

Institute for Policy Integrity

New York University School of Law

Memorandum

Date: June 28, 2010

From: Richard L. Revesz and Michael A. Livermore

Re: Comments on *Draft 2010 Report on Congress on the Benefits and Costs of Federal Regulations*

The Institute for Policy Integrity at New York University School of Law offers the following comments on the *Draft 2010 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities (Draft Report)*. These comments do not provide a comprehensive assessment of the Draft Report, but instead provide a preliminary set of suggestions for the Office of Information and Regulatory Affairs (OIRA) to consider. We look forward to working with OIRA on a continuing basis to improve the quality of decisionmaking of federal agencies. These comments also respond to the request for “suggestions about regulatory changes that might serve to promote economic growth, with particular reference to increasing employment, innovation, and competitiveness.”¹

The Institute for Policy Integrity (IPI) is a non-partisan advocacy organization and think-tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, cost-benefit analysis, and public policy. IPI and associated faculty and staff have produced scholarship on issues relating to the valuation of regulatory costs and benefits, the structure of regulatory review, the appropriate uses of economic analysis in rulemaking, and institutional design for regulatory systems.

Summary

In general, the Draft Report continues to be a useful document to summarize the activity of federal agencies in the past year. The Draft Report also continues to include a set of recommendations for reform, a useful practice that can help improve both the analysis and content of new rules. Importantly, OIRA has used this section to proactively raise a potential area where greater regulation could produce net benefits. These comments suggest that this section should be expanded by including discussion of the steps that agencies and OIRA have taken in the past year to implement the recommendations in the 2009 Report, including, where appropriate, collection of best practices.

There continue to be several additional important structural revisions that can be made to the Draft Report that will increase its ability to provide feedback to agencies on both the content of agency rules and agency decisionmaking procedures. The revisions include conducting aggregate distributional analysis of rulemakings, facilitating retrospective analysis, reviewing petitions for rulemaking, and

¹ OFFICE OF MANAGEMENT AND BUDGET, DRAFT 2010 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 47 (2010) (“Draft Report”).

identifying inconsistencies in how agencies treat core regulatory questions. Many of these suggestions were discussed in the comments IPI submitted for the 2009 Draft report, which are attached to these comments and incorporated by reference.

With respect to the specific request for suggestions on regulatory changes to promote the economic growth, we recommend that there be greater discussion of the reasons why economic growth should be a particular focus for regulatory attention—in particular, OIRA should clarify that the emphasis of agencies should be to produce growth in beneficial economic activity, not simply growth in economic indicators like gross domestic product. In general, agencies can promote this kind of growth by expanding the use of market incentives where possible and reducing regulatory uncertainty. In addition, agencies should, where possible, give greater attention to transition costs (and benefits) associated with new rules, including employment effects.

Greater Follow-up in the “Recommendations for Reform” Section

The Recommendations for Reform section provides an opportunity for OIRA to draw on its experience with agencies working on a range of issues and in a variety of contexts to draw general lessons about regulatory practices that can help improve the quality of decisionmaking across the federal government. OIRA should maintain the practice of using its expertise to make suggestions to agencies that can help them improve the regulatory process.

Last year, this section made recommendations in three areas: behavioral approaches; regulatory impact analysis; and transparency and open government. These three categories are all important and deserve attention. Recognizing the behavioral aspects of regulation—both how human behavioral and psychological characteristics can justify regulation, and how regulation can be designed to be effective in light of the most current research on behavioral responses—can help improve the efficacy of government action. Regulatory impact analysis continues to be at the heart of regulatory decisionmaking, and steps undertaken to improve this analysis can help facilitate sound agency choices. Finally, openness and transparency are both important values of the political system, and can help improve the quality of regulation.

The most important revision that can be made to the Recommendations for Reform section is to include a more detailed discussion of steps that were taken, both at OIRA and at agencies, to implement the recommendations from the 2009 Report. The Draft Report mentions that OIRA continues to support the recommendations from the past year and work with agencies to implement them, but there is insufficient discussion of what steps agencies and OIRA have undertaken. Nor does OIRA evaluate how well agencies have responded to the recommendations, or focus on agencies that have developed novel or successful responses.

