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**An Analysis of the Fourth Government Report  
On the Costs and Benefits of Federal Regulations**

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## Executive Summary

This paper critically reviews the draft of the Office of Management and Budget's fourth report on the benefits and costs of federal regulation. The purpose of this analysis is to offer constructive recommendations for improving that report.

We conclude that that this draft report represents a significant departure from previous reports. It provides very little in the way of new quantitative information. Instead, it solicits input on improving the report and the regulatory process. We have provided such input for the previous reports and believe that it has largely been ignored. We provide such input for this report in hopes that the regulatory process will become more transparent and that regulators and lawmakers will be held more accountable for regulations.

This draft report has failed to provide a reasonable analysis of newly proposed regulations. At a *minimum*, the Office of Management and Budget should provide a cogent analysis of these regulations.

We recommend that OMB make greater use of its in-house expertise to refine estimates of benefits and costs. We also argue that OMB should focus on the incremental impact of regulations rather than aggregate impacts. Finally, we believe that Congress should give OMB additional authority to enforce its guidelines on standardizing measures of costs and benefits.

## **An Analysis of the Fourth Government Report On the Costs and Benefits of Federal Regulations**

**Robert W. Hahn and Robert E. Litan**

The Office of Management and Budget's fourth draft report on the costs and benefits of federal regulation represents a substantial departure from previous reports. It fails to provide recommendations for regulatory reform, as Congress requires; nor does it provide much in the way of new qualitative information.<sup>1</sup> Instead, OMB's draft report highlights the need to rethink some basic steps in its analysis.<sup>2</sup>

The report provides substantially less new quantitative information than was contained in the previous report. No attempt is made to revise estimates of the aggregate benefits and costs of federal regulation; nor does the agency attempt to monetize some of the benefits associated with regulation. The report merely presents new information on significant regulations from April 1, 1999 through March 31, 2000. This information is provided by the agency that is issuing the regulation or the U.S. General Accounting Office (GAO).

The quantitative information that is presented on specific regulations is quite similar to the information reported in the previous year's reports. In particular, OMB takes the agencies' statements of the information as given. We have argued for several years that this approach fails to take advantage of insights that OMB's staff has about the strengths and weaknesses of specific regulations.

This is our third formal comment on OMB's annual regulatory report.<sup>3</sup> While we recognize that achieving greater regulatory accountability and transparency will take

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<sup>1</sup> The FY2000 Treasury and General Government Appropriations Act requires OMB to submit "an accounting statement and associated report" containing: "(1) an estimate of the total annual costs and benefits... of Federal rules and paperwork, to the extent feasible: (A) in the aggregate; (B) by agency and agency program; and (C) by major rule; (2) an analysis of impacts of Federal regulation on State, local, and tribal-government, small business, wages, and economic growth; and (3) recommendations for reform."

<sup>2</sup> "...we are taking this opportunity to step back and take a more careful look at both the methodologies and assumptions behind the hundred or so individual studies upon which our estimates are based and our approach to aggregating them." OMB (2001, 22042).

<sup>3</sup> Informal comments were provided on the first report.

time, we are disappointed that many of our previous recommendations have not been implemented.

The purpose of this comment is to answer some questions that OMB raises in its draft report; offer some recommendations for improving the report and the regulatory process; and offer some final thoughts about the nature of this benefit-cost exercise, how the report has succeeded and failed, and how it can be improved.

## **1. OMB's Six Questions**

Here are some answers to specific questions raised in OMB draft report.<sup>4</sup> We make two basic points. First, OMB has failed to draw on its own considerable expertise in analyzing newly proposed regulations. Second, at least for now, OMB should focus most of its limited resources on evaluating those regulations. If OMB wishes to pursue some of the other issues raised here, it should consider asking outside experts for help or hiring additional personnel.

### **Question 1: Should We Assess Older Regulations?**

It would be useful to address older regulations, but OMB has failed to do a good job assessing new regulations. Until it does a good job assessing new regulations, it should devote minimal resources to assessing old regulations.

