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**GEORGE MASON UNIVERSITY**

**REGULATORY STUDIES PROGRAM**

**Public Interest Comment on**

**The Office of Management and Budget's  
2005 Draft Report to Congress on the Costs and Benefits of Regulation<sup>1</sup>**

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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. RSP's comments on the Office of Management and Budget's (OMB's) eighth Draft Report to Congress on the Costs and Benefits of Federal Regulations (Draft 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.

**I. Key Features of OMB's 2005 Draft Report**

Like previous annual reports issued by OMB, the 2005 Draft Report tallies up agency estimates of the costs and benefits of economically significant regulations issued over the last year, and last decade. In 2004, federal agencies issued 45 major (economically significant) rules, 19 of which implement budget programs (OMB does not include costs or benefits of these in its tally), and 26 are social regulations. Of those social regulations, agencies provided economic analysis that included information on both costs and benefits for eleven. The analysis supporting seven Department of Homeland Security regulations estimate costs but not benefits, and another eight major regulations do not estimate both costs and benefits. The totals presented in the report and reproduced in the table below include only those regulations for which the issuing agency estimated both benefits and costs.

OMB Estimated Benefits and Costs of Major Rulemakings

	Annual BENEFITS	Annual COSTS
FY04	\$12.6 bil. - \$108.5 bil.	\$3.8 bil. - \$4.1 bil.
FY94-FY04	\$68.1 bil. - \$259.6 bil.	\$34.8. bil - \$39.1 bil.

For the first time in this report, OMB presents agency cost estimates for economically significant regulations issued as far back as 1981, the beginning of the regulatory review program at OMB. It concludes that major regulations issued over the last 24 years impose \$117 billion in regulatory costs each year. It also presents agency benefit estimates for major rules issued between October 1992 and September 2004, without reporting a cumulative benefit figure. Perhaps the most interesting feature of this new

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<sup>1</sup> Prepared by Susan E. Dudley, Director, Regulatory Studies Program. This comment is one in a series of Public Interest Comments from the Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

information is the graphical representation in Figures 2-1, 2-2, and 2-3. These show the difference in regulatory activity (costs, benefits, and net benefits) by year, and illustrate the “midnight regulation effect,” or tendency of regulatory activity to increase in the last year of a president’s term. OMB’s data presented in Figures 2-1 through 2-3 corroborate Mercatus research, which has quantified this effect using rigorous econometric analysis of *Federal Register* pages and executive orders.<sup>2</sup>

All of these cost figures are based on *ex ante* estimates developed by regulatory agencies prior to publication of rules. The Draft Report summarizes studies that have examined the impacts of rules after they were implemented, and requests public input on the value of comparing post-regulation to pre-regulation estimates to “validate” the accuracy of *ex ante* estimates developed through the rulemaking process.

Like last year’s report, the 2005 Draft summarizes studies on the effect of regulatory policies on economic growth. The different studies suggest that countries with less regulation and government intervention in the market place enjoy higher economic growth and per capita income—economic indicators that, in turn, are correlated with longer life-expectancy, and improved health.

Regulatory policies that secure, rather than diminish, property rights and minimize interference in competitive markets encourage entrepreneurship and innovation, and improve the quality of life.<sup>3</sup> U.S. policymakers should heed the results of these studies. The regulation-by-regulation analyses in OMB’s annual regulatory accounting report can identify for Congress and the public how well regulations, individually and in the aggregate, protect property rights and encourage entrepreneurship.

Section II of this comment discusses the benefit and cost estimates presented in this draft. Section III addresses OMB’s discussion of net benefits, and Section IV responds to OMB’s request for comment on the use of *ex post* analysis to validate these estimates.

## **II. Estimating the Costs and Benefits of Federal Regulation**

The real impact of federal regulation on Americans is difficult to measure. Policy objectives accomplished through government spending (supported by taxes and borrowing) are tracked annually through the fiscal budget, but there is no corresponding mechanism for keeping track of the off-budget spending accomplished through regulation.

