

Center for
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Business



OMB Report on Regulation

Flunks CSAB Test:

***Comments on the Office of Management and Budget's
"Draft [Third] Report to Congress on the Costs and
Benefits of Federal Regulation"***

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**OMB Report on Regulation Flunks CSAB Test:
Comments on the Office of Management and Budget’s
“Draft [Third] Report to Congress
on the Costs and Benefits of Federal Regulation”¹**

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Since 1975, the Center for the Study of American Business (CSAB) has been a leader in the independent analysis and evaluation of regulation and regulatory policy. Over this time we have published dozens of studies on these matters, including some that the Office of Management and Budget (OMB) has relied upon in preparing its reports to Congress on federal regulation.² CSAB is an integral part of Washington University, a non-profit institution of higher education. The views expressed herein do not necessarily reflect those of the Center or of the University to which it belongs.

OMB’s final Third Report to Congress must comply with certain statutory requirements set forth in Section 638(a) of the 1999 Omnibus Consolidated and Emergency Supplemental Appropriations Act (“the Act”). These provisions include procedural requirements (what processes OMB must follow in developing and vetting the report), analytic requirements (estimates of the costs and benefits of federal regulation), and decision-making requirements (recommendations for the reform of the federal regulatory apparatus, or of its outputs).

These comments follow the same general format as the independent evaluations of major rules that we are currently conducting under the Center’s Program on Regulatory Oversight (CSAB/PRO). In this project, we are evaluating agencies’ compliance with applicable statutory and executive requirements, including the Unfunded Mandates Reform Act of 1995, the Regulatory Flexibility Act (as amended by the Small Business Regulatory Enforcement Fairness Act of 1996), and President Clinton’s directive on centralized regulatory review, Executive Order No. 12866. More information on this project can be obtained from the CSAB/PRO Study Protocol.³

This framework divides an agency’s legal responsibilities with respect to regulation into three categories—procedural, analytical, and decision-making.⁴ Within each category there are

¹ OMB (2000), hereinafter referred to as the Draft Third Report.

² See, e.g., Hopkins (1996, 1997).

³ See Belzer (1999), hereinafter referred to as the Protocol. Copies can be obtained on request, or downloaded from the regulation section of our website at <http://www.csab.wustl.edu>.

⁴ CSAB/PRO does not deal with legal matters covered by the Administrative Procedure Act, largely because there is a well-developed market for legal advocacy with respect to procedural and substantive judicial review. In contrast, the statutory and executive requirements we examine have limited or non-existent judicial review

several discrete topics, and each topic frequently contains multiple evaluative criteria. We evaluate agency compliance with each criterion and assign letter grades (A–F) based on standards we published in the Protocol and on which we informally sought public comment.⁵ These letter grades are objective given our published criteria and should be generally replicable by independent analysts given the same information. We also aggregate upwards and assign additional, subjectively determined letter grades based on an informed evaluation of the relative importance of the individual evaluative criteria within each subcategory, which vary depending on the regulation at hand. Finally, we aggregate further upwards to encompass all evaluative criteria within three broad categories—procedural requirements, analytic requirements, and decision-making requirements. We will fully disclose the basis for these subjective determinations so that others can replicate our work and evaluate the credibility of our judgments.

Summary of Our Review of OMB’s Draft Third Report to Congress on the Costs and Benefits of Federal Regulation

Based on our evaluation, OMB deserves failing grades with respect to its compliance with the procedural, analytic, and decision-making requirements set forth in the Act. These grades, and the critical factors underlying them, are summarized in the table below and in the accompanying text. Further details are provided in the next major section.

Grade for complying with the Act’s procedural requirements: F

The Act sets forth specific procedural requirements OMB must follow in drafting government-wide guidance for (1) standardizing measures of costs and benefits and (2) the format of regulatory accounting statements (“Guidelines”), and to all reports to Congress containing such measures. These procedures include peer review of both the Guidelines and each regulatory accounting statement (i.e., report to Congress), and an adequate opportunity for public comment.

For both the Guidelines and the Draft Third Report, OMB used peer review processes that are impenetrable to the general public. Neither the Draft Third Report nor OMB’s Federal Register notice identifies the peer reviewers, the process used to select them, evidence of their independence and expertise in regulatory oversight, or the comments they provided. OMB initially gave the public just two weeks in which to digest the Draft Third Report and submit comments, and disclosed neither the text of the Guidelines nor comments provided by peer reviewers on either the Guidelines or the Draft Third Report. These practices are fundamentally inconsistent with the language and intent of the Act, which was written to enhance oversight of OMB given its highly criticized prior performance.⁶

provisions. Thus, there is a potentially severe “market failure” with respect to the oversight of these laws and directives.

⁵ We provided at least two copies of the Study Protocol to appropriate senior personnel in each executive branch and independent regulatory agency.

⁶ See, e.g., the summary of comments in OMB (1999), which tends to understate both the scale and scope of this criticism.