The annual report to Congress provides OIRA with an important opportunity to examine how well agencies are responding to its recommendations. The value of collecting and publicizing how agencies have responded serves multiple goals. First, it promotes transparency. Without adequate follow-up, the public does not know whether the recommendations are being diligently followed or are being ignored. For the recommendations to be meaningful they must influence agency behavior, and for the public to evaluate both OIRA’s recommendations and agency conduct, they must know how well those recommendations are being carried out in practice.

Second, increased follow-up will help increase public confidence in the administrative system. By demonstrating to the public how agencies are actively working to improve the regulatory process, OIRA

can help alleviate fears of unresponsive or ossified agencies. Too often, regulation and administrative agencies are poorly understood and sometimes vilified—this creates a false impression that harms agency moral, undermines the legitimacy of agency action, and skews public perception. Showing where the administrative system is engaged in a process of self-improvement can help correct misperceptions when concerns about unresponsive agencies are not justified. If agencies fail to engage in that process, disclosure of that failure holds those agencies to account and provides information valuable in the democratic process.

Third, by collecting and publicizing responses to the recommendations, OIRA can disseminate a set of best-practices that can facilitate future action. Where agencies have undertaken special efforts to improve their regulatory practices in light of OIRA’s recommendations, it should be recognized. More importantly, there is no reason for agencies to “reinvent the wheel” when approaches that have been developed by one agency can be appropriately applied in other contexts. OIRA can collect and publish the most successful responses to ensure that other agencies have sound templates that can facilitate their efforts to improve their regulatory processes.

Finally, by tracking agency responses to its recommendations, OIRA can evaluate whether its recommendations were sound. Only by seeing how the recommendations are implemented in practice, and evaluating the ultimate consequences of the recommendations, can OIRA see whether it is, in fact, promoting better regulatory practices. It may be the case that OIRA’s recommendations are mistaken, and cause more harm than good—diverting agency resources to unimportant analytic tasks, or pushing favored regulatory approaches that, when practiced, do not increase net benefits. To engage in a process of self-evaluation, OIRA needs to follow the impacts of its own suggestions.

There are many examples of where agencies have taken important steps to implement OIRA’s recommendations. At the Environmental Protection Agency (EPA), the *Regulatory Gateway* represents a major step in improving transparency, giving the public access to more information on ongoing regulation process, and facilitating public involvement in the regulatory process. The *Gateway* provides an excellent template of how to use information technology to engage the public. This success can potentially be repeated at other agencies.

Action at EPA in the past year also provides OIRA with an interesting test case of the efficacy of disclosure in changing behavior. The *Mandatory Reporting of Greenhouse Gases Rule*,² which requires the disclosure of greenhouse gas emission for major emitters, has now gone into effect. This rule provides an excellent opportunity for OIRA to examine what, if any, effects that disclosure has on the underlying conduct. If the rule is successful in reducing greenhouse gas emissions at low cost, it can provide a powerful example of the utility of disclosure in other contexts. The rule may also be able to show the limits of disclosure. If the marginal costs of the steps to reduce greenhouse gas emissions are below the social cost of carbon, then the limits of disclosure as a regulatory tool in this context can be estimated.

Inclusion of Suggestions for New Regulation

The Recommendations for Reform section also includes a discussion of steps that government can take to address the issue of childhood obesity. Recognizing the childhood obesity poses both private and

² *Mandatory Reporting of Greenhouse Gases (Final Rule)*, 74 Fed. Reg. 56,260 (Oct. 30, 2009).

social costs, the Draft Report recommends that “serious efforts should be made to identifying clear, simple, easily-applied rules or guidelines that people might use to reduce the risk of childhood obesity.”³

Historically, OIRA has largely served a checking function—ensuring that the costs of rules were justified by the benefits, and engaging with discussions with agencies over how to reduce the costs of regulation.⁴ While some steps have been taken in the past, such as the practice of “prompt” letter adopted by Administrator Graham,⁵ there remains more that can be done to give OIRA a more proactive role. There is no strong reason to believe that, systematically, agency inaction is not as large a problem as misguided or inefficient action. Social well-being can be reduced just as easily through the failure of government to correct an externality as through inefficient or overly strict rules. OIRA, in its central role, respond to both potential problems.