### **Question 2: Should We Focus on Specific Statutes or Categories of Regulations?**

OMB has significant expertise in assessing specific regulations and regulatory proposals. It should not focus on specific statutes or categories of regulations until there is evidence of significant inefficiencies.

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<sup>4</sup> See OMB (2001, 22042-22043).

**Question 3: Should We Seek to Develop A Better Way to Estimate the Aggregate Cost of Federal Regulation?**

The aggregate cost of regulation should not be the primary focus of OMB's efforts. As OMB and others have noted, top-down and bottom-up approaches to estimation have different strengths and weaknesses.<sup>5</sup>

**Question 4: How Should We Estimate Effects on State, Local, and Tribal Government, Small Business, Wages, and Economic Growth?**

Economists have not done much relevant work in this area. OMB should simply note that and provide information where available, but not invest significant new resources.

**Question 5: How Can We Improve the Estimates of Costs and Benefits of Significant Regulations?**

The answer is simple. OMB experts should say what they really believe about the costs and benefits of significant regulations rather than taking the agency numbers as given. Short of that, OMB should point to analyses, such as those done at the AEI-Brookings Joint Center, which provide a credible alternative to a regulatory impact analysis (RIA) provided by an agency.<sup>6</sup>

**Question 6: How Should We Treat EPA's Aggregate Estimates of the Benefits of the Clean Air Act?**

These estimates should be treated with great care for reasons explained in several academic studies.<sup>7</sup>

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<sup>5</sup> See, for example, Hahn and Hird (1991), and OMB (1999). OMB should review the relevant literature, and not devote significant resources to updating it.

<sup>6</sup> See the Regulatory Analyses at <http://www.aei-brookings.org/> for examples of such work.

<sup>7</sup> See, for example, Lutter (1998), Lutter and Belzer (2000), and Portney (2000).

## **2. New and Old Recommendations**

We offer recommendations in two parts: new recommendations that are relevant to this draft report and old recommendations from previous reports that we believe are still relevant.

### *New Recommendations*

**Recommendation 1: The Congress should pass a law requiring that all regulatory agencies comply with OMB guidelines when analyzing the impact of economically significant regulations.<sup>8,9</sup>**

The rationale is simple. OMB's guidelines represent a set of principles for improving regulatory analysis and making the regulatory process more transparent. They should be required for all significant regulations from both independent and executive agencies. Unless the President decides that the regulation addresses an emergency, Congress should require that proposed regulations cannot move forward if the agencies' RIAs fail to meet the guidelines.

Currently, OMB has no effective mechanism for enforcing its guidelines and it needs one. Previous efforts to enforce similar guidelines have fallen short of the mark.<sup>10</sup> Moreover, agencies frequently fail to communicate their findings in a clear manner.<sup>11</sup>

If Congress does not pass the law that we recommend, enforcement authority for implementing the guidelines should be included in a new Executive Order that applies to the executive agencies.

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<sup>8</sup> For guidelines, see OMB (2000b) and OMB(1996).

<sup>9</sup> Executive Order 12,866 classifies a rule as significant if it has an impact on the economy of \$100 million or more in one year. The Unfunded Mandates Reform Act classifies a rule as significant if the regulation has an impact on the private sector and/or state or local governments of \$100 million or more in one year.

<sup>10</sup> See for example, Hahn et al (2000), suggesting that agencies often do not quantify the impacts of alternatives in RIAs.

<sup>11</sup> See for example, Hahn and Litan (1997a), Hahn (1996), and Arrow et al (1996); also see Hahn (1999a) for a specific suggestion for summarizing results in a "Regulatory Impact Summary" and using the *Federal Register* to communicate findings of the regulatory analysis in a clear, concise fashion.

