
Testimony of

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**Before the
SUBCOMMITTEE ON ENERGY POLICY,
NATURAL RESOURCES
AND REGULATORY AFFAIRS
Committee on Government Reform
U.S. House of Representatives**

Hearing on

Regulatory Accounting

February 25, 2004

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FEBRUARY 25, 2004

Thank you for the opportunity to testify before you today. My name is Robert R.M. Verchick. I am the Ruby M. Hulen Professor of Law at the University of Missouri at Kansas City. I have also been a visiting professor of law at Aarhus University in Denmark and a guest professor at Beijing University in China. I hold an A.B. degree from Stanford University and a J.D. degree from the Harvard Law School. My expertise is in environmental law and property law. I am the Chair-Elect of the Environmental Law Section of the Association of American Law Schools and a Fellow at the Schloss Leopoldskron Center in Salzburg, Austria. Also, I am a Scholar at the Center for Progressive Regulation (“CPR”).

CPR is a nonprofit research and educational organization of university-affiliated academics with expertise in the legal, economic, and scientific issues related to regulation of health, safety, and the environment, and rejects the conservative view that government’s only function is to increase the economic efficiency of private markets.

Through research and commentary, CPR seeks to inform policy debates, critique anti-regulatory research, enhance public understanding of the issues, and open the regulatory process to public scrutiny.

My testimony today concerns the Office of Management and Budget's Draft 2004 Report to Congress on the Costs and Benefits of Federal Regulations ("Draft Report")¹

The Draft Report raises issues in four broad areas. Briefly, the report:

- 1) estimates the total costs and benefits of federal regulation for the period 1993-2003;
- 2) discusses some of the international literature on the effects of regulation on national economic growth and suggests that as a general rule regulation hinders economic growth;
- 3) discusses the impact of federal regulation on manufacturers and on the economy; and
- 4) invites commentators to identify potential regulatory reforms concerning the manufacturing industry.

My specific conclusions about the Draft Report can be summarized as follows:

- 1) OMB's estimates of the costs and benefits of federal regulation are confusing, sometimes arbitrary, and often skewed against regulations designed to protect health, safety, and the environment.
- 2) OMB's review of the international literature on the effects of regulation on national economic growth is oversimplified and does not support the conclusions it draws.
- 3) OMB's public invitation to identify potential regulatory reforms concerning the manufacturing industry is not based on any evidence suggesting a need and suggests a bias against regulations designed to protect health, safety, and the environment.

¹ The 2004 Draft Report is available at <http://www.whitehouse.gov/omb/inforeg/regpol-reports_congress.html>.

Far from using cost-benefit analysis as a neutral tool to evaluate public policy (a task which I believe is probably futile), OMB instead uses cost-benefit analysis to attack regulations the administration does not like. Yet OMB has declined to employ cost-benefit analysis to evaluate policies (such as reforms of the “New Source Review” program) that the administration favors for other reasons. The point is not that cost-benefit analysis should be used more extensively—it should not be. But the administration’s double standard concerning cost-benefit analysis belies the objective purposes OMB has asserted in defending this type of analysis. Given the biases in the Draft Report, OMB’s incantations of “sound science” must be met with skepticism.

I. OMB’s Estimates of the Costs and Benefits of Federal Regulation

OMB’s estimates of the costs and benefits of federal regulation are confusing, sometimes arbitrary, and often skewed against regulations designed to protect health, safety, and the environment. Specifically, (1) OMB’s tables suggest comparisons among agencies and rules which the facts do not substantiate; (2) OMB arbitrarily minimizes regulatory benefits; (3) OMB arbitrarily excludes deregulatory actions from cost-benefit review; and (4) OMB arbitrarily excludes agency “transfer rules” from cost-benefit review.

A. OMB’s Tables Suggest Comparisons among Agencies and Rules Which the Facts Do Not Substantiate.

The Draft Report’s cost-benefit tables invite readers to compare efficiencies among regulatory agencies and among individual rules. Estimates for the Department of Health & Human Services, listed on Table 3, for instance, are meant to be compared with

those of the Departments of Labor or Transportation, which appear immediately below. Unfortunately, as OMB later admits, such comparisons are illusory.