To track in a systematic way the change in regulatory activity over time, policy analysts often rely on such measures as the size of the *Code of Federal Regulations*, the number of pages printed in the *Federal Register*, or the size of the budgets of regulatory agencies.<sup>4</sup> These are all useful metrics, which provide insights into the growth, trends and composition of regulatory activity.

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<sup>2</sup> Jay Cochran, “[The Cinderella Constraint: Why Regulations Increase Significantly During Post-Election Quarters](#),” Mercatus Center at George Mason University. Working Paper, March 8, 2001. Additional research pending. Contact author for more information.

<sup>3</sup> The Mercatus Center has a new Policy Series with more information on these topics, available at <http://www.mercatus.org/globalprosperity/subcategory.php/213.html>. Recent issues in the series include primers on the role of institutions and property rights in entrepreneurship.

<sup>4</sup> Susan Dudley & Melinda Warren. *Upward Trend in Regulation Continues: An Analysis of the U.S. Budget for Fiscal Years 2005 and 2006*, Mercatus Center at George Mason University and Murray Weidenbaum Center on the Economy, Government, and Public Policy at Washington University in St. Louis. June 2005. <http://www.mercatus.org/regulatorystudies/article.php/1246.html>

They are, nevertheless, all proxies for what we really want to understand – the impact of federal regulation on individuals. This annual report to Congress offers another important attempt to understand the real impact of regulations, but it, too, is a proxy. For reasons we have outlined in comments on previous reports, the data as presented are inconsistent and fragmentary and do not provide a complete or accurate picture of the benefits and costs of regulation.<sup>5</sup>

The report recognizes that the estimates are “not a complete accounting of all the costs and benefits of all regulations issued by the Federal government during this period,”<sup>6</sup> and observes 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 reported in Table 1-2 [summarized on page 1 of this comment].”<sup>7</sup> We highlight some of the key drawbacks to OMB’s benefit and cost figures in this section.

## **A. The estimates cover a small fraction of federal regulation.**

### **1. Only “major” rules are considered.**

While OMB reviewed 45 major regulations in FY 2004, the benefits and costs presented in the Draft Report are based on agency estimates for eleven regulations. That is less than 0.3 percent of the final rules published in the *Federal Register* during the year. Of the major rules not included in the estimates, OMB classifies nineteen as “transfers,” and suggest they simply shift money from one segment of society to another without imposing any net social costs or benefits. Fifteen major “social regulations,” which OMB recognizes “may require substantial additional private expenditures as well as provide new social benefits,”<sup>8</sup> are also not included in the estimates because issuing agencies did not estimate both benefits and costs for them.

The report supports the limited focus with the following:

In summary, our evaluation of a few representative agencies found that major rules represented the vast majority of the costs and benefits of all rules promulgated by these agencies and reviewed by OMB. Because of this finding, we believe our decision to report only on the impact of major rules continues to have merit.<sup>9</sup>

### **2. Most “major” rules are not included.**

However, even if we accept that the major regulations reviewed by OMB do represent the majority of the costs and benefits of all rules issued by executive branch agencies, OMB’s figures cover less than one-fourth of those rules. OMB’s method of excluding any rule for which agencies have not estimated benefits and costs limits the coverage of its totals. For example, a cursory review of OMB’s Table 1-4 suggests that in FY 2004,

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<sup>5</sup> Previous Mercatus Center Public Interest Comments on OMB’s annual reports to Congress as well as those filed on the record with various agencies are available by agency at <http://www.mercatus.org/regulatorystudies/pic-topic.php?menuid=2>.

<sup>6</sup> 2005 Draft Report, p. 7.

<sup>7</sup> 2005 Draft Report, p. 9.