**Recommendation 2: OMB should issue a scorecard on the extent to which regulations comply with their guidelines.**

In its draft report OMB notes, "...using the standards of our new Guidelines, it is apparent that many of the regulatory estimates for regulations issued since 1990 are also not fully satisfactory."<sup>12</sup> OMB needs to be more precise. It would be useful if OMB issued an annual scorecard identifying the extent to which regulatory analyses comply with its guidelines. Going back to some date, such as 1990, would be useful as a way of providing a benchmark for comparison.<sup>13</sup>

**Recommendation 3: OMB should calculate net benefits of all significant regulations and focus attention on those regulations and programs with incremental net benefits and incremental net costs. It should also suggest modifying regulations where there could be significant improvements in economic welfare.**

OMB does not present information on the net benefits of individual regulations, although it does present ranges or best estimates for benefits and costs. In examining individual regulations, it would be helpful if OMB aggregated some of the information into a table. For example, OMB could specify the number of regulations that pass or fail a cost-benefit test using available data about monetary benefits of rules.<sup>14</sup> It could also summarize the kind of information and assumptions that agencies provide in doing their analysis. Finally, OMB could rank rules by the agencies and OMB's best estimate of their expected net benefits and cost-effectiveness.<sup>15</sup>

OMB solicited comments on regulations to reform. It could begin by listing the regulations included at [www.aei-brookings.org](http://www.aei-brookings.org) in the \$100 Million List.<sup>16</sup> A regulation or policy change is placed on the list if we think it would result in at least \$100 million in

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<sup>12</sup> OMB (2001, 22042).

<sup>13</sup> GAO or economists outside of the government could also perform this task.

<sup>14</sup> See, for example, Federal Focus (1995) and Hahn (2001).

<sup>15</sup> Where important benefits and costs cannot be quantified or monetized, OMB should explicitly indicate. See Morrall (1986).

<sup>16</sup> See [http://www.aei.brook.edu/100\\_million\\_club/100\\_million\\_club.asp](http://www.aei.brook.edu/100_million_club/100_million_club.asp)



annual net benefits for consumers and producers.

**Recommendation 4: OMB should be bolder in its recommendations to Congress, since Congress specifically requested that OMB provide such suggestions.<sup>17</sup>**

To characterize OMB's recommendations in this draft report as timid would be an understatement.<sup>18</sup> OMB is well positioned to recommend ways to improve the quality of regulatory analysis. For example, OMB could subject agencies that routinely produce high-quality analysis to less oversight. OMB could also suggest alternative oversight structures, ask for additional personnel for oversight, advise on peer review, and ask for money to contract out certain functions necessary to improve the quality of its report. OMB is also uniquely positioned to recommend improvements in regulations as well as elimination of wasteful regulation.

*Recommendations from Previous Joint Center Analyses*

**Recommendation 1: OMB should rely more heavily on its own expertise to inform judgments about the benefits and costs of regulation.**

None of the OMB reports take advantage of the expertise that resides within OMB to evaluate the economic impact of regulations. The major advantage that OMB analysts have over other potential authors of this report, such as academics, is that they are more familiar with the details of regulations and regulatory analyses. *Nowhere* in the draft of the fourth report does OMB take advantage of its expertise to provide estimates that would allow a comparison with the estimates prepared by the agencies.

It is clear from OMB's earlier correspondence with the agencies that it frequently disagrees with agency assessments. Those disagreements should be highlighted and

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<sup>17</sup> Section 628 (a) of the FY2000 Treasury and General Government Appropriations Act directs OMB to provide "recommendations for reform." See OMB (2001).

<sup>18</sup> For example, OMB suggest the possibility of not doing benefit-cost analyses prior to 1990, analyzing the net benefits of statutes and programs, and using a top-down approach to estimating aggregate net benefits. See OMB (2001, 22042–22043).

explained in this document. Thus, OMB review could provide a kind of quality check on agency analyses.

**Recommendation 2: OMB should focus more on incremental benefits and costs of new regulations.**

Both the aggregate impacts and incremental impacts of regulation are important. There are, however, diminishing returns to focusing on aggregate impacts because that is not where OMB's expertise lies. Moreover, measures of aggregate impacts do not help inform decisions on individual regulations, although they can affect overall policy.

