.html.

We are encouraged by the recommendation that analyses should "include separate schedules of the monetized benefits and costs that show the type and timing of benefits and costs and express the estimates in this table in constant, undiscounted dollars." (68 FR 5518) Without such schedules of cash flows, it is often impossible to evaluate estimates of total costs or benefits. EPA's prospective study of the costs and benefits of clean air regulations, for example, which dominate OMB's estimate of the costs and benefits of all federal regulation, are based on snapshots of costs and benefits in two years.[16]

The recommendation that agencies evaluate uncertainty with full probability distributions of potential consequences and a transparent discussion of scientific disagreement or uncertainty is also sound. Every step in a benefit-cost analysis involves uncertainty, and there is a tendency to choose a number that the agency believes is favorable to its policy choice. These biases tend to compound and amplify each other, producing an answer that may be absurdly far off in the tail of probability distribution. Every effort should be made to make the analysis transparent, including all of its uncertainties, and to use established scientific techniques to manage error distributions and to avoid biases.

The guidelines correctly recognize that "opportunity costs" are the appropriate concept for valuing both benefits and costs, and that individual willingness to pay captures this notion. Not only do "market prices provide the richest data for estimating benefits" (68 FR 5518), but also the most reliable. The Department of Transportation does careful, detailed benefit cost analysis for regulations such as passenger safety and CAFE. However, because it substitutes its own values for consumer values with respect to time preference or safety features, these analyses often support regulations that make consumers worse off. An honest benefit-cost analysis cannot just set aside individual preferences, such as the discount rate; nor can it ignore them, as DOT's analysis does with other vehicle attributes that consumers value.[17]

The guidelines recognize that it is not always possible to conduct an original study to estimate non-market benefits attributable to regulatory activity. With caveats, they endorse "benefits transfer methods" that apply existing estimates to a new context. With the exception of contingent valuation studies, which we discuss in detail below, we believe these approaches, subjected to the constraints and qualifications described in the guidelines, are reasonable.

The circular discusses discuses the difficulty of valuing the benefits of measures that reduce mortality. It seems to ask the wrong question, though, when it notes "For example, the elderly may have substantial willingness to pay for reductions in their mortality risk precisely because they have relatively few life years remaining." The more appropriate question is whether one would prefer to die at 30 or 75, and whether we as a society are indifferent between saving 50 years of life or 5.

OMB can make huge improvements in the practice of regulatory analysis by replacing the "lives saved" measure of benefits with a "life-years" metric. In addition to the technical advantages that are described in the literature, the change should make the practice of benefit-cost analysis more transparent to the general public. Most people can understand longevity as a suitable measure of health benefit, and can appreciate that longevity can be affected by regulatory costs as well as benefits, and by mechanisms both intended and unintended. Note that using life-years will also make it easier for the public to understand how discount rates apply to health and safety programs. With life-years as the measure of benefits, there is no need to discount. Instead, the costs of the program can simply be amortized over the life-years saved. Most people understand the notion of amortizing costs, and understand that it includes a provision for interest—the cost of financing long-term investments. The result is mathematically identical to discounting, but it is far easier for non-economists to understand. A similar methodology can be used to

[16] U.S. Environmental Protection Agency. The Benefits and Costs of the Clean Air Act, 1990 to 2010, November 1999. See 2003 Mercatus Center working paper on the costs of the Clean Air Act by Garry Vaughn, PhD.

[17] See The Mercatus Center's Public Interest Comments on DOT air bag proposals at http://www.mercatus.org/article.php/120.html, and on DOT light truck CAFE standards at http://www.mercatus.org/article.php/208.html.

simplify the adjustment for the shadow price of capital. Two different interest rates can be used: a lower rate (the social rate of time preference or SRTP) to amortize costs that represent foregone consumption, and a higher rate (the SRTP times the shadow price of capital) to amortize costs that represent foregone capital investment. Again, this is mathematically identical to the standard method described in Lind,[18] but it is far easier to explain to a lay person.

