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Public Interest Comment¹ on
The Office of Management and Budget's
Draft 2014 Report to Congress on the Benefits and Costs of Federal Regulations

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The George Washington University Regulatory Studies Center works to improve regulatory policy through research, education, and outreach. As part of its mission, the Center conducts careful and independent analyses to assess rulemaking proposals from the perspective of the public interest. This comment on the Office of Management and Budget's Draft 2014 Report to Congress offers suggestions for improving the information value of the Report, and does not represent the views of any particular affected party or special interest.

Introduction

Pursuant to the Regulatory Right-to-Know Act,³ the Office of Management and Budget (OMB) submits to Congress each year an accounting statement and associated report providing estimates of the total annual benefits and costs of federal regulations; an analysis of impacts of Federal

¹ This comment reflects the views of the authors, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at <http://regulatorystudies.columbian.gwu.edu/policy-research-integrity>.

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³ Consolidated Appropriations Act of 2001 (H.R. 5658, section 624, P.L. 106-554).

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regulation on State, local, and tribal government, small business, wages, and economic growth; and recommendations for reform.⁴

OMB's Draft 2014 *Report to Congress on the Benefits and Costs of Federal Regulations* (the Report) provides the Congress and the public with valuable information both on estimates of the effects of major executive branch regulations and also on OMB's focus and priorities as it reviews agency regulations. This comment addresses several topics covered in the Report: 1) implementation of President Obama's retrospective review initiative, 2) aggregate benefits and costs, and issues associated with their estimation, 3) effects of regulations issued by independent regulatory agencies, 4) presentation of trends in regulatory benefits and costs, 5) distributional impacts, and 6) employment effects.

Retrospective Review and Implementation of Executive Order 13563

Through a series of Executive Orders, including E.O. 13563 and E.O. 13610, President Obama has encouraged federal regulatory agencies to review existing regulations "that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned." E.O. 13563 additionally instructs executive branch agencies to develop and submit to the Office of Information and Regulatory Affairs (OIRA) retrospective review plans "under which the agency will periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives."

In line with those objectives, OMB made retrospective review a key component of this year's Report, and is seeking comments from the public on how to improve retrospective review efforts in the executive branch:

Consistent with this year's focus on the retrospective review of regulation, OMB requests comment on all aspects of the Administration's emphasis on looking back at the effectiveness of existing regulations, and building into new regulations a process for measuring their success in the future. We are especially interested in both new ideas for specific programs that could benefit from retrospective review,

⁴ This comment does not address Part II of OMB's Report, which reviews agencies' compliance with the Unfunded Mandates Reform Act.

as well as ideas that would facilitate the continuing institutionalization of regulatory lookback as a key part of every agency's standard regulatory agenda.⁵

As a part of our ongoing retrospective review project, the GW Regulatory Studies Center has assessed every economically significant rule (and many "other" significant rules) proposed in 2014 to evaluate whether agencies include plans for retrospective review as a part of their regulations. As part of this project, we submit comments to provide agencies with suggestions on how best to incorporate plans for retrospective review into their proposals. The importance of including plans to review regulations in the text of rules themselves is emphasized again in this year's Report:

The result [of retrospective review] should be a greatly improved understanding of the accuracy of prospective analyses, as well as corrections to rules as a result of ex post evaluations. A large priority is the development of methods (perhaps including not merely before-and-after accounts but also randomized trials, to the extent feasible and consistent with law) to obtain a clear sense of the effects of rules. In addition, and importantly, *rules should be written and designed, in advance, so as to facilitate retrospective analysis of their effects, including consideration of the data that will be needed for future evaluation of the rule's ex post costs and benefits.*⁶

However, our research indicates that many agencies are not currently complying with E.O. 13563 and OMB's direction to write and design their rules so as to facilitate retrospective analysis of their effects. Of the eighteen proposed rules that the Center has analyzed this calendar year as a part of this project, none includes a plan to retrospectively review whether the proposed rule will have the intended effect.