<p align="center">Summary of CSAB/PRO Evaluation of OMB’s Draft Third Report to Congress on the Benefits and Costs of Federal Regulation</p>		
<i>Evaluative Category</i>	<i>Critical Factors</i>	<i>Grade</i>
Procedural Requirements	<ul style="list-style-type: none"> • Impenetrable peer review process • Inadequate opportunity for peer review • Failure to disclose results of peer review • Inadequate opportunity for public comment • Failure to disclose statutorily-required Guidelines 	F
Analytic Requirements	<ul style="list-style-type: none"> • No estimates of costs and benefits by agency • No estimates of costs and benefits by agency program • No review of the validity and reliability of agencies’ benefit and cost estimates 	F
Decision-Making Requirements	<ul style="list-style-type: none"> • No credible recommendations for reform 	F

Grade for complying with the Act’s analytic requirements: F

The Act calls for estimates of costs and benefits across an array of margins, including (1) government-wide aggregates, (2) aggregates by agency and (3) agency program, and (4) by major rule. This is a clear expansion of the required scope and scale of OMB’s regulatory accounting obligations when compared with the law governing OMB’s first two reports to Congress. As it did in these earlier reports, however, OMB only provides estimates of government-wide totals, broad aggregates for four categories of “social” regulation, and a few major rules.⁷ OMB’s discussions of the effects of federal regulation on wages, small business, and economic growth are at best unhelpful, and possibly counterproductive. Also, OMB fails to supply estimates where the

⁷ OMB included estimates of costs and benefits only for “those major rules with quantified agency estimates of both benefits and costs.” For the 1998-99 coverage period, only 14 rules met this condition, which is not found in the Act. See OMB (2000) at 29.

promulgating agencies did not develop them, and does not provide any estimates of the social costs and benefits of what it calls “transfer rules”⁸ or rules promulgated by independent regulatory commissions.⁹ Even within the executive branch, OMB does not provide estimates by agency or agency program. In no instance does OMB provide estimates derived from its own insights from performing detailed regulatory review.

In certain respects the Draft Third Report represents a step backwards. For example, this time OMB offers only a highly compressed discussion of the deleterious effects of economic regulation and does not revise an insightful table included in its Second Report summarizing these effects.¹⁰

In short, OMB provides roughly the same information with respect to social regulation that it did in its first two reports to Congress, and much less information regarding economic regulation. The language in the Act expanding the scope and scale of OMB regulatory accounting appears to have had no salutary effect.

Grade for complying with the Act’s decision-making requirements: F

The Act directs OMB to provide recommendations for the reform of Federal regulation. Although the Act does not explicitly authorize OMB to make regulatory or policy decisions, it implicitly seeks OMB’s expert advice concerning what such decisions might look like if their purpose were to enhance the effectiveness or efficiency of the federal regulatory apparatus.

In the Draft Third Report, OMB offers no recommendations for regulatory reform. Instead, OMB merely identifies a small number of agency-initiated proposals that, if promulgated, might serve some regulatory reform purpose.

Detailed Evaluation

In the following subsections, we discuss in greater detail the basis for our overall evaluation of OMB’s performance with respect to the procedural, analytic and decision-making requirements of the Act.

Procedural Requirements

⁸ According to OMB, “transfer rules” are regulations “necessary to implement Federal budgetary programs.” See OMB (2000) at 27. That is, these rules take resources from some people and give them to others. OMB is correct that such transfers should not be counted as either social costs or benefits. However, OMB ignores the significant social costs (and potential social benefits) associated with governmental programs whose primary purpose is to redistribute income and wealth. OMB has summarily excluded the social costs and benefits of “transfer rules” in its estimates of government-wide aggregates, rendering its totals even less useful.

⁹ OMB includes a “discussion of major rules issued by independent regulatory agencies, although OMB does not review these rules under Executive Order 12866.” Instead of developing its own estimates of the costs and benefits of such rules, OMB relied on reports the independent regulatory agencies sent to the General Accounting Office as required by Congressional review provisions of the Small Business Regulatory Enforcement Fairness Act (SBREFA). See OMB (2000) at 23 and 28. The Act does not direct OMB to limit its Report to Executive branch departments and agencies, however.

¹⁰ See OMB (2000) at 14-15, and compare this discussion with OMB (1999) at 18-21, including Table 4.

OMB failed to adequately comply with respect to three specific sets of explicit or implicit procedural requirements of the Act: (1) independent and external peer review, (2) full disclosure of relevant documents, procedures, and peer review comments, and (3) opportunity for public comment.