In reality, the wide variations among agencies in their methodology, render comparisons across agencies virtually meaningless. OMB concedes that its data reflect troublesome variations, including, “different monetized values for effects, different baselines in terms of the regulations and controls already in place, [and] different treatments of uncertainty.” To choose just one example, OMB notes in Appendix A that some amortizations of aggregate benefits may reflect OMB’s preferred 7% discount rate, while others (when performed by the agency itself) may reflect a presumably lower rate. The difference is hardly trivial: the ratio between future benefits thirty years out, calculated using a 3% discount rate and a 7% discount rate is more than 3 to 1.²

It is true that OMB does not completely dismiss this point. Citing the many methodological variations, OMB warns that aggregate costs and benefits are “not strictly comparable.” But that, to put it mildly, is an understatement. Without any information about assigned monetary values and discount rates used for each rule, the figures are not comparable at all. Nor can OMB save face by suggesting that its tables are intended for “purposes of illustration” only. What valid relationship could these tables possibly illustrate? The comparisons cannot even show which rules save or cost more money than other rules, let alone by how much. They establish no relationship whatsoever between one agency or rule and another.

² For easy calculations involving discount rates, see Center for Progressive Regulation, “Honey, I Shrunk the Future,” Pricing the Priceless: Cost-Benefit Analysis of Health, Safety, and Environmental Protection, *available at* <http://www.progressiveregulation.org/perspectives/costbenefit.cfm> .

B. OMB Arbitrarily Minimizes Regulatory Benefits.

At times, OMB appears to present and shape its data in ways that arbitrarily downplay the benefits of regulations designed to protect health, safety, and the environment. Two examples make the point. First, in presenting estimates for “Light Truck CAFÉ for Model Years 2005-2007” (Table 4), OMB accepts cost and benefit estimates drawn from “a baseline of each manufacture’s production plans for a single model year.” Yet as it admits, this decision underestimates costs and benefits because manufacturers will almost certainly incorporate greater fuel economy standards early, in anticipation of increasing standards in the future. What OMB does not admit is that this behavior could, if its listed figures imply a trend, result in a greater ratio of benefits compared to costs. Thus, a decision to ignore the early compliance could result in a net omission of regulatory benefits.

OMB’s analysis of the “National Pollutant Discharge Permits and Standards for Concentrated Animal Feeding Lots” (Table 4) raises a similar point. The estimates of monetized costs and benefits appear roughly even, though the OMB notes that the monetized benefits do not include *all* of the predicted benefits which could have been monetized, such as “eutrophication and pathogen contamination of coastal and estuarine waters, reduced pathogen contamination of groundwater, reduced human and ecological risks from antibiotics, hormones, metals and salts, improved soil properties, and reduced costs of commercial fertilizers for non-CAFO operations.”

Yet OMB dismisses these omissions with a single sentence: “Only the first of these [eutrophication and pathogen contamination of coastal and estuarine waters] would likely significantly affect the benefits estimates if monetized.” This frail statement just

begs more questions. If the benefits of less eutrophication and water contamination are significant and can be monetized, why weren't they? How would the addition of this significant benefit affect the cost-benefit ratio? What does it mean to say that another unmonetized benefit would not "likely significantly affect" the benefits tally? Is it possible that the rest of the unmonetized benefits could, if monetized, "likely significantly affect" the benefits tally if *added together*? Such dismissals of regulatory benefits appear at best cavalier and, at worst, biased against public protection.

C. OMB Arbitrarily Excludes Deregulatory Actions from Cost-Benefit Review

This year, readers again look in vain for the many regulatory rollbacks that have so dominated the news in that last few years. By subjecting regulatory actions to cost-benefit review while allowing deregulatory actions a free pass, OMB shows a clear bias toward administrative rollbacks and against government intervention.

Surely the final rule on expedited appeals packaged within the so-called "Healthy Forest Initiative," and the Department of Interior's hardrock mining rules deserve the kind of regulatory scrutiny OMB gives to other regulatory initiatives. To its credit, OMB does mention in a footnote at least one deregulatory initiative, the EPA's Prevention of Significant Deterioration and Nonattainment New Source Review: Routine Maintenance and Repair Final Rule, an initiative it apparently has already reviewed. But it withholds its estimates on the grounds that the Court of Appeals for the District of Columbia has stayed its effective date. This excuse is unconvincing. OMB has in the past included

rules subject to legal challenge in its analysis.³ One would think OMB would have every interest in presenting its data on a high-profile initiative now under court review. Such withholding of data simply raises more questions about OMB's neutrality with regard to regulatory review.