In one rule, the Department of Energy did briefly state that it planned to pursue a retrospective review of rare earth prices to better inform future regulations that would require manufacturers to use rare earth products.⁷ However, while such a narrow review would be helpful to inform a broader analysis of the effects of DOE's regulations, such a commitment alone is not adequate to instruct the agency whether its rules are effective or not. While DOE should be commended for its limited inclusion of retrospective review, each executive branch agency has a ways to go before review is working effectively to improve regulatory outcomes.

⁵ 2014 Draft Report, page 57

⁶ 2014 Draft Report, page 7

⁷ Energy Conservation Program: Energy Conservation Standards for General Service Fluorescent Lamps and Incandescent Reflector Lamps. 79 FR 24179.

OMB can play an important role in encouraging agencies to include plans for review in their proposed rule, and took a step in that direction in this year's report:

[A]gencies have the ability to facilitate retrospective analysis at the time when rules are issued; for example, in some cases, they can require—as a provision of a rule—the submission of data that would be necessary for assessing that rule's effectiveness. In other cases, they may commit themselves in the regulatory text to conduct a retrospective review of regulation, including a plan and metrics to measure effectiveness, and a decision of whether the review identifies potentially net beneficial regulatory changes, by a certain date. OMB recommends that agencies pursue retrospective review in a comprehensive fashion—encompassing continual look-back at administrative procedures; thorough cost-benefit analysis of previously-issued, non-administrative regulations; and the incorporation of plans for retrospective policy assessment into rulemaking currently underway.⁸

To that end, OMB should encourage agencies to do the following in their proposed rules, especially economically significant rules.

1. **Agencies should identify the problem** that their proposed rules are intended to solve, and should identify how the proposed standards would address the stated problem. This step is crucial to the formulation of any policy: without knowledge of the problem that an agency is trying to address, the public cannot assess whether the policy or regulation has had the intended effect, which is key in retrospectively evaluating regulation.
2. **Agencies should provide clear, measurable metrics** that reviewers can use to evaluate whether a regulation achieves its policy goals. In order to measure the success of any rule following implementation, agencies must define what constitutes a “success,” and demonstrate how to measure the success of its rule. Any stated metrics of success should be linked to the problems identified, and provide meaningful measures of the extent to which the standards the agency is proposing actually accomplish the stated end goal.
3. **Agencies should commit to collecting information** to assess whether their measurable metrics are being reached. Many agencies have existing programs that collect information in the areas they regulate (e.g. EPA's GHG Reporting Program, NHTSA's Fatality Analysis Reporting System). To facilitate retrospective review, agencies should identify opportunities to use existing information reporting programs to measure the effects of their rules and work

⁸ 2014 Draft Report, page 54

within the authority of the Paperwork Reduction Act to collect additional information as necessary.

4. **Agencies should provide a clear timeframe** for the accomplishment of their stated metrics and the collection of information to support their findings. This timeframe should recognize and measure the intermediate objectives upon which achievement of the ultimate outcome depends, so that mid-course corrections can be undertaken as appropriate.
5. **Agencies should write their proposals to allow measurement of both outputs and outcomes** to enable review of whether the standards directly result in the outcomes that an agency intends. Agencies should also be aware of mediating factors that may have accomplished or undermined a policy's stated metrics absent the rule. Determining linkages between the rule and the measured outcomes is necessary to ensure that the policy itself resulted in the desired outcomes, rather than other factors beyond the agency's control.

In the Report, OMB provides agencies with very strong recommendations on how to improve the retrospective review process. Effectively implemented, retrospective review should improve regulatory outcomes and ex ante analyses alike. By clearly outlining the goals that regulations are meant to accomplish and establishing metrics to measure whether these goals are being met, incorporating the five steps listed above would hold agencies accountable to the public for the success of their rules and ensure that retrospective review is a priority even at the start of the rulemaking process.

Going forward, OMB should continue to encourage agencies to incorporate plans for retrospective review into their significant rules to facilitate transparency, public accountability, and measurement of the success of their rules. As part of its review of individual draft proposed and final regulations under Executive Order 12866, OMB should ensure that agencies not only commit to reviewing each regulation once it is implemented, but provide in the preamble the metrics and data they will use to evaluate the rule's outcomes and the validity of their ex ante estimates of benefits, costs, and other impacts.