While the "life-years" metric has advantages over the "lives-saved" metric, it would be a mistake to try to use *quality adjusted* life-years (QALYs). In the context of making public decisions about regulations, it will be difficult to persuade the public that it should accept age-based or health-based "quality adjustments." Rather, it should encourage agencies to use simple longevity as the measure of benefit through the use of the life-years metric.

B. The guidelines venture into some controversial areas and recommend procedures that are not consistent with economic principles or human behavior.

1. Contingent Valuation

When market data are unavailable, the guidelines cautiously endorse the use of the controversial benefit-valuation technique known as contingent valuation (CV). While observing that CV methods "have become increasingly common for estimating indirectly traded benefits," the guidelines note that "the reliance of these methods on stated preferences regarding hypothetical scenarios and the complexities of the goods being valued by this technique raise issues about its accuracy in estimating willingness to pay compared to methods based on (indirect) revealed preferences." Despite concerns about its accuracy, the guidelines conclude that CV may be the only method available to estimate "non-use" values, and do not dismiss CV as a tool. Instead, they state that "value estimates derived from contingent-valuation studies require greater analytical care than studies based on observable behavior," and proceeds to enumerate "best practices" for conducting CV. The best practices for conducting CV surveys address sampling, survey instrument design, transparency and replicability of results.

Relying on a technique because it is the only thing available is a weak endorsement, at best. All of the best practices, and all of the care in the world, will not redeem a technique that is fundamentally flawed. Before addressing issues the CV method itself, it is worthwhile to consider the nature of "non-use" values that it is purported to quantify. What are non-use values and how do they relate to values people assign to goods through markets?

Non-use values derive from the mere existence of something, like the Grand Canyon, the Costa Rican rain forest or the Alaskan wilderness. Some economists view non-use values as a form of externality that must be addressed by government action,[19] and the guidelines implicitly seems to accept this notion. The guidelines' suggestion that CV be used, despite its flaws, because there is no other method for valuing non-use values presumes that non-use values should be included in government decisions. Though generally discussed in the context of environmental amenities, non-use values exist for innumerable things. Some individuals may gain non-use values from the knowledge that the Alaskan wilderness is untouched by oil drilling, while others may gain non-use values from the knowledge that oil wells exist to provide jobs for Alaskan workers and national security. Some individuals may assign non-use values to knowing people attend church regularly, while others may gain non-use values from knowing others engage in hedonistic behavior. On whose values should government reallocation of resources be based?

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[18] *Discounting for Time and Risk in Energy Policy,* Robert C. Lind, ed. Baltimore: Johns Hopkins University Press (1982). A review of the Lind approach is provided in the next section.

[19] University of Southern California's "National Ocean Economics Project" provides information and links to research on non-market values of environmental amenities. http://ahf331b.usc.edu/nonmarket.html. Last accessed 4/4/03.

Some economists suggest that the concept of non-use or existence value is inconsistent with generally accepted economic principles.[20] Weikard distinguishes existence and bequest values from option values, which he considers a form of use value, and based on altruism,[21] and attempts a theoretical proof to show that individuals would not be willing to sacrifice use values to receive non-use values.

Boudreaux, Meiners & Zywicki raise related concerns, though they do not deny the existence of non-use values.

> "Although everyone experiences subjective utility gains and losses that do not correspond to market money values, the fact that subjective utility exists in humans does not justify government policy geared to that dimension. Of course, government policy and the law, if they are to serve useful social functions, must be geared to measures of human welfare. But because subjective utility is unmeasurable, government cannot be charged with the task of maximizing utility." (p. 793)

They also question the magnitude of existence values, questioning whether, if forced to actually pay for it, people would be willing to give up a significant amount of private economic goods in exchange for pure existence value.[22]

They show that the practical problems of CV cannot be resolved with better surveys because the technique itself is conceptually flawed.