D. OMB Arbitrarily Excludes Agency “Transfer Rules” from Cost-Benefit Review

The Draft Report does not report the costs and benefits of what it calls agency “transfer rules,” or rules that transfer money from the federal government to private parties. Indeed the Draft Report does not even list such rules if they were issued before October 1, 2002; it lists only such rules issued after that date. (Draft Report, Table 5). For transfer rules issued between October 1, 2002, and September 30, 2002, OMB provides only a brief description of the rules without any estimate of their economic costs or benefits. In its 2002 report to Congress, OMB explained why it had not analyzed the costs and benefits of transfer rules: “Rules that transfer Federal dollars among parties are not included because transfers are not social costs or benefits. If included, they would add equal amounts to benefits and costs.”⁴

The transfer rules listed in the 2004 Draft Report include many very expensive government programs. The money spent on these programs is, by definition, unavailable for other purposes. Such expenditures are opportunity costs in the classic sense. If, for

³ OFFICE OF MANAGEMENT AND BUDGET, STIMULATING SMARTER REGULATION: 2002 REPORT TO CONGRESS ON THE COSTS AND BENEFITS OF REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES, at Table 9 (hereinafter “2002 FINAL REPORT”) (listing costs and benefits of roadless area conservation area); *id.* at 104 (noting that the implementation of this rule had been enjoined by federal district court).

⁴ *Id.* at 36 n.30.

instance, the federal government chose not to spend an estimated \$1.2 billion⁵ to buy out peanut farmers' government quotas, that money could, presumably be used for something else. In OMB's 2003 final report, OMB states that one of its purposes in conducting cost-benefit analysis is to assess the opportunity costs of federal government programs.⁶ In addition, OMB's guidelines for cost-benefit analysis, issued last year, explicitly require agencies to assess the distributional effects of transfer payments.⁷ OMB's failure to consider the opportunity costs and distributional consequences of the transfer rules in Table 5 flouts OMB's own policy statements.

Further, OMB provides no principled definition of a transfer rule. Technically speaking, the transfer rules that lie outside the scope of conventional cost-benefit analysis are those rules that do not attempt to change, or have the effect of changing, the nature or level of economic goods or services provided by private economic actors. They simply transfer money from one entity to another after market actors have chosen the nature and level of goods and services to be provided.

The agency rules OMB includes within the category of transfer rules do not all meet this definition. For example, OMB includes as transfer rules agricultural subsidy programs that clearly affect the nature and level of agricultural goods provided in the United States. There can be little doubt, for example, that the agency rules associated with the 2003 farm bill's dairy-support program (Table 5) will influence the production

⁵ Environmental Working Group, Farm Subsidy Data Base, *available at* <<http://www.ewg.org/farm/progdetail.php?fips=00000&progcode=peanuts>>(using figures for 2002).

⁶ OFFICE OF MANAGEMENT AND BUDGET, INFORMING REGULATORY DECISIONS: 2003 REPORT TO CONGRESS ON THE COSTS AND BENEFITS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES.

⁷ *Id.*

of milk and thus affect the primary behavior of market actors. Yet OMB does not explain why these rules are “transfer rules” rather than rules that are properly subject to economic analysis. If the federal government chose to influence milk production through more conventional regulation – say, by tightening environmental standards for dairy farms – the costs associated with such regulation would appear in OMB’s cost-benefit tables. To characterize dairy-farm price supports as “transfer rules” simply because they influence market behavior by other means can only be described as arbitrary.

At the very least, OMB should: (1) provide a clear definition of the term “transfer rule”; (2) explain why the rules on Table 5 meet this definition; and (3) list the economic costs of the transfer rules it deems not subject to cost-benefit analysis, so readers can at least judge the relative expenses associated with the unevaluated transfer rules.

II. OMB’S USE OF INTERNATIONAL STUDIES TO QUESTION REGULATIONS DESIGNED TO PROTECT HEALTH, SAFETY, AND THE ENVIRONMENT

OMB attempts to make an international case for deregulation. First, it asserts that, globally speaking, economic growth is associated with less regulation. In support, OMB offers a preliminary report from the World Bank, a study from Canada’s conservative Fraser Institute, and a study co-authored by the conservative Heritage Foundation and the Wall Street Journal. OMB argues that the correlation between deregulation and economic growth forms, in fact, a causal relationship. Second, OMB suggests that its own regulatory agenda, described in its 2002 Final Report, matches “fairly closely” the pro-growth regulatory reforms praised in the World Bank’s preliminary report. Both claims have problems.