Independent and external peer review of the OMB's Guidelines. OMB acknowledges that the Act specifies certain procedural requirements, among them requirements to (a) “issue guidelines to agencies to standardize (1) measures of costs and benefits and (2) the format of accounting statements,” and (b) “provide for independent and external review of the guidelines and each accounting statement and associated report under this section.” However, OMB failed to disclose alongside the Draft Third Report (1) the government-wide Guidelines it drafted; (2) the process by which it selected peer reviewers; (3) the identity of these peer reviewers; (4) the peer reviewers’ expertise in regulatory oversight and related matters; (4) evidence of the peer reviewers’ independence; (5) how much time the peer reviewers were given to provide comments; or (6) the written and verbal comments peer reviewers provided.

The little information OMB offered in the Draft Third Report suggests that OMB provided peer reviewers very little time to comment. OMB states that it transmitted the Guidelines to the agencies in October 1999—approximately one year after the Act became law—and the same month in which it provided them to the peer reviewers.¹¹ However, OMB failed to provide any explanation for why it took nearly a year to draft the Guidelines or why it provided the peer reviewers less than a month to review and comment on them.¹² This appears to be a peer review process designed to fail.

Independent and external peer review of the Draft Third Report. With respect to the draft, OMB disclosed no information at all concerning its peer preview. The public has no clue who the peer reviewers were, how they were selected, the extent to which they are experienced in regulatory oversight and similar matters, or how much time they were provided to review it before it was released for public comment. Similarly, OMB did not disclose the text of the peer reviewers’ comments.

With respect to both peer reviews, the secrecy of OMB’s process irreparably undermines its public credibility. The best defense available to OMB is that the Congress did not explicitly require OMB to disclose this information. However tailored to the minimum requirements of law, this defense is a weak one insofar as OMB expects its peer review process to be taken seriously. It also serves to remind the Congress that granting OMB exemptions from routine sunshine provisions generally applicable to federal agencies enables it to maintain its traditionally secretive practices, even in cases (such as this) where there is no legitimate basis for preserving the confidentiality of pre-decisional internal executive branch deliberations.

¹¹ See OMB (2000) at 2. The Act was passed on October 21, 1998.

¹² Though OMB does not say so in the Draft Third Report, it is possible that peer reviewers had more than two or three weeks to review and comment on the draft Guidelines. If so, then OMB transmitted them to the agencies for use in preparing this report while peer review was underway. While the Act does not explicitly forbid such a practice, it would be clearly contrary to the law’s intent and it demeans the peer review process.

Full disclosure of relevant documents, procedures and peer review comments. OMB failed to disclose alongside its Draft Third Report the Guidelines that it sent to the agencies in October 1999, nor did it release comments received by peer reviewers on these Guidelines.¹³ OMB offers no logical basis for failing to disclose this information. Congress did not explicitly require full disclosure of this information in the Act, though it is difficult to imagine a fully-informed public comment process without it. In the absence of clear statutory language, agencies should be expected to follow relevant policy directives of the president, especially OMB, because it is the president's own staff office. The president's unambiguous policy on regulatory matters is full disclosure, as set forth in Sections 6 and 7 of Executive Order No. 12866.¹⁴ OMB's failure to disclose this information, despite its obvious relevance and its expert knowledge of presidential policy, seriously undermines the office's claims of good faith compliance with the Act.¹⁵

Opportunity for public comment. OMB failed to fulfill its responsibility to secure adequate and timely public comment. The Draft Third Report was noticed in the Federal Register on January 7, 2000, with a deadline for public comment of January 21, 2000.¹⁶ OMB's implicit reason for allowing just two weeks for public comment was OMB's statutory obligation to transmit the Third Report, in final form, along with the president's budget in early February 2000. However, OMB's notice offers no inkling why it delayed publication of the Draft Third Report until so late a date.

The Draft Third Report itself is undated, but its contents suggest that it was prepared several months ago. The only new major rules included in the Draft Third Report were reviewed by OMB between April 1, 1998 and March 31, 1999.¹⁷ This is the same coverage period OMB used in its first two reports to Congress, which the Congress required to be transmitted by the end of the fiscal year to which the relevant regulatory accounting amendment applied. Thus, despite having been given more than four extra months to complete the Final Third Report, OMB neither

¹³ At least one peer reviewer has identified himself by publishing his comments. See Hahn (1999). Hahn errs, however, in stating that OMB "issued" a draft of the Guidelines in September 1999; the Guidelines have not been publicly released. Also, Hahn's date conflicts with OMB's claim that it distributed copies to peer reviewers in early October.

¹⁴ Sec. 6 of Executive Order 12866 details disclosure requirements applicable to both regulatory agencies and OMB. More importantly, Sec. 7 requires full disclosure of contacts with persons not employed by the Federal government whenever a regulatory matter is elevated to the vice president or the president to resolve. Also, a rejection of secretive practices is the Order's stated *raison d'être*: "The objectives of this Executive order are to enhance planning and coordination with respect to both new and existing regulations; to reaffirm the primacy of Federal agencies in the regulatory decision-making process; to restore the integrity and legitimacy of regulatory review and oversight; and to make the process more accessible and open to the public" (emphasis added). This language clearly implies that centralized regulatory review under Presidents Reagan and Bush lacked integrity and legitimacy, presumably because OMB's procedures lacked the transparency of these new requirements. (CSAB/PRO is examining the implementation of Executive Order 12866 to measure its transparency.)