The suggestion for new regulatory action in the area of childhood obesity is an important step for OIRA. By using its expertise in regulation generally, and its central vantage point on the regulatory activities of many different agencies, OIRA can identify important cross-cutting issues, blind spots, or neglected areas where government action can have significant social benefits. The issue of childhood obesity seems to be a promising area where OIRA can bring its expertise to bear.

This section could be improved with added clarity and specificity. The Draft Report calls attention to the issue, and recommends a very general course of action—using information tools to help individuals and caregivers make better choices. However, specific actions that particular regulatory agencies can take are not explored. More detail—including specific regulatory proposals—would provide more guidance to agencies and help focus the issue more clearly.

OIRA should be commended for taking this step towards a more proactive role in recognizing that inaction on important issues can be as costly as inefficient actions. Identifying areas of under-regulation or lack of regulation could be an extremely useful role for OIRA to play, and would help ensure that regulatory review is not institutionally biased against regulation. To serve as a neutral arbiter promoting sound regulation, it is important that OIRA work with agencies to improve their regulatory proposals and identify new areas where agency action is needed.

The Social Cost of Carbon Process

The Draft Report includes some discussion of the interagency taskforce that was charged with providing a consistent set of values for the harm caused by the emission of greenhouse gases to be used in regulatory impact analysis of rules with potential climate impacts. Now that the taskforce has issued its final report, it provides a useful case study in interagency coordination for OIRA to examine. Most importantly, it should provide the impetus for OIRA to develop a set of guidelines on transparency for future processes of this nature.

There are several important dimensions along which the social cost of carbon process should be evaluated. From a substantive perspective, the taskforce was charged with an incredibly complex and

³ Draft Report, *supra* note 1 at 46.

⁴ For more detailed critique of the institutional contexts in which cost-benefit analysis was used, and how they led to an anti-regulatory bias, see RICHARD L. REVESZ & MICHAEL A. LIVERMORE, *RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH* (2008).

⁵ See OFFICE OF MANAGEMENT AND BUDGET, *MAKING SENSE OF REGULATION: 2001 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES* 44 (2001).

difficult task. The taskforce did an admirable job of integrating the most recent scientific and economic perspectives on the issue of climate change in a way that was rigorous and consistent, while recognizing areas of uncertainty and limited knowledge. While some of the taskforce's ultimate conclusions were problematic,⁶ there can be little doubt that they were the result of significant and weighty deliberations, and that alternative viewpoints were given consideration.

The charge of the taskforce—developing a single value that can be used to set regulatory policy at a number of agencies—was also extremely important. Climate change is an example of a regulatory issue with cross-cutting implications for a wide number of policies developed by agencies across the government. There is no central agency that has jurisdiction over all the decisions that have an effect on greenhouse gas emissions. From transportation infrastructure to wetlands preservation, electrical grid construction to local land-use planning, climate change touches on a vast number of government programs and regulatory regimes. To ensure some level of consistency and coherence in federal responses to climate change, some mechanism must be used to coordinate these disparate actors. The social cost of carbon, by taking advantage of the pricing mechanism and the widespread use of cost-benefit analysis in the federal government, is an extremely elegant tool to achieve that coordination. Rather than requiring time consuming consultation processes that may ultimately have little efficacy, a unified social cost of carbon can ensure that agencies are not wasting resources—either by taking overly costly measures, or failing to take justified action.

