

**STATEMENT OF WILLIAM L. KOVACS
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BEFORE THE
SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND
REGULATORY AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
ON THE SUBJECT OF THE DRAFT 2004 OMB ANNUAL REPORT TO CONGRESS
ON THE COSTS AND BENEFITS OF REGULATIONS
FEBRUARY 25, 2004**

Mr. Chairman and members of the subcommittee, thank you for inviting me to this hearing to discuss the *Draft 2004 OMB Annual Report to Congress on the Costs and Benefits of Regulations* (draft report) and how to improve regulatory accounting. I am William Kovacs, Vice President of Environment, Technology and Regulatory Affairs for the U.S. Chamber of Commerce (U.S. Chamber). The U.S. Chamber is the world's largest business organization representing more than three million businesses of every size, sector, and region. More than 96% of our members also qualify as small businesses.

The U.S. Chamber cares deeply about the regulatory process including cost-benefit analysis and the accounting methods used to assess it, because the costs and impacts of regulations on the nation's economy are staggering. In 2003, federal discretionary spending was \$825 billion, and the total of all individual income taxes paid in 2002 was \$1.037 trillion.¹ Compare these two observations with the annual cost of *all* federal regulations, which are presently estimated at about \$843 billion.² As another measure of comparison, the annual cost of

¹ *Treasury Department Gross Tax Collections: Amount Collected by Quarter and Fiscal Year, 1987–2003*. SOI Bulletin, Historical Table. Excel ver. 4. Issued Quarterly, Internal Revenue Service, Statistics of Income Division. [See Table 8.7 - Outlays for Discretionary Programs: 1962–2009; Budget of the United States Government--Fiscal Year 2005, Historical Tables.]

² W. Crain and T. Hopkins, *The Impact of Regulatory Costs on Small Firms*, Report RFP No. SBAHQ-00-R-0027 for The Office of Advocacy, U.S. Small Business Administration (July 2001).

environmental regulation is about \$197 billion³, while the total of all corporate income taxes paid in 2002 was \$211 billion⁴. The role of the Office of Management and Budget's (OMB), Office of Information and Regulatory Affairs (OIRA) in seeking to improve regulatory actions therefore has great significance to the business community and to small business in particular, since federal regulation costs small business \$6,975 per employee, almost 60% more per employee than a large company⁵.

Administrator John Graham and his OIRA staff are performing admirably in advancing the discussion of how to ensure that regulations are based on reliable information. The undertaking is also critical to establish the soundness, usefulness, and effectiveness of regulations. The U.S. Chamber encourages OIRA to continue with this effort and seek further improvements in the regulatory assessment process.

In simple terms, cost-benefit analyses are used to help determine if a particular regulatory action is worth the expenditure of public and private resources in relation to the benefits to be received. A reliable assessment that uncovers the advantages (or disadvantages) of regulatory options is essential when funding and other resources are limited, as they are in the real world. While U.S. Chamber policy recognizes that federal regulations play an important role in assuring public health, safety, and protection of the environment, the U.S. Chamber also believes that rules and standards must be based on scientifically sound, transparent, and peer-reviewed science. Moreover, federal agencies must utilize appropriate risk assessment and management protocols in developing their regulatory programs. This approach, along with reliable cost-benefit analyses should be used to prioritize regulatory objectives, identify appropriate regulatory options, and target resource allocations to address the most important

³ *Ibid*; Page 25.

⁴ Footnote 1. *Ibid*.

⁵ Footnote 2. *Ibid*. Page 3.

problems. Without such informed prioritization it will be difficult to ensure that the greatest public benefit will be achieved in the most efficient manner. Cost-benefit analysis, therefore, is not an end in itself. Rather, it is one of several decisional tools that policymakers must rely upon to assess regulatory options. In this respect, we are encouraged by OMB's effort to improve the cost-benefit methodology used by government agencies.