> The questionable results [recognized by OMB and others] are merely the manifestation of greater underlying and incurable problems that render contingent valuation studies generally—and attempts to discern existence value particularly—useless and unreliable. The problem confronting designers of contingent valuation studies is at the conceptual and theoretical level, not at the merely practical level of implementation. Contingent valuation studies are inconsistent with the fundamental principles of economic choice under conditions of scarcity and budget constraints and rest on a superficial understanding of the role played by dollar prices in a dynamic economy. (p. 776)

Values emerge, not as conscious, intentional decisions, but as the unintended and undesigned results of decentralized market activity. People do not have a single value for an environmental amenity, but rather schedules of different dollar figures dependent upon a nearly infinite variety of variables. As a result, Boudreaux *et al* conclude that stated market values are not acceptable surrogates for market prices.

Kahneman, Ritov, and Schkade have also examined CV methods and results to understand what stated preferences actually express.[23] They find that willingness to pay estimates derived from CV studies, though denominated in dollars, "are better viewed as expressions of attitudes than as indications of economic preferences," and that "the anomalies of CV are inevitable manifestations of known

[20] Hans-Peter Weikard, "The Existence Value Does Not Exist and Non-use Values are Useless." Paper prepared for the annual meeting of the European Public Choice Society, 2002. http://polis.unipmn.it/epcs/papers/weikard.pdf. Last accessed 4/4/03.

[21] This classification of option values as use values is consistent with other authors, including the U.K. Department for Transport, Local Government and the Regions *Economic Valuation with Stated Preference Techniques: Summary Guide.* http://www.dtlr.gov.uk/about/economics/05.htm. Last accessed 4/4/03.

[22] On this point, they defer to Adam Smith, who illustrated the concept two centuries ago with a hypothetical earthquake in China that killed millions. While a European would express sincere regrets about the plight of the dead, his concern would pale in comparison to a comparatively trivial misfortune of his own. Adam Smith, *The Theory of Moral Sentiments*, referenced in Boudreaux *et al.* (p. 774) This discussion is similar to that of Schelling (below) in the context of discounting deep-future benefits from reducing climate change.

[23] Daniel Kahneman, Ilana Ritov, and David Schkade, "Economic Preferences or Attitude Expressions?: An Analysis of Dollar Responses to Public Issues," in *Journal of Risk and Uncertainty,* 19:1-3; 203-235 (1999).

characteristics of attitudes and attitude expressions." (p. 204) They find that stated preferences derived from CV studies are analogous to juries' punitive damage awards, and are not consistent with economists' rational models.

Both jury awards and CV results seem to reveal a prescriptive notion of what should be, divorced from actual behavior or revealed preferences. But how much weight should these prescriptive notions carry in designing government policy?

Boudreaux *et. al.* point out,

> In market transactions, we can assume that all individual trades increase individual utility, because the occurrence of the trade itself suggests that the individual values the good received more highly than the good surrendered. Thus, it is only through the process of actual exchange of one good for another that we can know for sure that an individual values one option over another... Divorced from the discipline of making actual choices, the hypothetical choices presented by contingent valuation have little value. (p. 785)

Kahneman *et al* and Boudreaux *et al,* through very different paths, reach the conclusion that stated preferences divorced from any expectation of actually having to pay the stated values, are not accurate proxies for revealed economic preferences. The similarities Kahneman *et al* find between jurors and CV respondents suggests that, like jurors determining civil damage awards, CV respondents view the values they assign as imposing costs on someone other than themselves. They know they will never have to pay the values they profess to place on different amenities. Thus, these responses do not comply with the key concept of opportunity cost articulated in the guidelines – they do not "measure what individuals are willing to forgo to enjoy a particular benefit." Indeed, it strikes us as unrealistic to think that individuals would give up more than a small amount of income or other use value in exchange for a non-use value. It is equally unrealistic to assume that it is in society's interests to pursue government policies that would divert society's scarce resources based on these subjective, stated preferences.

If we begin to sacrifice the values that we know are real in favor of values that may be imaginary and that have no bounds, it is difficult to know where to stop. Encouraging government regulators to protect subjective non-use values (whether they relate to the environment, religious beliefs, or individual behavior) runs a serious risk of undermining the freedoms and productivity that makes America unique.

