

OMB's 2005 Draft Report to Congress on the Costs and Benefits of Federal Regulation
Peer review comments by
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General comment

Overall this is a good report. It improves incrementally on prior reports and lays out plans to make further improvements in the future. For the public it provides a useful window into the important, but obscure, world of regulation. For OMB and the agencies, as well of for Congress, it advances the state of the art and helps to institutionalize the process of evaluating regulatory benefits and costs.

Institutionalizing this process is important because of the continued rapid growth of federal regulation, which, although issued piecemeal by dozens of agencies on their own delegated authority, carries the full force of law and collectively imposes an economic burden on Americans comparable to the tax burden. It presents a serious management challenge for the President and for Congress, because it is so difficult to know the full scope of federal regulation and to reach informed conclusions about its merits. This annual report is an essential complement to other tools, such as the Semiannual Agenda and the Regulatory Program, for improving transparency and accountability in the regulatory process.

As OMB recognizes, the process of aggregating benefit and cost estimates from multiple individual analyses—of uneven quality to begin with—necessarily degrades their accuracy further. My own view, elaborated further below, is that calculating an accurate “total cost of regulation,” or a total benefit, may not be fully achievable. Nonetheless, I support the effort to try, while recognizing that: (1) decisions about any particular rule should still be driven by the merits of that rule, and (2) aggregated numbers, although fuzzy and somewhat arbitrary, should still be used to monitor trends, gauge general magnitudes, set priorities, and suggest directions for reform.

My comments are arranged in order of the report, but they generally make broader points about the methodology rather than specific changes to the text.

Chapter I A

While OMB has made improvements in the coverage and methodology of its aggregate estimates of benefits and costs, the report still has substantial limitations, which for the most part are appropriately noted.

One lingering concern is the problem of inconsistent assumptions and baselines. I do not believe that these can ever be made fully consistent. The costs and benefits of any particular regulation are defined by comparing the world with and without that particular regulation. If a second regulation is considered at the same time, there will be a certain amount of double counting or other interaction—which is manageable. When a large collection of regulations is

considered, however, the problem of interaction becomes impossible to manage. The costs and benefits of all regulations is not the sum of the individual cases; it can only be uniquely defined by comparing the world with *all* regulation and the world with *none*. This is an analytically intractable problem—it is also one of questionable policy relevance, since an all-or-nothing decision is not on anyone’s agenda.

I conclude that it may not be possible to construct a tally of regulations with a rigor that approaches that of the budget, nor will it be practical to manage regulations by setting up a “regulatory budget” with an authorization and appropriations process for regulatory costs.

Nonetheless, it is important for policymakers to have some notion of the total size of the regulation, even while recognizing that any given estimate is an approximation that inevitably lacks some rigor.

In constructing these tabulations, OMB should not automatically exclude the costs of any regulation for which benefits are not estimated. It can identify these and footnote them with a caveat, but not leave them off the summary table. Imagine how misleading it would be if we applied such a practice to the federal budget.

In Table 1-1 the asterisk notes that one deregulatory DOT rule involved negative costs. This highlights one of the arbitrary assumptions embedded in benefit-cost analyses: There is not unambiguous way to distinguish between positive benefits and negative costs. How a particular effect is classified depends on the frame of reference, which is arbitrary, and varies from one analysis to the next. In the theory of benefit-cost analysis, net benefits are well-defined as the sum across individuals of the difference in individual welfare, as measured by compensating variations, between two states of the world. The assignment of a particular increase in welfare to the category of “benefit” or “negative cost” (or correspondingly, to “cost” or “negative benefit”) is an artifact of the particular method of analysis. There may be dozens of legitimate ways to arrive at the same net benefits for a particular rule, but with very different estimate of benefits and costs. This is one of the obstacles to aggregation that I believe can never be satisfactorily overcome.

The ten year look-back is one way to recognize that older analyses have likely become obsolete. I would note that it might be a good idea to couple that observation with a sunset mechanism—requiring the agency to update the analysis periodically, or else to engage in a new rulemaking. There are a variety of legislative and administrative mechanisms to effect a sunset provision, and I encourage OIRA to continue to explore these. Meanwhile, it is misleading to simply let regulatory programs drop off the radar screen after ten years, since some of them continue to have substantial economic effects.

The lack of quantified benefits for homeland security regulations is a problem. This is not the first category of regulation to claim that the task is too difficult, and OMB should encourage the Department to develop suitable methods. FEMA, for example, has done an excellent job of developing benefit-cost tools for examining its hazard mitigation program. The threat of terrorism is different in important ways from the threat of natural disasters, but surely some progress can be made.

OMB notes that its citation of agency cost estimates should not be taken as an endorsement. This highlights the difficulty, which has been noted before, of relying on agency estimates; but I recognize that this report may not be the place for OMB to correct them. Still, there is an apparent bias both in agency and OMB practices, in that both have strong incentives to avoid labeling a rule with negative net benefits. It is certainly true that net-harmful regulations get issued, but it is very difficult for any agency to issue a regulation along with an analysis that demonstrates the costs exceed the benefits—even when the agency is acting reluctantly under a statutory mandate. Similarly, while OMB may disagree with an agency internally, it is unlikely to disparage the final decision—even in those cases when, as the saying goes, you have to “kiss a pig.” A transparent process is needed so that such regulations are exposed to outside scrutiny by Congress, academics, and the interested public. For this reason it would be helpful if OMB would produce more than just a summary report of benefits and costs. It should accumulate a database of analyses that is available to the public, where assumptions can be examined and tested. It should encourage the Commerce Department and other agencies to make independent estimates of costs and benefits, and include these varying perspectives in future reports.