Each of OIRA's Annual Reports to Congress has been an improvement over the preceding year's report. The latest revision to OMB Circular A-4, Regulatory Analysis (September 17, 2003), represents a significant step forward by providing uniform guidance to all federal agencies for the development of cost-benefit analyses. In addition, OIRA's Information Quality Guidelines, as well as its recently proposed Peer Review Bulletin, will provide the foundation needed for developing methodologies that allow us to develop more reliable cost-benefit analyses, and are necessary for ensuring that government decisions are sound, transparent, and open to the public.

The U.S. Chamber is not opposed to regulations per se and recognizes that many regulations are sound, sensible, and well founded. In fact, in many instances, regulations function as good business practices. That observation notwithstanding, because aggregate regulatory costs are so enormous, it is absolutely essential that federal agencies fully understand the real world costs and benefits of their regulatory actions and that resource expenditures be prioritized so that we as a nation achieve the maximum protection of human health and the environment with the public and private funds expended. As one of the tools needed to accomplish this task, cost-benefit analysis methodology must be made as reliable as possible.

THE CURRENT PROCESS IS COMPLEX AND CONFUSING TO THE PUBLIC

Unfortunately, measuring the costs and benefits of regulations is an extremely difficult and complex undertaking. Consequently and not surprisingly, many stakeholders have expressed various concerns about OMB's Annual Report to Congress, its regulatory accounting methodology, and Circular A-4.

One criticism is that the economic modeling methodology used for assessing the costs and benefits of regulations, especially in the aggregate, is inadequate and does not present the public with a reasonable and true account of the costs of regulatory impacts. The Crain and Hopkins study commissioned by the Small Business Administration's Office of Advocacy is widely cited in support of this observation.⁶ While Crain and Hopkins conclude that the true cost of *all* federal government regulations was an estimated \$843 billion in 2000, OMB, which examines only a few major regulations, concludes that regulatory cost burdens are much smaller, for example only about \$1.9 billion in fiscal year 2003 for the six major regulations examined. These numbers are difficult to compare, as they are derived from different bases (all regulations versus a few major regulations) and in different timeframes. However, differences in accounting methods notwithstanding, the "message" that is conveyed to the public about the size of regulatory impacts is very misleading. Certainly there is little doubt that there is a large discrepancy in the information that has been developed, and much public confusion as a result. OMB must resolve this issue in a manner that clarifies any uncertainties. If it does not, then neither Congress nor the public will be able to fully appreciate the true cost impacts of federal regulations on business and industry.

Organizations such as the AEI-Brookings Joint Center for Regulatory Studies and the Mercatus Center at George Mason University have made similar observations. These groups

⁶ *Ibid.*

have concluded that assessment approaches and modeling methodologies must be further improved to reliably and transparently calculate the cost-benefit impacts of government regulations. Absent such an initiative, stakeholder confidence in cost-benefit estimates will be weak, and rightly so. The lack of reliable modeling methodologies has resulted in extremely wide cost-benefit disparities between studies, and the disparities can be so great that they can literally render the results so subjective as to be useless.

Another concern is that OMB's Report only provides a "snapshot" of certain regulatory costs and benefits, mainly those associated with major rules and regulations, and at that, only a few of these are in fact considered in any great detail. For example, OMB's 2004 draft report is based on individual agency cost-benefit estimates for only six major regulations out of a total of 37 "major" rules reviewed by OMB. These six comprise less than one percent of all the final rules that were established by the U.S. government during the preceding 12-month period. This situation is particularly troublesome, because as OMB notes, the *...total costs and benefits of all Federal rules now in effect (major and non-major, including those adopted more than 10 years ago) could easily be a factor of ten or more larger than the sum of the costs and benefits reported...*⁷

LACK OF CONSISTENCY, BENCHMARKING, AND COMPREHENSIVENESS

Furthermore, neither OMB nor government agencies have made any significant attempt to retrospectively re-assess initial cost-benefit projections. As a result, OMB's reported information, which is based on agency projections of costs and benefits, is not benchmarked against what actually occurred after the regulations were implemented. This is an unacceptable situation. At a minimum, government agencies should be required to periodically revise and recalculate their earlier estimates based on what actually occurred after regulations have been

⁷ Draft 2004 OMB Report to Congress on the Costs and Benefits of Regulations, page 6.

implemented. Such an undertaking could perhaps be limited in the future should such recalculations convincingly demonstrate that original cost-benefit estimates in fact presented reasonable approximations of what actually transpired once the regulations were implemented.