2. What discount rate to use

The guidelines advise regulatory analysts to estimate the present value of benefit and cost streams of alternative regulatory (and non-regulatory) options using real discount rates of 3 and 7 percent. It states that a 7 percent rate "approximates the opportunity cost of capital and is the appropriate discount rate whenever the main effect of a regulation is to displace or alter the use of capital in the private sector." However, "when regulation primarily affects private consumption (e.g., through higher consumer prices for goods and services), a lower discount rate may be appropriate." Thus, a "social rate of time preference" of 3 percent adjusts for economic distortions, including taxes on capital, that create a divergence between this social rate and the private rate of return to capital. It further notes that "in some instances, if there is reason to expect that the regulation will cause resources to be reallocated away from private investment in the corporate sector, then the opportunity cost may be appreciably greater than the 3 to 7 percent discount rate," and in those cases encourages sensitivity analysis using higher rates (in the range of 10 to 25 percent).

This guidance appears to be a simplified version the discounting approach described in a 1982 book based on a conference organized by Resources for the Future (RFF) and edited by Robert Lind.[24] Economists have believed since the publication of the Lind book that the right way to evaluate a government investment or regulation is to account separately for time, for risk, and for the effects of taxation. A relatively low, risk-free discount rate, along the lines of OMB's 3 percent, for example, accounts for the time value of deferred consumption. A separate calculation of expected values is the best way to account for risk and uncertainty about future benefits and costs. And benefits and costs that increase or decrease private capital should be weighted by, say, a factor of 2 or 3 (although there is room for argument here), to reflect the fact that a dollar of capital in our economy is more valuable than a dollar of consumption. (This last adjustment factor is called the "shadow price of capital," and it is largely the result of a tax system that penalizes savings, thus making capital more scarce and ultimately more valuable than consumption.) This three-step procedure resolved the thorniest theoretical issues and helped to explain the difference between market rates of interest and the lower rates generally used in benefit-cost analysis.

While the guidelines refer to the Lind approach (which is laid out in OMB Circular A-94), they advise regulatory analysts simply to discount future benefits and costs at 3 percent and 7 percent, with sensitivity analysis using higher rates if private capital is displaced.

It also finds that

> Special ethical considerations arise when comparing benefits and costs across generations. Although most people demonstrate in their own consumption behavior a preference for consumption now rather than in the future, it may not be appropriate for society to demonstrate a similar preference when deciding between the well-being of current and future generations. Future citizens who are affected by such choices cannot take part in making them, and today's society must act in their interest. One way to do this would be to follow the same discounting techniques described above, but to supplement the analysis with an explicit discussion of the intergenerational concerns and how they will be affected by the regulatory decision. Policymakers would be provided with additional information when the analysis covers many generations, but without changing the general approach to discounting.
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> Some have argued, however, that it is ethically impermissible to discount the utility of future generations. On this view, government should treat all generations equally. Even under this approach, it would still be correct to discount future costs and consumption benefits, although perhaps at a lower rate than for intragenerational analysis. There are two reasons for thinking that a nonzero discount rate is the appropriate assumption for intergenerational analysis, even when all generations are to be treated equally. First, future generations are likely to be wealthier than those currently living, so a marginal dollar of benefits or costs will be worth less to them than it would be to those alive today, at least on average. If that holds true, it is appropriate to discount future benefits and costs relative to currently consumed benefits and costs even if the welfare of future generations is not being discounted. Estimates of the discount rate appropriate in this case made in the 1990s ranged from 1 to 3 percent per annum.[25]
>
> A second reason for discounting the benefits and costs accruing to future generations at a lower rate is increased uncertainty about the appropriate value of the discount rate, the

[24] *Discounting for Time and Risk in Energy Policy,* Robert C. Lind, ed. Baltimore: Johns Hopkins University Press (1982).

[25] Here, the circular refers to a recent symposium volume published by Resources for the Future. Paul R. Portney and John P. Weyant (eds.), *Discounting and Intergenerational Equity,* Washington, D.C.: Resources for the Future (1999).