<sup>8</sup> 2005 Draft Report, p. 6

<sup>9</sup> 2005 Draft Report, footnote 4.

this approach excludes an estimated \$5 billion to \$11 billion in costs, the majority of these for regulations associated with homeland security benefits. In contrast to OMB's reported one-year cost estimate of between \$3.8 billion and \$4.1 billion, its data suggest that costs imposed by major rules issued in FY 2004 really range from \$9 billion to \$15 billion.<sup>10</sup>

OMB hesitates to report these cost figures because agencies have not provide a corresponding benefit figure. However, understanding the costs of regulations is important in itself. That is why the federal government tracks on-budget expenditures for its various purposes. Although the benefits that correspond to these expenditures are recognized by decision-makers and are considered when determining whether a particular project is worth the cost, an overall understanding of expenditures or budgetary costs is essential for reasoned decision-making.

### **3. Rules that effect "transfers" are not included.**

Furthermore, there are real costs associated with regulations that effect large "transfers" from one group to another. Regulations involving "mere" transfers alter people's behavior, either by directly prohibiting or mandating certain activities or by altering prices and costs. Redirecting resources in this way imposes a real cost to society, which economists refer to as a "deadweight loss" or "excess burden." At the very least, OMB should estimate the deadweight loss associated with these transfers. OMB has estimated the "excess burden of taxation," including the federal administrative costs and taxpayer burden, 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 additional real resource costs.<sup>11</sup> OMB should investigate and report these costs.

### **4. Ten-year rolling total excludes rules with significant continuing costs.**

For these annual reports, OMB has adopted a ten-year rolling aggregate for determining what regulations to include in total cost and benefit estimates. As the costs and benefits imposed by regulations issued in the most recent year are added to the total, the costs and benefits estimated for regulations first imposed 11 years ago are dropped. The Draft Report states:

OMB has chosen a 10-year period for aggregation because pre-regulation estimates prepared for rules adopted more than ten years ago are of questionable relevance today.<sup>12</sup>

While OMB is certainly correct to question the validity of *ex ante* estimates of the expected impacts of regulations (see Section IV of this comment), that does not justify an arbitrary truncation of what is represented as a "total" cost and benefit estimate.

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<sup>10</sup> Based on the cost estimates presented in Table 1-4 of the Draft Report.

<sup>11</sup> Gordon Tullock. "The Welfare Costs of Tariffs, Monopolies and Theft" *Western Economic Journal*, 5, pp. 224-232. (1967).

<sup>12</sup> 2005 Draft Report p. 7.

Table C-2 in the appendix to the Draft Report lists the major rules issued in fiscal year 2003, which are no longer included in the estimates. Many of these are significant regulations, with lasting consequences on how Americans live their lives. For example, DOT's regulation requiring drug and alcohol testing has likely changed workplace dynamics, and EPA's land disposal restrictions have changed waste management practices and continue to affect Americans 11 years later.<sup>13</sup>

### **5. The costs and benefits of regulations issued by independent agencies are excluded from the totals.**

The 2005 Draft Report reviews and summarizes four major rules issued by independent agencies. Since these regulations are not subject to the requirements of Executive Order 12866 (including an economic analysis and review by OMB), less data on costs and benefits are available. Though it reports that all of the major independent agency rules provide information on costs and benefits, and three of them include quantified cost estimates, OMB does not present these data in its annual report.

We recognize that OMB has less access to, and oversight over, independent agency analyses than executive branch agencies. Nevertheless, its congressional mandate does not direct OMB to exclude independent agencies in developing its "estimate of the total annual costs and benefits... of Federal rules and paperwork."<sup>14</sup> Exclusion of independent agency regulations underestimates the impacts of federal regulation.

For example, a recent Mercatus Center study found that federal telecommunications and broadband regulations have significant costs. These regulations cost consumers \$105 billion annually in higher prices and forgone services.<sup>15</sup>

### **B. The reported benefits and costs are not based on an independent assessment.**

As in previous years, OMB offers no independent assessment of the quality or usefulness of agency analyses and, correspondingly, the estimates presented in this report. The reported benefits and costs are based on agency estimates, without independent verification or any assurance that assumptions and methods are consistent across programs and activities. Indeed, the report states that its "citation of, or reliance on, agency data in this report should not be taken as an OMB endorsement of all the varied methodologies used to derive benefits and cost estimates."<sup>16</sup> 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 provide an independent view of agencies' regulatory expenditures. OMB's reports to Congress should also 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

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<sup>13</sup> *Ex post* analysis would be interesting here. Have the restrictions changed waste transport practices? What are the relative costs and risks associated with the transport and disposal practices that have replaced land disposal?