A. OMB's Review of the Literature is Oversimplified and Does Not Make the Case for Less Regulation in the United States.

OMB relies mainly on the World Bank report to conclude that national wealth, productivity, and employment rates are all positively correlated with less regulation. (It correctly faults the Fraser and Heritage-WSJ studies for failing to isolate the effects of regulation from other influential factors like trade policies.) The World Bank report examines “five of the fundamental regulatory aspects of a firm’s life cycle”: starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business. Describing the World Bank’s findings, OMB states:

Australia, Canada, Denmark, the Netherlands, New Zealand, Norway, Singapore, Sweden, the United Kingdom, and the United States, among the richest countries in the world, are the least regulated. The study also finds that common law and Nordic countries regulate less than countries whose legal systems are based on French, German, and socialist origins. (Draft Report at 30)

There are many problems with the use to which OMB would put this report. I will concentrate on four. First, these simple conclusions ignore other means of market interventions which some wealthy countries use in place of direct regulation. Denmark, a country praised in OMB’s Draft Report and in which I have lived, imposes heavy taxes on industrial practices disfavored by the government, particularly in pursuit of environmental protection. The same is true in Norway and Sweden. Yet in its use of such examples OMB does not appear to be advocating elaborate taxes to achieve the benefits of direct regulation.

Second, OMB appears to assume, without citing any persuasive evidence, that the rewards of “economic freedom” accrue equally at every stage of deregulation. This

defies common sense. No one can dispute that Bolivia, whose inhabitants are buried in a jungle of bureaucracy and red tape, would do well to take a machete to its regulatory programs. (See Draft Report at text accompanying note 13.) Bolivia and similar countries could make vast economic improvements by simplifying business regulations. Of course, as the World Bank suggests, regulations should allow for property rights, contract enforcement, and the like. But what does this say about the United States, a country that has guaranteed such rights since its inception? For wealthy countries already classified as “economically free,” the benefits (or costs) of each felled regulation are highly individualized. The World Bank’s study can do little to inform regulatory evaluations on the margin.

Third, and related to the point above, the World Bank study does not even concern itself with many of the types of regulations OMB is most concerned about. A careful look at the World Bank study shows that its broad, transnational comparisons rely on some startling assumptions. For instance, in comparing regulations affecting market entry, the World Bank assumes a business that, among other things, (1) “is not using heavily polluting production processes,” (2) is not subject to industry-specific regulations (such as many environmental regulations), and that (3) is operating in the country’s “most populous city.”⁸

Whatever the study says about regulation in general, its comparisons say nothing about heavily polluting industries, those subject to special rules, or those operating outside cities like Tokyo and New York. This point is key because wealthy countries are, perhaps, the most likely to have specialized rules, directed toward specific industries or

⁸ The World Bank Group, *Doing Business: Methodology—Starting a Business*, available at <<http://rru.worldbank.org:80/DoingBusiness/Methodology/EntryRegulations.aspx>>.

specific pollution threats; and their large industries are less likely to reside in their country's most populous city, which is likely to be dominated instead by the service sector.

Finally, OMB, as it so often does, mistakes wealth for well-being. The two should not be equated.⁹ Consider two possible measures of well-being, average infant mortality and average life expectancy at birth. While it is true that some "less regulated" nations, such as Sweden and Singapore, rank among the best in international comparisons, other less regulated nations, such as the United States, do not.¹⁰ Indeed the five OECD countries that OMB describes as having the most regulation -- Greece, Italy, Portugal, Ireland, and France -- *all* have lower infant mortality rates than the United States.¹¹ All of those countries, with the exception of Portugal, have higher average life expectancy figures too.¹² Among all nations, the country whose figures are among the

⁹ For more discussion, see Robert R.M. Verchick, *Feathers or Gold? A Civic Economics for Environmental Law*, 25 HARVARD ENVIRONMENTAL LAW REVIEW 95, 109-15 (2001).

¹⁰ Sweden's infant mortality rate of 3.42 deaths per 1,000 live births is the world's second lowest. U.S. CENTRAL INTELLIGENCE AGENCY, THE WORLD FACT BOOK, "Rank Order: Infant Mortality," (2003), *available at* <<http://www.odci.gov/cia/publications/factbook/rankorder/2091rank.html>> [hereinafter, "Infant Mortality"]. Sweden's average life expectancy at birth, 79.97, places it ninth in the world. U.S. CENTRAL INTELLIGENCE AGENCY, THE WORLD FACT BOOK, "Rank Order: Life Expectancy at Birth," *available at* <<http://www.odci.gov/cia/publications/factbook/rankorder/2102rank.html>> [hereinafter, "Life Expectancy"]. Singapore's infant mortality rate of 3.57 deaths per 1,000 live births is the world's fourth lowest. "Infant Mortality," *supra*. Singapore's average life expectancy at birth, 80.42, places it fifth in the world. "Life Expectancy," *supra*. The United States' infant mortality rate of 6.75 deaths per 1,000 live births is the world's forty-second lowest. "Infant Mortality," *supra*. The United States' average life expectancy at birth, 77.14, places it forty-eighth in the world. "Life Expectancy," *supra*.