> longer the horizon for the analysis. Aversion to uncertainty discourages any such long-term investments. Private market rates provide a reliable reference for determining how society values time within a generation, but for extremely long time periods no comparable private rates exist. Symmetric uncertainty would have the effect of lowering the discount factor applied to future costs and benefits. Again the reasonable range might be expanded to include rates as low as 1 percent per annum.

OMB does not explore all the implications of using a lower discount rate for future generations. For example, it will never make sense to adopt a regulation that incurs short-term costs for long-term benefits. The alternative of waiting a year will always be superior, because the costs will shrink more than the benefits will.

The guidelines refer to a more recent RFF conference volume as justification for annual discount rates as low as 1 percent. Yet, a careful review of the papers in this volume does not offer clear support for a low intergenerational discount rate. Indeed, as many of the papers in the volume offer evidence that a low rate would be *inappropriate.*

The economists who contributed to the volume divide roughly into two camps, which have been called "descriptive" and "prescriptive." The descriptive camp argues for estimating the discount rate using economic theory combined with empirical data derived from behavior that reveals the value people place on the future. The prescriptive camp argues that, at least in the case of "intergenerational" time horizons (greater than 40 years), we should derive the discount rate from ethical principles. They are concerned that discounting purely for the passage of time may be morally wrong.

Among those in the prescriptive camp is Nobel Laureate, Kenneth Arrow,[26] who admits to taking "the problem of discounting for projects with payoffs in the far future (climate change, nuclear waste disposal) to be largely ethical." (p. 13) He tries to resolve an "apparent conflict in our moral intuitions."

> On the one hand, moral considerations are based on universalizability, in which case we should treat future generations as we would ourselves, so that the pure rate of pure time preference should be zero. But with zero time preference and a long horizon, the savings rates become inordinately high, possibly approaching one as the horizon goes to infinity. (p. 13)

He models "agent-relative ethics" in which "each generation will maximize a weighted sum of its own utility and the sum of utilities of all future generations, with less weight on the latter. At the very least, really distant generations are treated all alike." P.16. Despite his ethical approach to the problem, he concludes that ethical considerations do not support discounting deep future payoffs at a lower rate. (p. 20)

William Nordhaus also appears sympathetic to the ethical concerns alluded to by others in the volume, and he expresses them clearly.[27] "While the economic logic of using the market price for the discount rate is powerful, there are cases where the implications of that technique are questionable or unacceptable," (p. 147) because they "violate ethical intuition." (p. 149) To reconcile this conflict he examines different abatement strategies for climate change using a model that integrates the costs and benefits of carbon reductions with a scientific model of emissions, concentrations and climate change. He compares an "optimal" climate change approach (in which marginal costs and benefits of emissions are balanced, with approaches driven by differential discounting and concludes:

[26] Kenneth J. Arrow "Discounting, Morality, and Gaming" in Portney & Weyant (1999).

[27] William D. Nordhaus, "Discounting and Public Policies that Affect the Distant Future" in Portney & Weyant (1999).

> The dilemma of how much we should pay to slow global warming is in no way informed by the use of unrealistically low overall discount rates, or differential discount rates for environmental projects—both of which hide the underlying trade-off between the long-term objective and the economic cost. (p. 157) ... The main conclusion is that *ad hoc* manipulation of a discount rate on goods to achieve long-term goals is a very poor substitute for policies that focus directly on the ultimate objective. (p. 158)

Alan Manne attempts in a descriptive way to address the ethical dilemma of how to treat unrepresented future generations equitably by examining behavior under two different models.[28] He notes that future generations are likely to be wealthier in terms of labor productivity and conventional forms of capital, but poorer in terms of environmental resources. (p. 111) The infinite-lived agent (ILA) model and the overlapping generations (OG) model require different assumptions about altruism between generations (with the ILA model assuming an immortal agent who values future consumption as if it were his own, and the OG model assuming an agent with no bequest motives). Despite the "polar-opposite viewpoints on intergenerational altruism," his two models yield almost equivalent discount rates reflecting the marginal productivity of capital. He notes that "abatement represents a specific form of capital accumulation, and that [there are] appropriate markets for realizing the distant-future benefits from this type of activity." (p. 121)