¹⁵ OMB also did not disclose written and oral comments it received on both the Guidelines and the Draft Third Report from executive branch agencies and independent regulatory authorities indirectly subject to the reporting requirements of the Act. Because the Congress neither explicitly nor implicitly required OMB to disclose this information, OMB is well within its statutory authority to keep these materials secret. Should the Congress conclude that the public interest is better served by full disclosure of this information, future regulatory accounting legislation must, at a minimum, include explicit language requiring it.

¹⁶ See 65 FR 1296.

¹⁷ See OMB (2000), Chapter II. The term "major" is used here in the same manner as used by OMB.

expanded the coverage period to match the fiscal year nor published a draft for public comment on or about September 30, 1999.

In the face of predictable criticism, OMB extended the deadline for public comment to February 22, 2000.¹⁸ Nevertheless, OMB's failure to schedule publication of the Draft Third Report in time to comfortably meet the statutory deadline reflects an apparent disinterest in effective public oversight of its regulatory accounting process. Had OMB been seriously interested in obtaining informed public comment while still meeting the statutory deadline, it would have published the draft much earlier. Alternatively, had OMB experienced legitimate delays in preparing the draft while still convinced of the utility of informed public comment, it would have proactively sought an informal extension of the statutory deadline from the relevant Congressional committees well prior to publication.¹⁹

Further, now that transmittal of the final Third Report to Congress is temporally disconnected from the president's fiscal budget, it is uncertain when OMB will actually complete it. In 1998, OMB secured a similar informal short-term stay of the statutory deadline for transmittal but published its final Second Report four months later. Similar delays in transmitting the final Third Report will deprive the Congress of the opportunity to conduct timely oversight.

Analytic Requirements

The Act directs OMB to provide specific analyses of the benefits and costs of federal regulation:

- (1) an estimate of the total annual costs and benefits (including quantifiable and nonquantifiable effects) of Federal rules and paperwork, to the extent feasible:
 - (A) in the aggregate;
 - (B) by agency and agency program; and
 - (C) by major rule; and
- (2) an analysis of impacts of Federal regulation on State, local, and tribal government, small business, wages, and economic growth.²⁰

This language is similar, but not identical to, language governing OMB's prior two reports to Congress. Nevertheless, OMB appears to have interpreted the language as if it were the same. The reporting format and the substance of the Draft Third Report are substantially unimproved

¹⁸ This extension was published on January 27, 2000—six days after the original public comment period expired. See 65 FR 4447.

¹⁹ Whether or not intended, OMB forced interested parties to seek informal Congressional intervention. This also occurred in 1998, when OMB published its Draft Second Report on August 17 (at the height of the summer vacation season in Washington, D.C.) for 30 days of public comment. Had an extension not been obtained in 1998, OMB would have had just two weeks to digest these comments, respond to them, and finalize the report.

²⁰ See Sec. 638(a)(1)-(2).

and unexpanded from previous editions. Nowhere in the draft does OMB indicate that it changed its format or content in response to altered statutory language.

The two prior OMB reports to Congress were severely and widely criticized for failing to exercise independent judgment in the reporting of cost and benefit estimates, for major rules in general, and the Environmental Protection Agency's 1997 report to Congress on the costs and benefits of the Clean Air Act in particular.²¹ CSAB regulatory policy experts joined in this criticism.²² In response, OMB defended its practice of relying exclusively on agency estimates; providing alternative estimates from OMB's expert analysts would be "problematic" or "beyond our capabilities for the current report." OMB hid behind a floor statement by Senator John Glenn stating that "OMB will not have to engage in extensive analyses of its own."²³ This conveniently disregarded the fact that in the normal course of regulatory review, OMB analysts routinely develop alternative estimates so as to better inform White House officials about the likely consequences of proposed actions. Rather than publish alternative cost and benefit estimates derived from this work, OMB chose to merely compile estimates obtained from the agencies and suppress the additional insights that centralized regulatory review had generated.

Even so, OMB acknowledged that the exercise of such independent judgment was "consistent with the Regulatory Accounting Amendment's requirements for standardized measures and independent and external peer review of costs and benefits and the format of accounting statements" and "we will carefully consider them for the next report." Now that the day of reckoning has arrived, OMB persists in merely compiling agency estimates. The Draft Third Report does not describe how OMB "carefully considered" the suggestion that it exercise its own informed professional judgment, nor why it decided once again not to do so.