<sup>14</sup> PL 106-554, 31 U.S.C. 1105

<sup>15</sup> Jerry Ellig. *Costs and Consequences of Federal Telecommunications and Broadband Regulations*. A Working Paper in Regulatory Studies. Mercatus Center at George Mason University. February 2005. <http://www.mercatus.org/regulatorystudies/article.php/1074.html>

<sup>16</sup> 2005 Draft Report p. 9.

analysis; it has access to agency analyses, interagency discussions, and public comments on individual rules. In the 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 weaknesses of each analysis.

### **C. The reported benefits are subject to considerable uncertainty.**

The estimated benefits of Environmental Protection Agency regulations comprise over 87 percent of OMB’s reported lower bound benefits for fiscal year 2004, and 93 percent of the upper bound benefits. For the 10-year period, EPA rules contribute over 60 percent of lower bound and 80 percent of upper bound benefits. Previous Mercatus Center comments on OMB’s annual estimates have raised questions about these estimates,<sup>17</sup> as have other reviewers.<sup>18</sup> The Draft Report comments in particular on the “uncertainty in the reduction of premature deaths associated with reduction in particulate matter and the monetary value of reducing mortality risk.”<sup>19</sup>

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. 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” (most reliable estimate) for scientific purposes. OMB must work to eliminate these biases.

### **D. Other studies of regulatory costs can provide a check against which to assess OMB estimates.**

To provide Congress and the public a more comprehensive picture of the benefits and costs of regulation, OMB’s annual reports to Congress should provide a review of the available literature. The draft report notes that actual estimates “could easily be a factor of ten or more larger than the sum of the costs and benefits” it reports, and suggests “[m]ore research is necessary to provide a stronger analytic foundation for comprehensive estimates of total costs and benefits by agency and program.”<sup>20</sup>

While OMB’s regulation-by-regulation approach to estimating benefits and costs contributes a valuable dataset for regulatory accounting, other studies (some of which

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<sup>17</sup> Previous Mercatus Center Public Interest Comments on OMB’s annual reports to Congress as well as those filed on the record with EPA are available by agency at <http://www.mercatus.org/regulatorystudies/pic-topic.php?menuid=2>. For example, in our comments on OMB’s 2001 report to Congress, 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. Public Interest Comment available at: <http://www.mercatus.org/article.php/69.html>.

<sup>18</sup> Randall Lutter and Richard Belzer, “EPA Pats Itself on the Back,” Regulation. Vol. 23, No. 3. (2000) <http://www.aei-brookings.org/admin/authorpdfs/page.php?id=120>

<sup>19</sup> 2005 Draft Report, p. 10.

<sup>20</sup> 2005 Draft Report, p. 9.

apply other approaches) can provide useful data points for understanding the impact of regulations.

The draft report does refer to a recent Small Business Administration report, by Professors Mark Crain and Thomas Hopkins, which pegs the annual cost of regulations at \$843 billion in 2000.<sup>21</sup> This suggests that OMB’s cost range of \$35 to \$39 billion may be low by a factor of 20, rather than 10. A revised SBA report is forthcoming later this year.

Several Mercatus Center studies examine the available literature (including agency estimates) to develop estimates of the costs of regulations addressing (1) water quality,<sup>22</sup> (2) workplace issues,<sup>23</sup> and (3) telecommunications.<sup>24</sup> We compare the results of these with OMB’s estimates in the table below.