> Provided that the consumption discount rate is standardized between the two formulations, both the OLG and ILS results are driven by the same considerations with respect to economic efficiency. The global externalities are internalized as though the production side of the economy employed both present and future prices as a guide for decisions on investment and abatement expenditures so as to maximize the economic discounted value of green output that is available for consumption. The economic efficiency conditions are identical for both OLG and ILA, and equity issues may be separated from those relating to efficiency. (p. 120)

There are two papers that do conclude that very low rates are appropriate to protect intergenerational equity when evaluation long-term projects (and thus may be viewed as supporting OMB's proposal).

Dasgupta, Maler and Barrett[29] develop a model with a choice set that includes not only productive capital but "natural capital." Using this 2-choice model, they identify situations when it would be optimal for society to halt growth in productive capital stock (which depletes natural capital) to allow regeneration of natural capital. This implies a discount rate of zero or negative.

There are obvious problems with this model. First, the naïve assumption that productive capital depletes natural capital is clearly wrong. Improvements in farming techniques, fertilizer, pesticides and biotechnology have all greatly improved our ability to produce more food on less land. Without this "productive capital," a significantly larger amount of "natural capital"—water and land—would have to have been diverted to food production. The unrealistic Malthusian simplicity of the model also does not appreciate the ability of human ingenuity to restore natural capital (or the social benefits produced by natural capital).

If OMB's intent is that federal regulatory agencies should suppress economic growth in order to give nature more breathing room, then it ought to be explicit about that objective. Does OMB believe, for example, that tax cuts should be avoided because they might stimulate unwanted economic growth? It is difficult to take this rationale seriously.

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[28] Alan S. Manne, "Equity, Efficiency, and Discounting" in Portney & Weyant (1999).

[29] Partha Dasgupta, Karl-Goran Maler, and Scott Barrett, "Intergenerational Equity, Social Discount Rates, and Global Warming," in Portney & Weyant 1999. See also positive comments on this paper by V. Kerry Smith in the same volume.

William R. Cline combines prescriptive and descriptive approaches in his paper.[30] He contends there are two reasons for discounting (which are embodied in the social rate of time preference): (1) a pure rate of time preference or "impatience" and (2) the expectation that people will be better off in the future (the elasticity of marginal utility multiplied by the growth rate of per capita income). He asserts that it is "ethically indefensible to discount future consumption solely because of impatience." (p. 132). Assuming a growth rate of consumption of 1 percent per year, and an elasticity of marginal utility of "in the range of one to two," he advocates a discount rate of 1.5 percent. (p. 133)

All of these attempts to give an ethical interpretation to discounting are reminiscent of the literature of the early twentieth century.[31] Early authors tended to view an individual's discount rate as a measure of his character. What Cline calls "impatience" Fisher called a "defective telescopic faculty." Fisher argues that family fortunes tend to rise and fall across generations because those who inherit wealth have weak characters and high discount rates, and tend to dissipate their fortunes; in the next generation hardship will build character, lower discount rates, and rebuild fortunes. Others looked for a correspondence between discount rates and social class or race.

This whole line of inquiry is misguided. Discount rates are simply prices, determined by supply and demand conditions. Prominent among these is the technology for shifting consumption forward and backward in time. Even a solitary Robinson Crusoe (for whom ethical considerations are presumably limited) may have a negative discount rate (say, if rats are eating his stock of corn at 10 percent per year) or a positive one (if he learns to plant the corn). As is the case with other market prices, people who can trade with each other at a market rate of interest will make each other better off; substituting a non-market price will necessarily make some of them worse off. How is that ethically superior?