As a further consideration, some methodological approach should be established that can enable OMB to more reliably gauge the impact of all federal rules that are in effect, not just those major rules promulgated over the previous ten years or some other arbitrarily established timeframe that fails to capture the full cost and benefit impacts of regulations on the public. The assertion that rules promulgated more than ten years ago are not presently of significant consequence should be convincingly demonstrated and not just stated as a matter of fact.

An additional concern is that many so-called “minor” rules might in fact really be “major” in their impact. Despite this possibility, OMB excludes cost and benefit estimates for all “non-major” rules. Is this a problem? It may be, but this is not clear at present. For one thing, it is the individual government agencies themselves that determine, absent oversight, which rules are “major” and therefore require preparation of a regulatory impact analysis. How, under these circumstances, can the public have any confidence in the assessed impacts? Are some agencies “gaming” the system, for example, by purposefully understating costs or benefits of proposed regulations to avoid having to perform a regulatory impact analysis? An example of an agency gaming the system is the U.S. Environmental Protection Agency’s (EPA) determination that its extremely controversial Total Maximum Daily Load (TMDL) standard only had an annual impact of \$25 million⁸; yet state studies estimated the cost of implementing the TMDL standards at \$670 million to \$1.2 billion annually⁹. It will take more than 15 years to complete the

⁸ 64 *Fed. Reg.* 46043 (August 23, 1999).

⁹ Testimony of David Holm, President, Association of State and Interstate Water Pollution Control Administrators before the House Subcommittee on Water Resources and the Environment, Page 3 (February 10, 2000).

estimated 40,000 TMDLs that would have to be performed, so there are likely comparable recurring costs in this time period.

Another way agencies avoid the preparation of regulatory impact analyses altogether is by proposing de facto regulations through the issuance of guidance documents, or by using consent decrees to avoid rulemaking procedures and OMB or public scrutiny. A good example of this “guidance” problem is EPA’s Environmental Justice Program, which establishes an entire administrative program that is spelled out through guidance documents.¹⁰ This problem is rampant throughout the federal government, with agencies such as EPA and the Occupational Safety & Health Administration (OSHA), in particular, issuing countless numbers of guidance documents in lieu of regulation. Between March 1996 and October 2000, EPA issued 2,653 guidance documents, and OSHA issued 3,374 guidance documents.¹¹ Not all guidance documents act as regulations, but the sheer numbers issued by agencies become a vehicle for avoiding the preparation of cost-benefit analyses. Unless questions such as these can be answered now, closer scrutiny of regulatory practices at individual federal agencies is warranted.

Equally problematic, the various government agencies use manifold different cost-benefit assessment methods. As a result, it’s fair to say that OMB finds itself in the difficult position of comparing apples and oranges, again making the public highly suspect of reported aggregated cost-benefit estimates. OMB’s revised Circular A-4 may improve this situation, especially by promoting transparency, ensuring more consistent practices across federal agencies, and allowing better cross agency comparisons. Such efforts aimed at improving the

¹⁰ W. Kovacs, U.S. Chamber of Commerce, “Comments to the Office of Management and Budget (OMB) concerning OMB’s Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations” (May 5, 2003).

¹¹ *Non-Binding Legal Effect of Agency Guidance Documents*, Seventh Report by the Committee on Government Reform, House Report 106-1009, U.S. House of Representatives (October 26, 2000).

inter-consistency of the individual government agency cost-benefit assessments should be encouraged.