<b>Agency</b>	<b>OMB Reported Costs</b>	<b>Mercatus Center Estimate</b>
Department of Labor	\$0.3 billion	\$91 billion
EPA - Water	\$3.2 – \$3.7 billion	\$98 billion
Telecommunications	NA	\$105 billion
<b>Total</b>	<b>\$3.5 – \$4.0 billion</b>	<b>\$294 billion</b>

The Mercatus estimates are more comprehensive, both in the time period covered and the number of rules included within the three categories, however, they are by no means upper bound estimates of the costs of regulations in these categories. Each of the studies attempts to be conservative in its derivation of cost estimates. Yet, summing our cost estimates for these three types of rulemaking alone (workplace, water quality, and telecommunications) provides an estimate over five times larger than OMB’s upper bound cost figure. The Mercatus studies suggest costs for these three categories of regulation of \$294 billion per year, where OMB presents estimates of the costs of all major rules over the last decade of between \$34.8 billion and \$39.4 billion.

### **III. Benefits, Costs, and Net Benefits**

Chapter II of the Draft Report continues OMB’s review of agencies’ analyses of major rules, and compiles estimates of the costs imposed by regulations issued between 1981 and 2004. It also compiles agency estimates of benefits between 1992 and 2004, and

<sup>21</sup> W.M. Crain and T.D. Hopkins, “The Impact of Regulatory Costs on Small Firms.” Report prepared for the Office of Advocacy, U.S. Small Business Administration, 2001. Available at <http://www.sba.gov>.

<sup>22</sup> Joseph Johnson, Ph.D., “The Costs of Regulations Implementing the Clean Water Act.” Mercatus Center at George Mason University, 2004. <http://www.mercatus.org/regulatorystudies/article.php/629.html>.

Robert Raucher, Ph.D. and John Cromwell, “The Costs of Compliance with Regulations Issued under the Federal Safe Drinking Water Act Amendments of 1996.” Mercatus Center at George Mason University, 2004.

<sup>23</sup> Joseph M. Johnson, *A Review and Synthesis of the Cost of Workplace Regulations*, Mercatus Center at George Mason University, Working Paper Series, September 2001. Available at: <http://www.mercatus.org/regulatorystudies/article.php/10.html>

<sup>24</sup> Jerry Ellig. *Costs and Consequences of Federal Telecommunications and Broadband Regulations*. A Working Paper in Regulatory Studies. Mercatus Center at George Mason University. February 2005. <http://www.mercatus.org/regulatorystudies/article.php/1074.html>

from these, calculates net benefits (benefits minus costs) for that period. These are valuable additions to OMB's annual reporting effort.

The Draft Report suggests that net benefit is "a theoretically superior measure of the overall value of regulation."<sup>25</sup> We agree. In Mercatus Center's most recent study of the costs of regulation, Jerry Ellig examines not only the costs, but the consequences of telecommunications regulation.<sup>26</sup> As discussed in the next section, understanding the actual impacts of regulation is essential.

However, as regulatory scholars have observed, there is considerable value in examining separately the cost side of the equation.<sup>27</sup> Companies maintain internal cost accounting systems to track expenditures for different purposes, and the federal government tracks on-budget expenditures for its various purposes. Though the benefits that correspond to these expenditures are recognized at the micro decision-making level (to determine whether a particular project is worth the cost), no one would deny that an overall understanding of expenditures or budgetary costs is also essential for reasoned decision-making.

The desired benefits of regulation are the force behind legislative initiatives that create them, and these desired benefits of regulation are often better understood, qualitatively, at least, than the costs. However, as challenging as it is to understanding the real social costs of regulation, quantifying benefits is more difficult. This is particularly true when the benefits in question relate to small changes in public health, as is the case with the majority of the benefits quantified by OMB, or "non-use" values associated with the environment.

In addition to presenting the results of its review of the costs and benefits reported in regulatory analyses graphically in Figures 2-1 through 2-3, we would like to see a table that reports these data by regulation and by year. That would allow researchers to understand the composition of these estimates. Did OMB rely on the same screening approach used to create its 10-year rolling total—including costs only for rules for which agencies had also quantified benefits?