Issues with Estimates of Aggregate Benefits and Costs

Chapter I of the Report presents estimates of the aggregated annual benefits and costs of regulations issued over the last decade with more detail for fiscal year 2013, and examines the broader impact of federal regulation. The benefits and costs of regulations, individually and in the aggregate, are notoriously hard to measure. This annual report probably offers one of the more comprehensive estimates available on the expected benefits and net benefits (benefits minus costs) of federal regulation; but, as OMB acknowledges, it has limitations.

Some of these limitations, particularly with respect to the uncertainty and assumptions underlying the estimates of air quality benefits, which comprise between 60 and 80 percent of the monetized benefits and around half of the monetized costs reported,⁹ are discussed in the GW Regulatory Studies Center's comment on OMB's 2013 Report to Congress.¹⁰ In a separate comment on this year's draft report, Louis Anthony Cox further discusses the limitations of that large component of benefits and offers recommendations for improving their estimation.¹¹

Here we discuss issues related to the coverage of regulations included in the FY 2013 estimates, the treatment of "co-benefits," and valuation methods for quantifying the benefits of live-saving regulations.

Estimated Benefits and Costs in FY 2013 Include a Small Fraction of Major Rules Issued

The Report presents estimated annual benefits of regulations issued in FY 2013 of between \$25.6 billion and \$67.3 billion, and annual costs of between \$2.0 billion and \$2.5 billion. As in the past, OMB's figures are based on agency estimates and include only rules for which agencies estimated *both* benefits and costs. OMB reports that in FY 2013, executive agencies promulgated 54 major rules, only seven (13 percent) of which included monetary estimates for both benefits and costs. This is a smaller percentage of rules than were covered in any of the last 10 years addressed in this report. (For example, the FY 2012 report includes 30 percent of the major rules in the totals.) Twenty-eight of those 54 major rules issued by executive branch agencies were considered "transfers" from taxpayers to program beneficiaries.

However, Tables 1-6(b) and 1-6(c) list 17 non-transfer rules for which agencies did not estimate benefits and/or costs. Eight of these were issued pursuant to the Affordable Care Act.¹² Given the importance and significance of the President's signature legislation, it is disappointing that the

⁹ OMB states that "EPA rules account for 63 to 82 percent of the monetized benefits and 46 to 56 percent of the monetized costs. Of these, rules that have as either a primary or significant aim to improve air quality account for 98 to 99 percent of the benefits of EPA rules." Draft Report p. 15.

¹⁰ Susan E. Dudley, Brian F. Mannix, & Sofie E. Miller. "Public Interest Comment on the Office of Management and Budget's Draft 2013 Report to Congress on the Benefits and Costs of Federal Regulations." July 23, 2013. https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/2013_OMB_Report_to_Congress_PIC.pdf

¹¹ Louis Anthony (Tony) Cox, Jr. "Public Interest Comment on the Office of Management and Budget's Draft 2014 Report to Congress on the Benefits and Costs of Federal Regulations." September 2, 2014. https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/TCox_2014_OMB-Report-to-Congress.pdf

¹² Seven issued by HHS and one by OPM.

implementing regulations are not compliant with the President’s requirement that agencies “propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify)” and “select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity).”¹³ Given the lack of ex ante information on benefits and costs, it will be particularly difficult for the issuing agencies, OMB, and the public to evaluate whether these rules are achieving their objectives, as required by the President’s regulatory lookback initiative.