Perhaps the most compelling paper in the volume to debunk the ethical arguments for a low intergenerational discount rate is that of Thomas C. Schelling, who interestingly (1) focuses almost exclusively on ethics, and (2) does not directly address the discounting question.[32] He addresses concerns about future climate change, which is the main impetus behind intergenerational discount rate discussions. He observes first that the beneficiaries of deep future benefits (e.g., from climate change) will accrue to descendants of people in now-developing countries. He further submits that beneficiaries 50 years from now will be much better off than their current ancestors, but probably not as well off as people in currently developed countries.[33] From these observations he concludes that "any [carbon] abatement program is essentially a foreign aid program." (p. 99)

By pointing out that by taking abatement actions to address climate change today we are transferring welfare from current generations to future wealthier generations, he turns on its head the ethical arguments of intergenerational equity. "The real significance of the diminishing marginal utility of consumption, that is, of discounting future increments to consumption, is in the choice between helping, with material assistance, the early generations in the developing countries [who are desperately poor] or the later generations [who we expect to be less poor]." (p. 101) Thus, his insights suggests that raising material welfare now (consumption, health, safety) meets a more urgent need, and may be the best defense against any possible adverse effects of climate change. "We must always consider, when

[30] William R. Cline, "Discounting for the Very Long Term" in Portney & Weyant (1999).

[31] See, for example, Irving Fisher's Theory of Interest (1930).

[32] Thomas C. Schelling, "Intergenerational Discounting" in Portney & Weyant (1999).

[33] He bases these presumptions on three factors:

1. Four-fifths of the world population is in developing countries now and nine-tenths will be in 50 years.
2. Developing country economies are currently susceptible to climate, and in 50 years they probably still will be more susceptible to climate than the economies in now developed countries.
3. Despite more rapid economic growth over the next 50 years, they will probably still have lower per capita income than their contemporaries in developed countries (p. 99).

investing in greenhouse gas abatement for the benefit of those future people, the opportunity cost of investing now in more rapid development for the benefit not only of those future people but of their equally worthy and more needy ancestors." (p. 101)

As illustrated above, very few of the papers in the book OMB references support discount rates as low as 1 percent, as OMB recommends in its guidance. Most of the authors who expressed concern that the results of traditional discounting violate ethical intuition were unable to defend making decisions based on an arbitrarily low discount rate.

Looking hundreds of years into the future is difficult, especially because it is hard to divorce the analysis from ethical concern over unborn descendents, so let's examine the circular's proposed 1 percent discount rate approach by looking to the past. If we could go back in time, would we really ask our (relatively poorer) ancestors to set their money aside at a 1 percent return for our benefit? Indeed, would we even be better off if they had done so? They would have had to forsake many higher return investments to make this "investment in the future" and as a result, our standard of living would likely be lower today, even with the "inheritance" they left us invested at a one percent rate.

In comments on a paper in the volume, Jerome Rothenberg notes that abatement (of future problems, like climate change) takes two forms: prevention or adaptation. A subset of adaptation "is to make provision for a general subsidizing of those [future] generations in terms of overall productivity—in effect, a reimbursement to them for sustaining unmitigated climatic damages." (p. 106) Thus, the opportunity cost of preventive abatement actions is the lost productivity of adaptation/reimbursement investments, which can be approximated by market rates of return on capital.[34]

We believe it is a mistake to vest the discount rate with moral significance. It is simply a price, formed by the interaction of supply and demand and strongly influenced by the state of technology. It should reflect the opportunity cost of the investment, or the foregone benefits of other projects not undertaken as a result of a mandated government expenditure, which could have provided value for future as well as current generations.

Rates of return that are required for private investments are already much higher than those routinely accepted by government agencies, in part because of the burden of taxation. If government agencies are permitted to justify proposals that return benefits of only one percent, and do that only after decades or centuries pass, low-value government-mandated projects will displace ever greater amounts of private investment, raising the question of how the CEA can forecast long-term economic growth in excess of one percent annually, when it is so willing to displace the high-value private investment that drives economic growth.

