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Subject: Comments on Cost-Benefit Draft

Attached find PDF file of comments on the OMB Draft Report to Congress on the Costs and Benefits of Federal Regulations
- TOC-Comments-OMB-Costs1.pdf

Comments:
On the 2003 Draft Report to Congress on Costs and Benefits of Federal Regulations
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Citizens and business persons concerned with the growing costs of the federal regulatory burden have seen benefit-cost analysis and cost-effectiveness analysis as ways to bring to light and possibly mitigate that burden. Since it is indisputable that regulations come with high costs, it seems a matter of common sense that those costs should be taken into account when deciding on the wisdom and soundness of a particular public policy. Do the purported benefits outweigh the expected costs? Do the benefits and costs fall disproportionately on one group at the expense of another? Are there less costly ways to achieve the same results? Is the problem addressed better at the state or local level rather than at the federal level?

In many cases such analyses indeed expose the costs of regulations and head off bad regulations, at the federal, state and local levels. Such analyses have been used successfully by Governor William Weld in Massachusetts, Governor George Allen in Virginia and Governor George Pataki in New York among others. At the federal level members of Congress have used such analyses to call to task bureaucrats and appointed officials who have neglected to take account of the full impact of their policies.

But cost-benefit analysis is a second-best approach. It is true that the perfect should not be the enemy of the good, and thus that such approaches should not be rejected in favor of an impossible utopia. But the Office of Management and Budget 2003 Draft to Congress on cost-benefit analysis exposes how second bests can degenerate into far worse policies. In this case the Draft shows how the costs of using cost-benefit analysis might outweigh the benefits. The alternative to such analysis is a return to a strict regime of private property rights and contracts, supported by a sound tort law system.

Market Failures or a Failure to Have Markets?

OMB cites attempts to mitigate the affects of market failure as a reason often used to justify regulations. This is a faulty premise from which to proceed and it guarantees faulty calculations.

OMB correctly acknowledges that many regulations are mandated by Congress and that agencies must accept the inherent valuations in such mandates. This suggests

that in fact most valuations of benefits are really political decisions. From this perspective it would be valid to quantify the costs of a regulation while recognizing that the valuation of benefits is subjective and not strictly quantifiable.

But to attempt to calculate benefits as if they were mitigating the costs of market failures misses the fact that the problem tends to be a failure to have markets. Functioning markets with property rights allow negative externalities to be costed out within the system. If no one owns a lake, if it remains in the commons, it is subject to overfishing, becomes a dump for pollutants and so forth. With private ownership or well-defined use rights or easements, use conflicts will be solved. If, for example, a company wants to dump pollutants in the lake that will reduce its value as a fishery, it can pay the owners for that right.

Conflicts that seem to require regulations occur in the absence of property rights. While it is beyond OMB's mandate to determine how best to make property out of commons, OMB should not suggest that market failures justify regulations.

The Political Problem

A major problem with cost-benefit analysis is the fact that the government agencies make the cost and benefit estimates themselves, based on their own data, with OMB reviewing those proposed rules. But the agencies have their own institutional and political interests and have a strong incentive, whenever a judgment call is possible, to misstate or to skew their numbers and data in ways that maximize the budgets, payrolls, power, and influence of the agency.

The growth of regulations in part can be accounted for by the fact that the U.S. Congress has abrogated Constitutionally-given law-making authority to unelected bureaucrats. Rather than voting, for example, on the details of what constitutes a disability under the provisions of the Americans With Disabilities Act of 1990, Congress set out vague and often contradictory definitions and left it to the agencies to figure out what Congress meant. The agencies then were free to push as far as they could for definitions that served their agency interests.

Government agencies have a track record of misstating or misinterpreting numbers when it services their purposes. For example, the Environmental Protection Agency abandoned sound scientific principles in the data they provided concerning the number of deaths from smoking. While the number usually cited for smoking deaths in America is 400,000 per year, a rigorous analysis of the data by Robert Levy of the Rosalind Marimont in *Regulation* magazine found the real number to be about 163,000. (See <http://www.cato.org/pubs/regulation/regv21n4/lies.pdf> .) The authors note, for example, the failure to adjust statistics for variables such as alcohol consumption that would contribute to deaths attributed to smoking.