One potential set of issues arises in the context of transparency. The interagency taskforce process was announced as part of the regulatory impact analysis of a relatively small rule concerning the energy efficiency standards for vending machines.⁷ There was no official process for outside groups to contribute comments directly to the taskforce—rather, the rules where the taskforce's recommendations were discussed provided the venue for public comments. No public meetings were held, and there was not solicitation of public comment. The proceedings did not have their own website, deliberations were not publicized, and a separate docket of materials was not created. The document was not submitted for formal peer review and agency bodies designed to facilitate comments by outside experts—like the EPA's Science Advisory Board—were not consulted. While all of these decisions may be justified, there is no formal set of guidelines that exists to facilitate decisions on transparency and public participation in these contexts and ensure consistent treatment of related issues in the future.

While it is clear that public participation in general has many positive benefits—increasing the legitimacy of decisions and eliciting new information—there are also downsides, and there should be opportunities for agencies to consult each other, brainstorm, and express new ideas without the chilling effect of public scrutiny. Ultimately, the degree of public participation for a given administrative process must balance the value of new information and increased legitimacy against cost in delay and frankness of discussion. As OIRA considers future efforts to harmonize and coordinate agency action through mechanisms like the social cost of carbon and forums like the interagency taskforce, it should consider

⁶ See Comments of the Environmental Defense Fund & Institute for Policy Integrity on the Proposed Rulemaking to Establish Light-Duty Vehicle Greenhouse Gas Emission Standards and Corporate Average Fuel Economy Standards (Nov. 27, 2009) (discussing discount rates, uncertainty, and risk aversion, among other issues).

⁷ Department of Energy, *Energy Conservation Program: Energy Conservation Standards for Refrigerated Bottled or Canned Beverage Vending Machines*, 74 Fed. Reg. 44913, 44947 (Aug. 31, 2009).

developing a set of guidelines, based on this experience and others, to appropriately calibrate the level of transparency in future processes.

Additional Structural Changes

In the set of comments prepared by IPI last year, several recommendations were made for structural changes to OIRA's annual report to Congress. While some of the changes to the final 2009 Report responded to those recommendations, these comments reiterate several of those recommendations for future consideration.

In the annual report, OIRA should examine the petitions for rulemakings that are received by agencies in the past year or which remain pending. These petitions may provide important information on potential areas of over- or under-regulation that can be appropriate areas for agency action. By collecting and discussing these petitions, OIRA can publicize how well agencies are responding to this public information, and can also create a central location where pending petitions can be found. OIRA can also draw attention to petitions that are particularly promising, or that have been languishing for long periods of time before the agencies.

Timely treatment of petitions by rulemakings is required by the Administrative Procedure Act, and is a sound regulatory practice. Petitions can serve an important agency forcing role to address areas of inaction—it was a petition that started the process that ultimately led to *Massachusetts v. EPA*. Petitions also give interests affected by regulation (or lack of regulation) an opportunity to have input into the administrative process—allowing petitions to sit for extended periods of time without adequate response reduces the legitimacy of federal agencies. OIRA can play a helpful role in aggregating information on pending petitions and prodding agencies when necessary.

Regulation and Economic Growth

In the Draft Report, OIRA requests comments on “suggestions about regulatory changes that might serve to promote economic growth, with particular reference to increasing employment, innovation, and competitiveness.” This request targets a particular goal—promoting economic growth—that may not always align with maximizing net benefits. For OIRA to focus public comments and its own analysis of this issue, it would be useful to know why OIRA has targeted growth as an area of concern.

As OIRA recognizes in the Draft Report “there is a complex and not fully understood relationship between GDP growth and improved lives or subjective well-being” in part because “GDP does not capture directly the benefits of regulation, such as environmental protection, that does not result in increases in goods or services produced.”⁸ Given this nuanced discussion during an earlier section of the Draft Report, the call for recommendations for steps that can be taken to increase growth—without a discussion of why growth should be the correct goal of regulatory reform—is odd.

Soliciting suggestions for steps that can be taken to increase growth also has a vaguely anti-regulatory connotation. Because many of the benefits produced by regulation are not captured in measures like GDP, deregulation may be growth promoting, when looked at through a narrow lens. But the losses from those steps may be greater than the benefits.

⁸ Draft Report, *supra* note 1 at 33-34.