In addition, we encourage regulatory agencies and OMB to follow Circular A-4 issued in March 2004 when developing new regulations and evaluating existing ones. Government decisions based on benefit-cost analysis are not a good substitute for market processes. Before undertaking regulatory activity, it is essential to ask what systemic problem in the market makes the action necessary. If none can be identified, no amount of analysis can produce a regulation that will make manufacturers, employees and consumers better off.<sup>28</sup> As the international studies OMB reviews highlight, policies that undermine

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<sup>25</sup> 2005 Draft Report, p. 36.

<sup>26</sup> Jerry Ellig. *Costs and Consequences of Federal Telecommunications and Broadband Regulations*. A Working Paper in Regulatory Studies. Mercatus Center at George Mason University. February 2005. <http://www.mercatus.org/regulatorystudies/article.php/1074.html>

<sup>27</sup> As Hopkins notes, tracking only the cost side follows the lead of the federal fiscal process, which does not measure benefits. Thomas D. Hopkins, "Regulatory Costs in Profile," Policy Study No. 132, Center for the Study of American Business, (August 1996); Murray Weidenbaum and Robert DeFina, "The Cost of Federal Regulation of Economic Activity," American Enterprise Institute, (May 1978).

<sup>28</sup> Our Public Interest Comments on the Department of Energy's energy efficiency standards and the Department of Transportation's corporate average fuel economy standards (available at [www.mercatus.org](http://www.mercatus.org)) highlight the problems with regulations issued in the absence of any market failure. These regulations, while sometimes supported by some manufacturers, harm American consumers.

property rights or interfere in competitive markets not only hinder the productivity and competitiveness of individual companies or sectors, but also harms the nation's economy.

#### **IV. *Ex post* validation of costs and consequences of regulations**

All of the cost figures in the Draft Report are based on *ex ante* estimates developed by regulatory agencies prior to publication of rules. Chapter 2 of the Draft Report observes

These *ex ante* estimates are "pre-regulation" forecasts of what the agency expects will happen, with regard to both benefits and costs, if the rule takes effect. However, an *ex ante* estimate is no more than an informed guess and, like other forms of prospective modeling, the estimates may or may not prove to be accurate once real-world experience with the rule is accumulated and analyzed. Moreover, new data may become available after a rule is promulgated that renders the pre-regulation estimates outdated and erroneous.<sup>29</sup>

OMB requests public input on the value of comparing post-regulation measures of impact to pre-regulation estimates to "validate" the accuracy of *ex ante* estimates developed through the rulemaking process. Chapter 2 presents summaries of retrospective conducted by agencies and others.

This is a very worthwhile endeavor. While agency compliance with OMB Circular A-4 should begin to improve the *ex ante* estimates of the costs and benefits of regulation, regulators will never be omniscient. The most careful *ex ante* analysis will ever be able to anticipate all the behavioral changes and consequences regulations will induce.<sup>30</sup>

When they have been undertaken in the past, *ex post* assessments have proved illuminating. For example, the National Highway Traffic Safety Administration (NHTSA) has conducted careful studies on the costs and benefits of many of its regulations after they were implemented. These are summarized in the 2005 Draft Report, but an earlier report provided more detail on NHTSA's comparison of the costs and benefits of its rule requiring center high-mounted stop lamps in passenger vehicles, with prospective estimates developed in the regulatory impact analysis (RIA) supporting the rule. It found that the RIA had underestimated costs by more than a factor of two and overstated effectiveness by a factor of more than seven. NHTSA noted that auto manufacturers' prospective estimates of the costs were more accurate than NHTSA's. Despite the revealed inaccuracies in prospective estimates, NHTSA concluded that the regulation still provided net benefits, they just were not as large as had been anticipated.<sup>31</sup>

This reveals that even careful RIAs, such as the one prepared by NHTSA, may not predict actual effects because they do not take into consideration behavioral responses to regulations. It also reinforces the importance of identifying a market failure before taking a regulatory action, as called for in Circular A-4. Even policies supported by the best

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<sup>29</sup> Draft 2005 Report to Congress on the Costs and Benefits of Federal Regulations, March 2005. p. 35.