Government accounting also is notoriously questionable. For example, Amtrak has come under criticism for running deficits since its creation as a government owned

and operated passenger railroad three decades ago. In 1997 Congress mandated that it be self-sufficient in its operating budget by 2002. Almost up until the moment that the Amtrak Reform Council, which monitored its progress, found it would not meet its goal and would have even larger deficits than originally imagined, it claimed it was on target. In fact it attempted, with the support of members of Congress, to exempt itself from generally accepted accounting principles. Amtrak would place expenses normally considered to be operating expenses into the capital expenditures accounts. (See Vranich and Hudgins, "Help Passenger Rail by Privatizing Amtrak," Cato Institute *Policy Analysis* No. 419, November 1, 2001, <http://www.cato.org/pubs/pas/pa419.pdf>.) Amtrak also misstated its on-time arrival numbers by selectively measuring only at certain stops.

Similarly, in New York City in the 1970s the government listed as capital expenditures many operating expenses, including salaries. These practices led to the city's bankruptcy.

It is an eternal struggle for OMB, the General Accounting Office and inspector generals to monitor their respective agencies. The point is that relying on the agencies for data on which to base cost and especially benefit calculations is a mistake.

The Problem of Pragmatism

Another problem with cost-benefit analysis is found in a major philosophical dispute from past centuries. Pragmatic school thinkers of the nineteenth century set forth a principle for social good "the greatest good for the greatest number." This principle implicitly assumed that all goods, including private actions, have social aspects to them; that goods and actions often conflict; that some way to place numerical values on such goods and actions can be devised so that policy judgments can be made scientifically. This principle was developed by classical liberals such as John Stuart Mill and thus many assumed that the principle is consistent with a free, opened society.

But this principle was in part a rejection of the earlier liberal tradition that held that each individual has the unalienable right to life, liberty and property, and that the purpose of government is to protect those rights. The social assumption inherent in this principle is that the rights of individuals do no conflict if individuals do not initiate the use of force against one another and instead exchange via mutual consent.

Pragmatism proved to be very impractical. No objective formula ever could be discovered that would allow such comparisons of social goods to be made. Inevitable, subjective assumptions had to be made.

Cost-benefit analysis is simply a variation on philosophical flawed pragmatism and will be no more objective or scientific.

The practical problems with such analysis are already clear from actual numbers offered in the OMB Draft. The benefits listed in Table 2 range between \$135.5 billion

and \$217.5 billion, while costs are listed as ranging between \$37.7 billion and \$43.8 billion. The benefits listed for EPA in Table 1 range from \$913 million to \$4.8 billion. These are huge variations that show the inexact nature of such calculations.

In a way, reading the details of the OMB suggestions for doing cost-benefit analysis reminds one of the process of central planning in East bloc countries before the fall of communism. These countries technically were supposed to plan out every aspect of their economies, with cost numbers for inputs and outputs of all goods and services. In point of fact, such calculations never worked out. Each agency and industry understated its expected outputs and overstated its needs. Central planners tried to correct for what they knew were inaccurate numbers but never were able to make such a system work.

New Pattern of Force?

Another problem with cost-benefit analysis is that, like the social principle of pragmatism, it must assume that every activity has social costs and benefits that can be measured and taken into account when promulgating or evaluating regulations. Thus this well-intentioned way to balance costs with benefits could open the door to bringing even more activities under the control of governments. Limitations on freedom thus will become easier.

Political support and budget limitations certainly will determine how far a government agency can go in limiting freedom. But it must be kept in mind that when Congress abrogates its lawmaking powers to the bureaucracy, it gives up much of the power to control agency choices.

Return to Property Rights and Contract

OMB is limited in what it can do concerning its mandate to evaluate the costs, benefits and effectiveness of regulations. But it is important for policymakers and administration officials to recognize the problems with this approach.

The failed philosophy of pragmatism challenged an older and sounder paradigm of individual rights to life, liberty and property, with contract rights as a corollary. The pragmatic principle and cost-benefit analysis both posit conflicts between individuals and winners and losers when regulations seek to mitigate supposed negative externalities. The property rights and contract approach posits individuals whose interests do not conflict and all exchanges between individuals as win-win situations.

Lawmakers and administration officials might usefully calculate and publicize many of the costs of proposed regulations. But attempting to calculate benefits and balancing them with the costs is problematic at best. They should look instead at strategies to allow markets to emerge where they do not exist and allow the property rights and a contract, regime rather than government-mandated regulations, deal with externalities.