The report describes in detail the uncertainties surrounding the benefits of reduced emissions of particulate matter. This continues to be an area of concern, not only in the degree to which it affects the tabulation of benefits in this report, but also in the degree to which it apparently influences the government’s priorities for regulation. We can only hope that these uncertainties are reduced soon.

I.C. and Table 1-5

Budgetary rules

It is reasonable to exclude “budgetary” regulations from this report, but I believe the best argument for this is not the presence of large “transfers.” Rather, it is division of labor: these regulations are best evaluated in the context of the federal budget programs that they support. If they are covered there, they need not be covered in this report. Another way to look at the distinction is to note that the costs imposed by budgetary rules primarily occur through the imposition of taxes; non-budgetary rules primarily impose costs by other means.

I.D. and Table 1-6

Independent Regulatory Agencies

One effect of excluding independent agencies from the report is that the non-budgetary regulations this year were all “social” regulations. However, there is a large class of “economic” regulations that are non-budgetary. Some of these have large costs that do not represent transfers (e.g., regulations implementing Sarbanes-Oxley). Others may have large transfer components, but still are susceptible to enlightening economic analysis (see, e.g., Jerry Ellig’s recent analysis of telecommunications regulation, available at <http://www.mercatus.org/regulatorystudies/article.php/1074.html>). I would encourage OMB to continue to pursue methods of including the actions of independent agencies in this annual report.

I.E. Impacts

It is helpful that the report draws on GAO's work with UMRA, as well as SBA's efforts to quantify the impact of regulation. OMB should consider expanding the scope of this section in future reports by asking the Commerce Department to examine the impact of regulation on the international competitiveness of U.S. industry—expanding on the work done last year through the manufacturing initiative. International competitiveness is a growing concern, and it would be helpful if OMB and the Congress had some systematic information on the degree to which regulatory mandates are a factor.

In the section on wages, it would be a good place to note that social regulation in the workplace may not provide benefits to workers beyond what they can bargain for or choose in the labor market. That is, exposures to hazards in the workplace are not necessarily externalities, and therefore we have little reason to expect regulation to produce net benefits beyond those that could be bargained for. Note that the estimated value of mortality reduction used in the analysis of other social regulations has been derived from wage premium studies. The flip side of this is that market prices are already encouraging mortality reductions in the workplace, and compensating for hazards that remain. Absent some other market failure, social regulation in this context would be expected to produce negative net benefits.

This would also be a good place to note that economic regulation, when it produces transfers that increase the level of wages, may also lower the level of employment. (And, in any case, such transfers generally represent losses of consumer surplus, with a deadweight loss on the side.)

I applaud OMB for including international comparisons as an indicator of the macroeconomic effect of regulation. On this broad scale, the tools of benefit-cost analysis can easily miss the forest for the trees, and international comparisons help overcome that limitation. For example, we know that there are economies in the world that are so over-regulated that little economic activity takes place outside the government sector and the informal sector. Under those circumstances, benefit-cost analysis of the rules would not be able to identify much in the way of costs (or benefits), because hardly anyone is actively complying with them. But the total cost of such stifling regulation might easily be an order of magnitude larger than that nation's entire GDP. Note that the Millennium Challenge Corporation is in the process of developing metrics of economic freedom for use in allocating foreign aid. OMB should continue to monitor this literature and use it to support its annual report.

II.A. Trends

The attempt to document trends in the benefits and costs of regulation is useful, even though the assumptions underlying it are unavoidably messy. Here again the ambiguity between "benefits" and "negative costs" has reared its head. OMB has made some attempts to establish consistency across rules and years in the way "negative costs" are classified, but the truth is that there may be no firm basis for deciding this.

II.B. Validation

I would encourage OMB to continue to look for ways to validate ex-ante estimates, to validate general methodologies, and to do more retrospective evaluations of regulatory programs. This is difficult to do when resources are scarce, but in the long run it will be worthwhile. I recall one epidemiologist who noted that the best time to look for evidence of human health effects from pollutants is just after a new standard has been issued, so that exposures are changing; unfortunately, that is the only time the agency is not interested in the analysis. The rulemaking process demands ex-ante analyses; once the standard is revised the agency moves on to the next problem. OMB needs to find ways to encourage ex-post analyses, perhaps by using the GPRA process to tie regulatory agency budgets to demonstrated metrics of performance.

In addition to doing more analyses of individual regulations, OMB should not rule out broader studies of particular sectors or particular categories of regulation. For example, what trends do we see in worker safety and health, and do they correlate at all with the benefits claimed from OSHA regulation? OMB can draw on economic data in the Commerce and Labor Departments, as well as indicators of health in HHS databases, to pursue such studies.