<sup>30</sup> Brian Mannix, "The Planner's Paradox," *Regulation*, Vol. 26, No. 2, Summer 2003 <http://www.cato.org/pubs/regulation/regv26n2/mannix.pdf>.

<sup>31</sup> OMB's 1998 Report to Congress describes the results of NHTSA's analysis in more detail than the current Draft Report. It is available at <http://www.whitehouse.gov/omb/inforeg/costbenefitreport1998.pdf>.

benefit-cost analysis are not likely to be socially optimal substitutes for market forces unless they correct a market failure.

Retrospective analyses will not necessarily be more straightforward than prospective analyses, however. They are more reliable when the intended benefits of regulations are measurable, as is the case with motor vehicle or workplace accident statistics. Health effects are less readily measured and correlated with regulatory actions, particularly when a regulation's contributions to the health issue in question is not expected to be statistically observable. Furthermore, the problem of identifying the proper baseline from which to measure benefits and costs remains, even when looking retrospectively. What innovations would have occurred, but not for the regulation?

Nevertheless, making retrospective analysis of the impacts of regulations a standard practice, rather than an exceptional exercise, would inform the policy debate in beneficial ways. Policy makers would have information with which to eliminate or modify ineffective rules, expand more effective rules, and design future regulations that meet the needs of American citizens.

## **V. Conclusions and Recommendations for Improving Regulatory Accounting**

Unlike fiscal expenditures tracked through the federal budget, no reliable direct measure exists of the off-budget expenditures required through regulations. Thus we rely on proxies, such as *Federal Register* pages and the size of regulators' budgets, for what we really want to understand—the impact of federal regulation on individuals. OMB's annual report to Congress offers another important attempt to understand the real impact of regulations, but it, too, is a proxy. For reasons we have outlined above and in comments on previous reports, the data as presented are inconsistent and fragmentary and do not provide a complete or accurate picture of the benefits and costs of regulation.

**1. The estimates of the total costs of regulation presented in OMB's 2005 draft report to Congress are significantly understated.** The total benefits and costs presented in the Draft Report cover a fraction of the major regulations issued over the last decade. This year's estimates are based on agency estimates for eleven regulations—less than 0.3 percent of the final rules published in the *Federal Register* during the year. Annual cost estimates published by the Small Business Administration are over twenty times higher than those presented by OMB (\$843 billion compared to under \$40 billion). Mercatus Center studies of the costs of categories of regulations are also significantly higher than those reported by OMB. Relying only on data provided by agencies for the rules OMB reviewed this year suggests that costs range from \$9 billion to \$15 billion, almost three times the reported estimate of \$3.8 billion to \$4.1 billion.

OMB should not limit its totals to rules for which agencies estimate both costs and benefits. It should also present Congress a review of other reliable estimates of regulatory impacts.

**2. As in previous years, OMB offers no independent assessment of the quality or usefulness of agency analyses, and correspondingly, the estimates presented in this report.** The reported benefits and costs are based on agency estimates, without independent verification or any assurance that assumptions and methods are

consistent across programs and activities. They are dominated by reductions in one pollutant.

OMB could identify strengths and weaknesses of the methodologies agencies use to estimate benefits and costs, and, at a minimum, include those observations in this report in the form of a “report card” on each analysis.

- 3. Understanding the costs of regulations has value.** OMB is correct that theoretically, net benefits is the best measure of the real impact of regulations. Nevertheless, tracking the costs of regulations, analogous to tracking fiscal expenditures through the budget, is important for keeping regulators accountable to Americans.
- 4. *Ex post* validation of costs and consequences of regulations is essential.** Examining the consequences of regulations once they are in effect could address some of the problems with the estimates reported in the Draft Report. Making retrospective analysis of the impacts of regulations a standard practice, rather than an exceptional exercise, would inform the policy debate in beneficial ways. Policy makers would have information with which to eliminate or modify ineffective rules, expand more effective rules, and design future regulations that meet the needs of American citizens.