Table 1-7(b) identifies two “non-budget transfer rules” issued by the Department of Labor (addressing “Wage Methodology for the Temporary Nonagricultural Employment H-2B Program,” and “Application of the Fair Labor Standards Act to Domestic Service”). OMB states “the primary economic impact of each of these two rules is to cause transfers between parties outside the Federal Government.” Non-budget transfers are a frequent motivation for regulatory actions, including some regulations that have very large economic impacts in addition to the income transfers. EPA’s Renewable Fuel Standard has become one of the largest mechanisms for transferring income from consumers to farmers, for example, but it also has very significant economic and environmental impacts that need to be examined.¹⁴ Moreover, the existence of very large transfers will often translate into very large rent-seeking costs,¹⁵ so that transfers cannot be dismissed as equal measures of benefit and cost (to different parties) that simply offset each other. Generally, OMB should direct additional analytical attention to regulatory transfers and their economic impacts.

Co-benefits

The Report recognizes that “the large estimated benefits of EPA rules issued pursuant to the Clean Air Act are mostly attributable to the reduction in public exposure to a single air pollutant: fine particulate matter (referred to henceforth as PM),” and that many of these benefits are “associated with the ancillary reductions in PM that come from reducing emission of hazardous air pollutants.” The Report states that “the consideration of co-benefits, including the co-benefits associated with reduction of particulate matter, is consistent with standard accounting practices and has long been required under OMB Circular A-4.”¹⁶

¹³ 2014 Draft Report, p. 3, Citing Executive Order 13563.

¹⁴ Miller, Sofie E. “Crony Environmentalism.” *Regulation Magazine* Spring 2013: 2-3.

¹⁵ See, e.g., Gordon Tullock, “The Welfare Costs of Tariffs, Monopolies, and Theft,” *Western Economic Journal* 5 (3) (1967): pp. 224–232.

¹⁶ Report section I.A.2., p. 13-14.

This discussion of co-benefits is incomplete and somewhat misleading, however. It is certainly true that the principles of benefit-cost analysis have always required that, to the extent practicable, the ancillary or unintended side-effects of government action—both positive and negative—should be included in the accounting. The term “co-benefits” is a more recent coinage, and conveys an unfortunate message: that the analyst should be looking for ancillary effects on the benefit side of the ledger, and not on the cost side. This is, of course, false; any such one-sided analysis will be systematically biased and will lead to inferior policy choices. Both ancillary benefits *and* costs should be included in the analysis.

Typically, for a variety of reasons, the analyst’s prior expectation should be that co-costs will exceed co-benefits. The mercury rule cited in the OMB report can be used to illustrate one application of this principle. Straightforward economic analysis tells us that EPA should be able to reduce PM emissions more cost-effectively by constraining PM emissions directly (which it has, in fact, already done) than by constraining mercury emissions to produce an indirect PM reduction. Therefore, after taking into account EPA’s direct PM rules, it is implausible to claim that the mercury rule has incremental PM co-benefits that exceed the total costs of the rule. Any such benefits will have been obtained by paying a higher price than would be incurred by constraining PM directly. In recent years there has been a dramatic growth in the “co-benefits” claimed by agencies for their rules,¹⁷ giving the impression that the underlying analyses are, indeed, strongly biased by a one-sided search for beneficial ancillary effects.

Valuing mortality risk reduction

The Report discusses the fact that regulatory benefits are strongly dependent upon assumptions about the value of mortality risk reduction.¹⁸ Yet, except for a brief footnote, it only discusses these benefits in terms of VSL – the “value of statistical life.” OMB guidance directs agencies to “consider providing estimates of both VSL and VS LY” (the value of statistical life-years), and OMB often asks agencies to provide life-year estimates when they appear different from lives. In a report that is intended to aggregate and compare regulatory benefits across decisions and across time, it would be far preferable for OMB to focus more attention on VS LY.

The reason is simple: benefit estimates based on VSL cannot be compared and aggregated, because “saved lives” is not a metric that can easily be compared and aggregated, or even meaningfully defined outside of specific narrow contexts. This is true regardless of how

¹⁷ See “Perpetuating Puffery: An Analysis of the Composition of OMB’s Reported Benefits of Regulation,” *Business Economics*, Vol. 47, No. 3. National Association for Business Economics, August 2012.