On discount rates, OMB should reject proposals to derive "ethical" rates and should instead follow its own guidelines: "market prices provide the richest data for estimating benefits." (68 FR 5518)

3. Treatment of Transfer Payments

The draft guidelines suggest that regulatory transfer payments (offsetting benefits and costs that net to zero, but effectively transfer wealth from one group to another) do not affect total resources available to society. (68 FR 5524) This is too simplistic. Often these wealth transfers are the political motivation for the regulation. Indeed, the guidelines are skeptical of economic regulations, whose effects are dominated by wealth transfers, because we know that the net effect of economic regulation generally is a substantial social loss.

Because of rent-seeking, wealth redistribution by regulation is not a zero-sum game. There are real costs associated with regulations that effect large "transfers" from one group to another. At the very least,

[34] Rothenberg also notes that when investments come at the expense of investment and consumption, a social discount rate, rather than the private cost of capital, is appropriate (p. 107).

OMB should estimate the deadweight loss associated with the transfer (as it has done in previous years' reports). In Circular A-94, OMB has estimated the "excess burden of taxation" at 25 percent of revenues. It would be surprising if transfers effected by regulation had a deadweight loss any less than that. In addition, regulations that transfer wealth are typically the product of lobbying and other rent-seeking behavior on the part of the beneficiaries. Such rent-seeking will dissipate the benefits, so that costs assumed to be transfers may in fact represent real resource costs.[35] OMB should investigate and report these costs.

VI. Accounting Statement

The guidelines direct agencies to prepare an accounting statement for major final rules to be used in OMB's annual report to Congress on the costs and benefits of regulation. To the extent that agencies follow the suggested format and guidelines, the estimates provided in OMB's annual reports will be much more reliable than they are today. As noted above in the discussion of transfer costs, we encourage the guidelines and the accounting statement to recognize that so-called transfer payments can include large dead-weight losses that should not be ignored.

VII. Conclusion and Recommendation

Issuing clear analytical guidelines, and holding agencies accountable for complying with them, is an important step toward regulatory reform. Many aspects of the draft guidelines are sound. However, the circular should be more demanding of agencies' initial justifications of regulatory action. It should stress the comparative analysis of market failure and regulatory failure, and not simply rely on the results of benefit-cost analysis to justify regulatory interventions. This is necessary to avoid the "Planner's Paradox"—the tendency of planned solutions to appear superior to unplanned market solutions in any forecasting model or benefit-cost analysis.

The circular's guidance for estimating benefits and costs has some serious flaws, particularly its recommendation for the use of non-market "contingent valuation" benefits and non-market "ethical" discount rates. These recommendations cannot be defended and would undermine the care and detail embodied in the rest of the guidelines. Taken together, they amount to a license to: "Imagine some benefits. Imagine they go on forever. . . ." If these techniques are permitted, then economic analysis will lose its capacity to impose scientific rigor on regulatory decisions. The guidelines should also recognize that regulatory transfer payments impose real costs on society and develop recommendations to account for the associated dead-weight losses.

OMB should leave the current (2000) guidelines in place while it revises the draft guidelines to address these concerns and make it clear that contingent valuation surveys and unrealistic discount rates will not be accepted.

[35] Gordon Tullock. "The Welfare Costs of Tariffs, Monopolies and Theft" *Western Economic Journal*, 5, pp. 224-232 (1967).

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Progress in OMB's Regulatory Accounting Reports

DEPARTMENT/AGENCY	Date Started	Agency PROGRAM	Date Started
Agriculture	3/02		
Commerce			
Defense			
Education	3/02		
Energy	3/02	Energy Efficiency & Renewable Energy	2/03
		All Other DOE	
Health & Human Services	3/02	FDA	2/03
		All Other HHS	
Housing & Urban Development	3/02		
Interior			
Justice			
Labor	3/02	OSHA	2/03
		All Other DOL	
State			
Transportation	3/02	NHTSA	2/03
		Coast Guard	2/03
		All Other DOT	
Treasury			
Veterans Affairs			
EPA	3/02	Office of Air	2/03
		Office of Water	2/03
		All Other EPA	

Dark Gray = Missing information from OMB's reports

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