Growth, at least in the short-term, can also be increased by placing costs on future generations, or drawing down natural resources at an inefficient rate. Extracting non-renewable resources as fast as possible might lead the economy to grow, but if those resources are simply consumed, then that growth is illusory—shifting consumption to the present generation is not really growth. Large scale borrowing can also generate greater growth (at least domestically) in the short-term, but again, if the proceeds from borrowing are consumed, borrowing only shifts wealth from future generations.

OIRA should clarify that the kind of growth that is an appropriate goal of regulatory policy is long-term, sustainable growth of national productivity of both market and non-market value. When expressed in this way, this goal is identical to maximizing net benefits, but with an emphasis on the dynamic effects of regulation over time.

The Draft Report asks specifically for suggestions in the areas of employment, innovation, and competitiveness. Each of these topics is of particular salience given current economic conditions, but requires greater specificity in the types of regulatory goals that OIRA is interested in promoting.

The effect of regulation on each of these topics is hotly contested. Even the terms of the debate are somewhat difficult to define. For example, a classically understood cause of unemployment is minimum wage laws, which interfere with the setting of a market clearing price for labor.⁹ But even in this simple case, the unemployment *problem* is contestable. The problem could be understood as price controls on wages interfering with the natural operating of the market. Alternatively, the unemployment problem could be understood as the economic conditions that cause worker productivity to fall below a “living wage.”¹⁰ Defining the problem will help define appropriate government responses.¹¹ Voluntary unemployment, where individuals exit the workforce because there are no jobs available that provide adequate compensation, can be understood as a positive (or neutral) effect of wealth on valuations of leisure. Impoverishing people to the point where they have to take lower-wage jobs, or reducing regulation in industries with high externalities may have short-term positive effects on the aggregate workforce participation rate, but would not represent an overall welfare improvement.

Competitiveness also raises ambiguities. For example, the effect of environmental regulation on capital location (the pollution haven effect) remains a largely unsettled question within the economics community.¹² The extent of such an effect remains an area of study and debate. Even if a pollution haven effect exists, and firms do relocate in order to escape strict environmental regulation, it is not clear that this is a negative outcome. It may simply be the natural result of differing risk preferences or levels of development, in which case those shifts should not be avoided¹³—reduction in competitiveness of this type would have positive consequences.

⁹ See e.g. HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH* 467 (6th ed. 2003)

¹⁰ See generally, David Fairris & Micahel Reich, *The Impacts of Living Wage Policies: Introduction to the Special Issue*, 44 *Industrial Relations* 1 (2005) (“This living wage concept implies a social norm with values that economics are not accustomed to considering . . .”).

¹¹ Of course, the government does not necessarily face mutually exclusive options—it could both eliminate price controls and effectuate policy to increase worker productivity. But whether the fact that some workers have low productivity is something that requires government intervention is subject to debate.

¹² See generally, *THE ECONOMICS OF POLLUTION HAVENS* (Don Fullerton, ed. 2006)

¹³ See generally, Richard L. Revesz, *The 'Race to the Bottom' and Federal Environmental Regulation: A Response to Critics*, 82 *MINN. L. REV.* 535 (1997).

Innovation too requires clarification. *Ceteris paribus*, innovation seems like a good thing. For example, firms taking steps to change production processes to reduce the costs of complying with environmental regulations should produce economic benefits (so long as other externalities are not exacerbated). When purveyors of Ponzi schemes find innovative ways to hide their activities from victims and authorities, it does not generate net benefits for society. For innovation to be a legitimate goal of public policy, it must be innovation that increases net social benefits.

OIRA should clarify that the role of regulation is not only to increase employment, competitiveness, or innovation, but is also to ensure that employment, competitiveness, and innovation maximizes net benefits for society. If a regulation reduces nominal productivity within an industry by internalizing externalities, then the incentives of employers are better matched with society at large, and labor resources can be transitioned to industries with higher overall economic value. Competitiveness should (perhaps) be promoted in industries that generate net social benefits, but reduced competitiveness in industries that do not generate net benefits may only indicate that other countries have different risk preferences. Innovation that produces net benefits should be encouraged—innovation that simply transfers wealth or produces net social costs should be discouraged.