¹⁸ Report p. 18.

persuasive the valuation literature may be. We simply do not know, and cannot know, how many lives have been “saved” in the aggregate. In context we may be able to figure out how to count lives saved by a particular mechanism, but we cannot come up with a consistent universal metric. The underlying problem is that “saved lives” does not include any measure of time.

In contrast, life expectancy, or life years, is a standard metric that is defined rigorously, can be used to account for mortality benefits in a wide variety of contexts, and can be aggregated and compared without any confusion. It is a robust summary statistic that reflects the mortality risks across an entire population, including risks of all kind and at all ages. It takes a fraction of a second to look up the life expectancy in, say, Belize. But how many lives have been saved there? What does that question even mean?

An additional advantage of using life expectancy as the measure of mortality benefits is that we know exactly what the objective is: to live longer. If we speak in terms of “saved lives,” we can’t be sure of the objective. Suppose we are evaluating a range of policy options, all of which have small marginal effects on mortality risks. If we take maximizing life expectancy as the objective, subject to a resource constraint, the solution will give us a cost-effectiveness criterion—a fixed dollar amount per incremental year of life expectancy, or VSLY. The optimum decision rule would be to adopt those measures that met the cost-effectiveness criterion, and to avoid committing resources to those that didn’t.

Note that if we use another decision criterion in place of this one, we will get a shorter life expectancy for the same expenditure of resources. If we use a VSL rule, for example, we might “save more lives,” whatever that might mean; but, on average, people will live shorter lives. In most cases the two criteria would likely lead to very similar outcomes. When they don’t, however, we have to ask ourselves whether selecting a portfolio of policies that results in shorter life expectancy can really be said to be improving public health.

This simple mathematical fact creates a strong presumption for using life expectancy as the standard metric in evaluating regulatory decisions, with a flat VSLY as the cost-effectiveness criterion. As a first-order approximation of mortality benefits, this is far more robust than the VSL approach. An agency that uses some other decision rule, such as a flat VSL, needs to explain why it might choose policies that will lead to a shorter life expectancy. We can’t rule out that such justifications may exist, but agencies should be clear about what the rationale is for using a decision rule that does not maximize life expectancy.

Major Rules Issued by Independent Regulatory Agencies

The total reported estimates do not include regulations issued by independent regulatory agencies. However, Table 1-10 and Appendix C provide valuable summaries of the information on benefits and costs provided by independent regulatory agencies which are not subject to the

substantive requirements of Executive Orders 12866 and 13563, nor to OMB review. Not one of the 18 major rules promulgated by these independent regulatory agencies included quantified estimates of benefits and only two rules quantified costs. This might underestimate the number of major rules because neither OMB nor other observers have adequate information to determine whether independent agencies' designations of "major" or "non-major" are reasonable. Thus, we concur with OMB that:

for the purposes of informing the public and obtaining a full accounting, it would be highly desirable to obtain better information on the benefits and costs of the rules issued by independent regulatory agencies. The absence of such information is a continued obstacle to transparency, and it might also have adverse effects on public policy. Recall that consideration of costs and benefits is a pragmatic instrument for ensuring that regulations will improve social welfare; an absence of information on costs and benefits can lead to inferior decisions.

Trends in Annual Benefits and Costs

Figure 1-1 of the Report presents annual benefits and costs for each of the 10 fiscal years covered. OMB's statement that "the estimates we report here are prospective estimates made by agencies during the rulemaking process" is not accurate. OMB *starts* with agencies' prospective estimates, but then removes benefits and costs for regulations that have since been vacated by courts or superseded by subsequent implementing regulation. While this is necessary to avoid double counting when aggregating regulatory benefits and costs across years to estimate totals, it skews estimates of benefits and costs to current years when looking at trends. Current year estimates include agencies' most optimistic estimate of the outcome of their newly promulgated regulations. It will not be until future years that adjustments will be made to account for subsequent regulations or court actions.¹⁹

To illustrate, regulations establishing NAAQS claim large benefits associated with air quality improvements, but it is not until implementing regulations are issued that those improvements begin to be realized. When EPA issued its NAAQS for PM_{2.5} in 2006, it estimated benefits of almost \$40 billion per year, yet OMB's Report attributes none of those benefits to 2006. Instead, OMB allocates them to subsequent years when implementing regulations were issued.²⁰ Yet, the

¹⁹ Note that OMB does not attempt to revise ex ante estimates of benefits and costs based on actual experience with a regulation's effects, so under this approach, past year estimates can only be reduced.