As it did in its two prior reports, in the Draft Third Report OMB fails to offer any insight concerning the validity and reliability of agency benefit and cost estimates. This is a separate and distinct issue from the problems associated with aggregation across rules, problems that OMB spends considerable time discussing and few, if any, experienced regulatory analysts dispute. Nevertheless, the largest problem underlying aggregation is not incompatible regulatory baselines, what OMB refers to as "apples and oranges" problems, or similar technical matters. Rather, the largest problem is that agency benefit and cost estimates have not been demonstrated to be valid or reliable even for the limited purposes to which they have been used—discerning *ex ante* the likely costs and benefits of draft major regulations before they are promulgated, as an aide in regulatory decision-making. OMB, alone among government agencies, is best positioned to offer critical insights concerning this fundamental issue. Yet OMB has failed once again to disclose this information.

Instructive along these lines is the dramatic reduction in OMB's reported upper-bound estimate of the annual benefits of environmental regulation, from \$3.2 trillion (EPA's "95th percentile upper-bound estimate" in its 1997 report to Congress on pre-1990 Clean Air Act

²¹ See OMB (1999) at 101-102 (criticisms of OMB's reliance on agency estimates for major rules) and 97-99 (criticism of OMB's use of EPA's benefit estimates for the Clean Air Act).

²² See Belzer (1998) and Chilton (1998).

²³ See OMB (1999) at 102.

regulations) to \$1.45 trillion (EPA's "best estimate").²⁴ OMB acknowledges quite candidly that this reduction was made at EPA's request. EPA apparently believes that criticism of its \$3.2 trillion per year benefit estimate "was somewhat misdirected," presumably because of its "upper bound" character. Apparently, EPA also believes that its "best estimate" of \$1.45 trillion per year in benefits is credible and not itself highly controversial. Except for attributing this belief to EPA—and, by unambiguous implication, *not* to OMB—OMB has nothing more to say about it.

OMB notes that the agencies use a wide variety of conversion factors for monetizing similar types of benefits. Perhaps inadvertently highlighting both its lack of confidence in the agencies' conversion factors and its own *laissez faire* approach to the observed inconsistencies, OMB says the agencies have been allowed to pick and choose from the literature based on their own political and bureaucratic interests:

There is a relatively rich body of academic literature on this subject. The methodologies used and the resulting estimates vary substantially across the academic studies. Based on this literature, agencies have each developed estimates they believe are appropriate for their particular regulatory circumstances.²⁵

Of course, this is precisely what the Congress directed OMB to prevent, seeking instead government-wide consistency by applying the valuation literature consistently. OMB has signaled quite clearly that it has no intention of actually demanding interagency consistency, even if the Congress wants it.

More troubling than interagency inconsistencies in valuation are the unjustified conversion factors OMB uses when faced with unmonetized but quantified estimates of pollution reductions obtained from EPA. Instead of developing its own conversion factors based on the available literature, OMB simply incorporates the highest factor ever found in a similar EPA action. Thus, OMB monetizes avoided hydrocarbon and nitrogen oxide emissions at \$519 to \$2,360 per ton; sulfur dioxide at \$3,768 to \$11,539 per ton; and particulate matter at \$11,539 per ton as well. OMB further notes that EPA has "recommended" that the *average* monetized value for nitrogen oxides be increased to an extraordinary \$7,999 per ton—239 percent of EPA's previous upper bound and 1,441 percent of its previous lower bound.²⁶ OMB's unusually specific request for comment on EPA's new figure appears to be as much a cry for help as an appeal for mercy.

Whichever of these astounding figures is used, they dramatically inflate OMB's reported benefits from environmental regulation. They are invalid except under extraordinary assumptions. For example, the observed associations between outdoor air pollution and indoor mortality in a handful of epidemiological studies must be assumed to be causal without regard for usual scientific standards.²⁷ Also, middle-aged workers' willingness-to-pay to avoid small incremental

²⁴ Compare OMB (1999) at Table 1 with OMB (2000) at Table 1.

²⁵ OMB (2000) at 20, footnote 23.

²⁶ OMB (2000) at 32.

²⁷ The problem of discerning causality from statistical association has a long history. See, e.g., Graham (1995). Practical criteria have been developed to help make such judgments. See Federal Focus (1996). Neither the Federal Focus guidelines, nor any others, appear to have been used to justify assuming causality.

mortality risks must be directly transferable to large incremental risks faced by the critically ill elderly, an assumption that however convenient lacks any economic merit.²⁸

Clearly, OMB has little influence, much less control, over what it reports to Congress as the benefits of environmental regulation. It has been compelled to allow the fox to count the chickens in the henhouse and dutifully report whatever the fox says.

More broadly, OMB has failed to make any discernable advancement toward improving the quality of agency estimates despite promises to do so in its Second Report. OMB has the benefit of independent and external peer review plus more than a year's additional experience with regulatory accounting, yet there is no evidence that any improvements in quality have occurred as a result. Rather, OMB appears to have firmly institutionalized the very practices that were so strongly criticized in the past and that OMB had promised to reform. In short, the quality of OMB regulatory accounting under its current management doesn't get any better than this; absent a major change in leadership or philosophy at OMB, the prospects for quality improvements seem dim.