OIRA should clarify that the goal of regulatory policy, with respect to employment, competitiveness, and innovation, should be to ensure that labor, capital, and intellectual resources are marshaled in such a way as to maximize net social benefits. With this more specific goal in mind, there are at least two general approaches that are likely to help agencies achieve greater economic growth: regulatory simplification (especially the use of market incentives to achieve regulatory goals), and reducing regulatory uncertainty.

Regulatory simplification, especially the use of markets and information technology to cut down on compliance costs, will have economic benefits, including increased innovation. As a general principle, simplifying regulatory approaches, reducing paperwork or other transaction costs, and using market incentives, will increase the net benefits of regulation and allow resources to move to more productive uses. Market approaches also have an effect on innovation by providing continuing economic incentives to achieve regulatory benefits at lower costs.

A particularly valuable line of analysis for OIRA to undertake would be to examine the role of regulatory uncertainty in affecting economic growth, and proposing tools to reduce that uncertainty. The lengthy rulemaking process and the unsettled and politically contingent nature of regulatory and enforcement actions may contribute to economy-wide uncertainty that hinders investment. Developing suggestions for improving the regulatory process to reduce uncertainty could be a key contribution for OIRA.

Employment

While concerns about employment are sometimes raised as objections to regulatory policy, employment effects can typically be thought of as transitional costs associated with regulatory changes. Under standard economic assumptions, if new regulations reduce demand for labor in one sector of the economy, wages should respond and employment should increase in other sectors. Only if aggregate demand for labor was reduced would labor participation be affected.

However, even if laid-off employees do find new work, they do not necessarily find employment with commensurate wage levels. Regulation may make certain worker skills obsolete, or may permanently reduce employment opportunities in certain sectors on a regional basis. If workers have a difficult time

acquiring new skills, or are unable or unwilling to relocate geographically, they may face permanent reductions in their wage rates.

Joblessness may also carry long-term hedonic consequences that are not fully captured by standard economic models.¹⁴ If workers face long-term reductions in their well-being, even after they have found work at equal wage rates, then these effects should be taken into account. In addition, unemployment may have negative external effects on the families and communities of laid-off workers. Increased rates of crime (including domestic violence) or alcohol and drug use imposes costs on individuals and communities. These costs should be taken into account where possible.

For these reasons, attention to the transition costs associated with regulation, including long-term impacts on wage levels and well-being, is warranted. While ignoring transition costs is an acceptable assumption for certain kinds of economic analysis, agencies can improve the accuracy of their cost-benefit analyses and conduct more informed decisionmaking by attempting to take into account these costs.

At the same time, it is important that the role of regulation in contributing to joblessness or job growth should be placed in the proper context. The United States has a dynamic economy, in which labor mobility is a key component. Jobs are created and destroyed on a regular basis, as part of the process of competition and growth that is the basis of long-term economic prosperity. Avoiding regulation of industries with high externalities in order to avoid transition costs is a poor long-term policy strategy.

Allowing regulation to be shaped by fears about unemployment can also have negative consequences. Some regulatory programs may be designed inefficiently in order to avoid transition costs when compensatory mechanisms would be a more cost-effective tool to address distributional imbalances. Agencies should undertake greater efforts to identify the distributional effects of regulation or lack of regulation and use this information when designing policies going forward.

It is also important to keep in mind that other types of government policy may be far more efficient at addressing concerns about joblessness. At the level of aggregate employment and workforce participation, tax policy, for example, can be used to spur broad based growth in employment more efficiently than adoption of sub-optimal levels of regulation. To the extent that job creation is seen as a policy goal, the whole range of tools at the government's disposal should be evaluated, rather than examining regulatory reform in a vacuum.

¹⁴ Richard E. Lucas et al. *Unemployment Alters the Set Point for Life Satisfaction*, 15 PSYCHOL. SCI. 8 (2004); David A. Weisbach, *What Does Happiness Research Tell Us About Taxation*, 37 J. LEGAL STUD. 293, 320 (2008).