²⁰ We note that OMB appropriately removed reference in its final 2013 Report to comparisons across administrations.

costs and benefits of EPA’s 2013 NAAQS PM_{2.5} are attributed in this Report to FY 2013 even though they also will not be achieved without other, subsequent, implementing actions.

Distributional Effects

In the Report, OMB emphasizes that the costs and benefits of regulations may be borne by different subgroups of the population. For example, OMB is aware of the possibility that regulations may “disproportionately help or hurt those at the bottom of the economic ladder, or those who are suffering from some kind of acute condition or extreme deprivation,”²¹ and suggests that additional analysis on the topic could be useful for constructing guidance to agencies on how to best incorporate the human dignity principles of E.O. 13563.

Existing research, both from the GW Regulatory Studies Center and other sources, addresses the effect of regulation on low-income Americans. Our research particularly has focused on energy efficiency standards promulgated by the Department of Energy, which apply to home appliances—such as dishwashers, air conditioners, and refrigerators—that consume energy. To the agency’s credit, DOE provides its own analysis of subpopulation impacts. Unfortunately, DOE’s own analysis shows that its efficiency standards can have a disparate impact on the poor and the elderly.²²

In addition, the existing literature on implicit consumer discount rates for energy-using durables suggests that the discount rates used by DOE to calculate consumer benefits are better representative of high-income households than median- and low-income households.²³ Using higher discount rates, which better represent the implicit time preferences of median- and low-income households, shows that energy efficiency standards are a net cost on them.²⁴ In effect, these standards act as a transfer payment from lower-income households to higher-income households, and will continue to do so as long as discount rates of 3 and 7% are used to calculate net benefits.

²¹ 2014 Draft Report, page 8.

²² Miller, Sofie E. “Public Interest Comment on the Department of Energy’s Direct Final Rule: Energy Conservation Standards for Residential Dishwashers.” September 14, 2012.

²³ Hausman, Jerry A. 1979. “Individual Discount Rates and the Purchase and Utilization of Energy-Using Durables.” *The Bell Journal of Economics* Vol. 10, No. 1: 33 – 54.

²⁴ Miller, Sofie E. “Public Interest Comment on the Department of Energy’s Proposed Rule Energy Conservation Program: Energy Conservation Standards for Residential Furnace Fans.” December 18, 2013. See also: Miller, Sofie E. “Regressive Furnace Fans.” *Regulation Magazine* Spring 2014: 13-14.

Dr. Diana Thomas of Creighton University has contributed additional research on the overall distributional effects of regulation. Her research finds that risk-reducing regulations tend to have a regressive effect because they are intended to address low-probability risks. These regulations represent the risk preferences of higher-income households, although the cost of reducing these risks is borne by the entire population. As such, these rules are regressive in that they “redistribute wealth from lower-income households to higher-income households by causing lower-income households to pay for risk reduction worth more to the wealthy.”²⁵

OMB should be commended for recognizing the importance of the distributional effects of regulation, and should consider these resources when evaluating how best to assess distributional effects in new regulations. As noted above, these distributional impacts may be particularly significant for regulations that “transfer” wealth among populations.

Employment and Economic Growth Effects of Regulation

In Section D.3., OMB appropriately recognizes the complexity of the questions surrounding the effect of regulation on wages and employment. A new edited volume contributes valuable insights into these questions, and we encourage OMB to consider it in the final Report.²⁶

²⁵ Thomas, Diana. “WORKING PAPER: Regressive Effects of Regulation.” No. 12 – 35. November 2012.

²⁶ Coglianesi, Cary, Adam M. Finkel, and Christopher Carrigan, eds. *Does Regulation Kill Jobs?* U of Pennsylvania, 2014.