OMB made other commitments in its Second Report that appear to have fallen by the wayside as well. For example, many commenters (including CSAB experts) recommended that OMB disaggregate benefit and cost information by regulatory program and for each major rule, something that governing law now explicitly requires:

We are committed to adding such information for additional years in the next report, as required by the Regulatory Accounting Amendment. As we develop this information for individual major rules, *it will then be possible to examine the merits of assembling estimates for individual programs or program elements* (emphasis added).²⁹

Apart from partially extending its compilations of agency estimates by an additional year, there is no evidence in the Draft Third Report that OMB has made any headway in fulfilling this commitment.

The law also requires OMB to provide “an analysis of impacts of Federal regulation on State, local, and tribal government, small business, wages, and economic growth.”³⁰ Useful estimates of the effects of regulation on these margins are surely difficult to develop. For example, estimating the effects of regulation on wages would require analysts to estimate both direct effects, such as wage reductions caused by regulations to which employees or firms must comply, and indirect effects, such as tax-interaction consequences caused by regulatory induced distortions of labor markets. Indeed, the language in Sec. 638(a) seems to reflect the widespread myth that the cost of regulations is borne by firms or employees, but not both. In fact, firms are mere conduits for both costs and benefits: all are passed through to consumers, employees, customers, suppliers of inputs other than labor, stockholders, or the government. They find their final resting place in households, whose members work as employees, purchase goods and services as consumers, contribute to the public sector via taxes and fees, and add to capital investment as

²⁸ See Viscusi (1995).

²⁹ See OMB (1999) at 102.

³⁰ Sec. 638(a)(2).

bond- and stockholders. Thus, it is fundamentally incorrect to imagine that the direct effects regulations might have on “wages” bears any resemblance to the total effect they have on household welfare, and it is the latter measure that is interesting and relevant for policy making.

Instead of helping to educate Congress and the public on this point, however, OMB merely preserves the myth that underlies it and reinforces the false premise that “firms” bear costs and “consumers” reap benefits. It is perhaps fortunate that OMB’s discussion of the effects of regulation on “wages” is both qualitative and largely free of content.³¹ In fact, OMB cannot even provide the agencies’ own estimates of the direct effects of federal regulation on wages because the agencies it supervises generally do not develop such estimates.

To comply with its statutory obligation to report on the effects of federal regulation on small business, OMB only reports that which is already known and arguably led to the statutory reporting requirement. Leaving aside the question of true incidence discussed above, OMB notes correctly that small businesses bear a disproportionate share of costs because they have fewer units on which to spread the fixed costs of compliance. OMB also cites work done for the Small Business Administration years before the Congress established OMB’s regulatory accounting responsibility. OMB supplies no new information or insight; it cannot even summarize the effects tallied by federal regulatory agencies because, for the most part, the agencies do not seriously estimate small business impacts.³²

OMB is no more responsive and is arguably disingenuous in its discussion of the effects of federal regulations on economic growth. Faced with peer-reviewed economics literature showing reduced productivity resulting from environmental regulation, OMB claims that its unverified aggregate estimate of benefits ought to be added to GDP because such benefits were not initially counted.³³ Of course, there are many other good things that are not included in the National Income and Product Accounts, such as the value of child-raising performed by parents rather than hired nannies, the value of homemaking services performed by household members rather than hired maids and cooks, and the value of leisure activities not requiring the expenditure of vast sums on summer homes, wilderness adventures, and the like. Similarly, NIPA does not take account of social costs other than direct expenditures. Adding to GDP OMB’s cost or benefit estimates muddies the debate over the extent to which regulation reduces economic growth. Adding only OMB’s benefits estimate is disingenuous.³⁴

³¹ OMB (2000) at 20-21

³² See OMB (2000) at 19-20. Ironically, OMB touts language in Executive Order 12866 that explicitly requires agencies to analyze small business effects and use it to differentiate large and small firms in regulatory decision-making: “The Executive Order called on the agencies to tailor their regulations by business size in order to impose the least burden on society, consistent with obtaining the regulatory objectives.” OMB does not, however, discuss agencies’ actual compliance with this provision, or its own efforts to secure such compliance.

³³ This is the same estimate of aggregate social benefits about which OMB earlier provided seven major reasons why it shouldn’t be taken too seriously. See OMB (2000) at 3-6.

³⁴ GDP also includes as “product” a vast amount of economic rent. An administratively simple flat tax on income would disemploy an army of accountants and lawyers, causing GDP to decline. Principled objections to such a tax have been raised, but the loss of GDP from curtailed rentseeking opportunities has not been one of them. Instead, Members of Congress often claim that simplifying the tax code (generating unemployment among accountants and tax lawyers) would constitute a net social benefit.