¹¹ See "Infant Mortality," *supra* note 10.

¹² See "Life Expectancy," *supra* note 10.

closest to U.S. figures is Cuba, one of the most repressed and regulated nations on earth.¹³

My point is not that life in Sweden is the same as life in Singapore, or that life in America, for that matter is comparable to life in Cuba. Rather my point is that one cannot generalize among countries on any single axis without arriving at conclusions that often make one laugh. OMB should abandon its quest for a regulatory Theory of Everything, and instead focus on studies appropriately tuned to the effects of regulation in the United States.

B. OMB's Regulatory Agenda Does Not Follow from the World Bank Study

OMB apparently hopes to earn points for its own regulatory agenda by suggesting it matches the World Bank's recommendations "fairly closely." Indeed, it cites its own 2002 Final Report, Chapter 1 as evidence of its compatibility with World Bank analysis. This is, at best, a case of wishful thinking. The World Bank's preliminary conclusions – which are addressed to countries of all levels of wealth and with myriad forms of government – is pretty simple: avoid unnecessary interference with competitive markets, enhance property rights, expand technology, reduce court involvement in business matters, and make reform a continuous process.

Most Americans, including those at OMB, would no doubt agree that centralized management of the economy, especially when its intended

¹³ Cuba's infant mortality rate of 7.15 deaths per 1,000 live births is the world's forty-fourth lowest. "Infant Mortality," *supra*. Cuba's average life expectancy at birth, 76.8, places it fifty-first in the world. "Life Expectancy," *supra*. For U.S. figures, see *supra* note 10.

effect is to shield business from competition, is not a good idea. But OMB's regulatory agenda, as expressed in the 2002 Final Report, recommends something very different. OMB's report prominently argues for strongly centralized regulatory oversight, a Baroque system of outside peer review, and an expanded bureaucratic staff.¹⁴ These elements, of course, are not recommended in the World Bank Report. Indeed some of the OMB's agenda appears at odds with the World Bank's general injunction against unnecessary bureaucracy and red-tape, to which the OMB's own system of review contributes.¹⁵

III. OMB'S PUBLIC INVITATION TO IDENTIFY POTENTIAL REGULATORY REFORMS CONCERNING THE MANUFACTURING INDUSTRY

OMB invites comments on regulatory reforms concerning the manufacturing industry. Specifically, it seeks proposals that might reduce unnecessary costs, increase effectiveness, enhance competitiveness, reduce uncertainty, and increase flexibility. Yet OMB makes no case that current regulations significantly contribute to unnecessary costs, ineffectiveness, losses in productivity, or inflexibility. OMB is peddling a solution (deregulation) in search of a problem. What accounts for this? According to OMB it is because manufacturing industry is heavily regulated. But many industries are.

OMB would do better to invite comments on regulations that could address problems that we *know* we have. We know that greenhouse gases, unregulated under

¹⁴ 2002 FINAL REPORT, *supra* at note 3, chap. 1.

¹⁵ For more on OMB's increased, centralized power, see *See* FRANK ACKERMAN & LISA HEINZERLING, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING 42, 110-11, 168-69, 195, 207-08 (2003).

federal law, threaten America's future health, productivity, and even national security.¹⁶ We know that asthma, a disease related to urban air pollution, has become the number one childhood illness in the United States.¹⁷ We know that sewage pollution costs Americans billions of dollars annually in medical care, lost productivity, and property damage.¹⁸ Yet on these subjects, OMB remains silent. Regulations protecting health, safety, and the environment are vital to our nation's interests. OMB should not downplay this truth any longer.

¹⁶ See Mark Townsend and Paul Harris, *Now the Pentagon Tells Bush: Climate Change Will Destroy Us*, GUARDIAN (U.K.), Feb. 22, 2004, available at <<http://www.guardian.co.uk/usa/story/0,12271,1153531,00.html>>.

¹⁷ EnviroHealthAction, Children's Environmental Health, available at <<http://www.envirohealthaction.org/children/asthma/>>.

¹⁸ Natural Resources Defense Council, Press Release, Aging U.S. Sewer Systems Threaten Public Health, New Report Finds, available at <<http://www.nrdc.org/media/pressreleases/040219a.asp>>