**Recommendation 3: OMB should make it easier to compare regulations by standardizing some key assumptions.**

The OMB report should allow the reader to compare across regulations and agencies by using standardized assumptions. Some agencies choose not to monetize certain key impacts such as the value of statistical lives saved. In addition, agencies often use different assumptions for key parameters, such as discount rates, when they evaluate the impacts of their regulations. Those differences in assumptions make it difficult to compare programs across agencies. OMB could make appropriate adjustments to facilitate such comparisons, or alternatively, it could ask the regulatory agencies to help with this task.

**Recommendation 4: OMB should interpret its mandate broadly to include significant regulatory initiatives at independent agencies, and future policies that could involve major regulatory authority.**

OMB included a preliminary assessment of the quality of analysis of significant rules issued by independent agencies. OMB should review analyses that could have significant future regulatory impacts by applying the same high standards that are supposed to be applied to proposed significant regulations. Examples include proposals for addressing climate change and the federal regulation of electric power.

**Recommendation 5: OMB should more carefully evaluate the strengths and weaknesses of the EPA §812 retrospective study if it wants to use those numbers. Specifically, it should estimate the sensitivity of the study's results to changes in arbitrary assumptions.**

Undoubtedly, one of the most controversial parts of previous OMB reports was the use of the EPA §812 retrospective study, which provides estimates of the aggregate benefits of clean air. In its report two years ago, OMB used an upper bound of \$3.4 trillion. Last year, the report lowers that estimate to \$1.5 trillion, which represents EPA's expected value. It is arbitrary to use an agency's best estimate as the upper bound. If OMB believes that the EPA §812 overestimates benefits, it should adjust EPA's numbers accordingly. OMB should then use the adjusted upper bound in its report.<sup>19</sup>

**Recommendation 6: Congress should require each Federal Regulatory Agency to produce an annual report on the costs and benefits of its regulatory activities, which can be used in OMB report.<sup>20</sup>**

Requiring each regulatory agency to produce an annual report on the benefits and costs of its regulatory activities would make the regulatory process more transparent. These requirements could also improve estimates of the economic impact of regulatory activity. In addition, the agency reports would help OMB produce its overall assessment of the impact of federal regulation.<sup>21</sup>

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<sup>19</sup> Lutter (1998) provides several reasons why the EPA §812 may be an overestimate.

<sup>20</sup> If Congress does not require this, the Executive Branch should, to the extent permitted by law.

<sup>21</sup> A consensus seems to be emerging that the independent agencies are producing little information that evaluates the economic impact of their regulations. That finding is consistent with OMB's review, a report by the General Accounting Office, and research by Furchtgott-Roth and Hahn. See GAO (1998), Hahn (2001) and Furchtgott-Roth (1996). More generally, Hahn (2001) and Furchtgott-Roth (1996) find that regulatory agencies provide very little information on the economic impacts of a large number of regulatory activities in which they are engaged.

### 3. Conclusion

This paper critically reviews the draft of the Office of Management and Budget's fourth report on the benefits and costs of federal regulation. We conclude that this draft report represents a kind of "holding pattern," presenting little new data and simply raising several pertinent questions.

The draft report fails to provide a good analysis of new regulations; fails to provide any suggestions for improving specific regulations; and fails to suggest substantial improvements in the regulatory process. At a *minimum*, OMB should be required to provide a cogent analysis of newly proposed regulations. That it has failed to do so in any report thus far, including the current draft, suggests to us that OMB faces formidable political obstacles. Some of these obstacles may be reduced in the new administration, but we would like to see Congress give OMB additional authority to enforce its guidelines.<sup>22</sup>

Congress should also encourage OMB to take greater advantage of its in-house expertise in providing a candid assessment of the benefits and costs of regulation along with an agenda for reform. Sharing those insights would enable interested parties to obtain a better sense of how economists most familiar with the individual regulations tally up the benefits and costs. OMB's assessment could then be compared with independent assessments to develop a more complete picture of the benefits and costs of regulation.

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<sup>22</sup> We would actually like to see the Congress go further and codify some version of the Executive Order. See Hahn and Litan (1997b).

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