In sum, we give OMB a failing grade with respect to complying with the analytic requirements of the Act. Once again, OMB has failed to provide any informed analysis or insight despite its widely acknowledged expertise. In its Second Report, OMB agreed that independent estimates of costs and benefits were desirable and consistent with the intent of the regulatory accounting law. In this draft, however, OMB did not provide such estimates—not its own estimates, those of its peer reviewers, or those of anyone else. OMB also failed to provide cost and benefit estimates for most, never mind all, of the major rules it reviewed from April 1998 through March 1999.

Decision-making Requirements

Congress also directed OMB to provide “recommendations for reform” aimed at enhancing the efficiency or effectiveness of federal regulation.³⁵ As it did in its two previous reports to Congress, OMB simply did not comply with this provision of law and thus deserves a failing grade.

In its First Report to Congress in 1997, OMB dodged the statutory requirement to provide recommendations for regulatory reform and was sharply criticized for doing so.³⁶ OMB relied heavily on the correct but irrelevant point that aggregate estimates of benefits and costs do not illuminate the merits of individual regulatory or deregulatory actions. In doing so, OMB ignored its own 16 years of experience in evaluating *individual* regulations, in many cases having made public, written recommendations that agencies not proceed with certain actions because likely social costs substantially exceeded likely social benefits.

In its First Report, OMB also cast its own regulatory oversight activities in a remarkably negative light, raising doubts as to whether OMB review actually offers any demonstrable added value:

Although considerable progress has been made in providing micro data in advance of regulatory proposals and in developing best practice guidance, further progress is needed to continue improving regulatory decisions. Specifically, we need to ensure that the quality of data and analysis used by the agencies improves, that standardized assumptions and methodologies are applied more uniformly across regulatory programs and agencies, and that data and methodologies designed to determine whether existing regulations need to be reformed is developed and used appropriately.³⁷

OMB recommended several specific actions to “improve the quality of data and analysis on individual regulations and on regulatory programs and program elements as a first step toward developing the evidence needed to propose major changes in regulatory programs.” These actions included:

³⁵ See Sec. 638(a)(c) of the Act; *cf.* Sec. 625(a) of the relevant appropriations language for FY1997 and FY1998.

³⁶ See OMB (1997, Chapter IV and Appendices).

³⁷ See OMB (1997). In its Second Report, OMB responded to GAO criticisms of inconsistencies in agency analytic practices by reiterating this same peculiar defense. See OMB (1999) at 67.

- an OMB-led effort to “raise the quality of agency analyses used in developing new regulations by promoting greater use of the *Best Practice* guidelines”;
- the establishment of an interagency group that would “subject a selected number of agency regulatory analyses to *ex post* disinterested peer review”;
- additional efforts by OMB to “develop a data base on benefits and costs of major rules by using consistent assumptions and better estimation techniques to refine agency estimates of incremental costs and benefits of regulatory programs and elements”;
- additional OMB work to develop “methodologies appropriate for evaluating whether existing regulatory programs or their elements should be reformed or eliminated using its *Best Practices* document as the starting point”; and
- new efforts by OMB to systematically “track the net benefits (benefits minus costs) provided by new regulations and reforms of existing regulations for use in determining the specific regulatory reforms or eliminations, if any, to recommend.”

None of these actions required any additional legislative authority or appropriations, yet three years later OMB has taken only limited steps toward implementing them.³⁸

In its Second Report, OMB touted a pre-existing administration initiative on electricity restructuring that was purported to “save consumers at least \$20 billion a year on their electricity bills.” Remarkably, these savings were calculated to three significant digits at the household level, and disaggregated into direct benefits from reduced electricity prices and indirect benefits from reduced costs of production for other goods.³⁹ Some commenters, including CSAB, noted with skepticism that OMB’s promotion of this reform proposal was highly peculiar, in part because estimates from proposed legislation are substantially more uncertain than estimates of the effects of specific regulations. More tellingly, this recommendation was based on an area in which OMB regulatory review staff had limited experience.⁴⁰ OMB responded to these comments (and thirteen extensive public comments on the substance of the administration’s electricity restructuring initiative) by scanning the annual Regulatory Plan and biannual Regulatory Agenda, finding ten additional agency-initiated proposals (out of hundreds of proposed regulatory actions) that could qualify in some sense as “regulatory reforms.”

In the Draft Third Report, OMB offers neither procedural nor substantive recommendations for reform. Nor does OMB tout a major administration initiative or propose any

³⁸ Some of these limited steps were mentioned in OMB’s Second Report. See OMB (1999) at 89-91. OMB also touted a memorandum sent to the “Regulatory Working Group” by the Administrator of OMB’s Office of Information and Regulatory Affairs “requesting that they give greater attention to the analysis of economically significant rules and to focus specifically on the *Best Practices* document.” The Draft Third Report does not mention any follow-up efforts on these fronts or any analysis of their effectiveness, suggesting that they have been quietly abandoned.

³⁹ See OMB (1999) at 87.

⁴⁰ Federal electricity regulations are promulgated by the Federal Energy Regulatory Commission, an independent agency exempt from OMB review under both Executive Order 12866 and its predecessor, Executive Order 12291.

changes in regulatory procedure or oversight that might improve the quality of agency analysis. OMB only mentions a handful of agency-initiated regulatory proposals found in the 1999 Regulatory Plan.⁴¹ Out of 164 specific actions, OMB identifies ten that, in its view, provide a “sample” of regulatory reform initiatives that “either increase the regulated entities’ flexibility, reduce paperwork burden, clarify the regulated entities’ responsibilities with plain language, or substitute performance standards for command-and-control.”

From a regulatory reform perspective, however, the items in this “sample” are generally disturbing. Some would expand the reach of Hazard Analysis and Critical Control Programs (HACCP) in federal food safety regulation despite the lack of evidence that these programs actually work as federal regulators have implemented them. Moreover, there is increasing evidence that federal regulators are using HACCP-based programs to convert paperwork errors into substantive violations of the nation’s food safety laws, a practice that is generally incompatible with common-sense notions of regulatory reform. Further, the ostensible reliance on “performance standards” in these initiatives may be better characterized as the back-door imposition of best available technology requirements—that is, “performance standards” in which only the performance of an agency’s preferred technologies constitutes compliance.

Other items in OMB’s sample of agency-initiated reform proposals appear to merely tinker at the margins of existing regulatory programs. None of the proposals cited represents a major reduction in the federal government’s regulatory presence.

Based on the absence of any credible reform proposals in the Draft Third Report, we are compelled to judge OMB’s compliance with this portion of the Act to be a total failure.

Conclusions

The best description (and criticism) of OMB’s Draft Third Report and its regulatory accounting efforts to date is that they do not get any better than this. Like its earlier reports, OMB has merely compiled agency estimates of benefits and costs. It has provided no value-added information gleaned from years of centralized regulatory oversight and extraordinary attention to detail, and it has offered no recommendations for reforming either the process or substance of federal regulation. More troubling, OMB has responded poorly to the Congress’ explicit requirements that it issue government-wide Guidelines and provide for peer review of both these Guidelines and the Draft Third Report. These statutory provisions were intended to improve consistency across agencies and improve the quality of agencies’ regulatory analysis. Without a serious effort on OMB’s part to implement these provisions, little improvement can be expected.

Nor is the quality of OMB’s regulatory accounting likely to improve merely if Congress renews or expands this annual reporting requirement. OMB has either chosen not to exercise this new legal authority or it has been prevented from doing so. Given the depth of analytic expertise

⁴¹ “The 164 regulations under development in the Regulatory Plan may be viewed as specific recommendations for regulatory improvement or reform based on statutory mandates and the Administration’s priorities.” See OMB (2000) at 35.

and programmatic knowledge possessed by OMB staff, the latter explanation seems far more likely. Thus, a fundamental change in leadership – for example, the removal of political interference—is necessary before OMB’s regulatory accounting will measurably improve.

Especially troubling in this Draft Third Report are the “black box” peer review procedures OMB created, which are impenetrable to the general public and incompatible with the law. Because these new procedures are so opaque, OMB’s Draft Third Report (as well as the yet undisclosed Guidelines) provides the façade of credibility without any foundation. Unless and until OMB gets serious about providing useful information and insight into the real costs and benefits of federal regulation, OMB reports to Congress should be viewed as a handy reference for agency estimates, at least where such estimates exist. However, these reports should not be construed as credible, independent summaries or analyses of the federal government’s regulatory presence. For such information Congress and the general public will have to look elsewhere.

Peer review can be an extremely useful tool in detecting flawed arguments and improving the rigor of reasoning and analysis. It also helps avoid the perils of research conducted without reality checks. That is how peer review generally works in academic settings, where successful peer review is a necessary condition for research to gain respected publication. However, peer review also can be used as a shield to hide from or deflect potential adversaries. This is the model of peer review too often used by government agencies, perhaps in part because publication is a foregone conclusion and cannot be prevented irrespective of the quality of the research. Where its work is statutorily required to be peer reviewed, OMB should set an honorable example for the agencies it oversees.

OMB’s reports to Congress have indirect value even if they cannot be relied upon to inform substantive policy decisions. Like its predecessors, the Draft Third Report reveals the critical need for *independent* regulatory oversight. Congress can help itself by creating and staffing its own office of regulatory analysis, then ensuring that it is as protected as possible from the kind of political interference that has descended like a fog on OMB. No firewalls will be perfectly effective, however, and it will take many years for a congressional office to build a reputation for nonpartisanship and independence (or for OMB to reclaim the reputation it has lost). Meanwhile, Congress and the public have no choice but to rely on non-governmental institutions to perform independent regulatory oversight.

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