NEED FOR SOUND SCIENCE AND RELIABLE ASSESSMENT METHODOLOGY

Underlying all these expressed concerns is the need for sounder science and improved modeling methodology. Although OMB has made great strides in this area, much progress remains to be accomplished. Too many regulatory actions are still based on unsound data, poor analyses, and use of inadequate scientific and economic modeling methods. Given the great magnitude of aggregate regulatory cost estimates, this is an intolerable situation.

As but one example, EPA's regulatory activities aimed at addressing fine particulate matter encompass the major portion of the costs and benefits included in OMB's aggregated estimate of the impact of regulations promulgated over the past decade. That this is true is particularly alarming, as there is persuasive evidence that the underlying science of particulate matter does not support EPA's regulatory stance. This observation has most recently been brought to the fore in a peer-reviewed science journal article written by academic researchers Gary Koop and Lise Tole of the University of Leicester, Leicester, UK¹². In their article entitled, *Measuring the health effects of air pollution: to what extent can we really say that people are dying from bad air?*, the authors conclude that uncertainties about air pollution-mortality impacts are so large as to question the plausibility of previously measured links between air pollution and mortality.

A key assumption made by EPA in its cost-benefit analysis of the regulatory impact of its environmental regulations is that inhalation of fine particles is *causally* associated with a risk of premature death at concentrations near those experienced by most Americans on a daily basis.

¹² G. Koop and L. Tole, *Measuring the health effects of air pollution: to what extent can we really say that people are dying from bad air?*, *Journal of Environmental Economics and Management*, Vol. 47, 2004, pp. 30-54.

If in fact, however, there is no plausible link, one has to wonder in all seriousness about the veracity of EPA's fine particulate matter cost-benefit estimates, which are far from inconsequential. For example, in the past decade, 60 percent of all the benefits and costs of all the major federal rules analyzed by OMB in its annual reports to Congress are accounted for by major rules issued by EPA, and it should not go unnoticed that the majority of the benefits calculated by EPA derive from reductions in exposure to particulate matter.

Simply put, the public and regulators must establish and incorporate an improved understanding of the influence of uncertainties in both risk and cost-benefit impact analyses. The U.S. Chamber made more extensive comments concerning this specific issue to EPA in January, noting especially EPA's marked bias in its treatment and assessment of scientific information concerning particulate matter. In sum, the U.S. Chamber firmly believes that sound science, quality data, reliable environmental and economic modeling methodologies, and transparent weight-of-evidence techniques must be used in assessing health impacts. Without such underlying attention to scientific details, cost-benefit estimates are doomed to fail.

COST/BENEFIT ANALYSIS MUST CONSIDER LOST OPPORTUNITY COSTS

Another concern is that current cost-benefit analyses do not address what societal needs are ignored when a decision is made to implement a regulation. Consider, for example, a hypothetical decision to implement a regulation aimed at reducing carbon dioxide emissions by limiting the use of carbon-based energy resources. One may rightly ask, will making this decision to have a carbon-free energy environment result in the diversion of resources from other initiatives, such as for pre-natal health screenings, medical treatment for the uninsured, medical or biotechnology research, or toward progress in developing advanced materials or communications systems? Clearly, the use of funds to accomplish specific regulatory objectives

can have unintended consequences, such as benefits not realized. This problem must be addressed and points to the need to *prioritize* regulatory objectives based on a balanced assessment of the benefits and costs of *all* regulatory options.

Simply put, the public will be best served when it gets the most bang for the bucks that are expended. This will be accomplished when those regulations that are implemented are in fact those regulations that are really needed, and when those regulations that are implemented are those regulations that are the most efficient and have the least amount of unintended consequences.

A REGULATORY ACCOUNTING PILOT STUDY IS ADVISABLE

The Chamber recommends that Congress begin to address some of the above noted issues and concerns by funding a pilot study program aimed at assessing how to improve cost-benefit impact assessment methodologies and to integrate these improved assessment approaches into the consideration of, and establishment of, regulatory and budgetary priorities. This undertaking should be fully transparent and subject to open peer-review. Given the likely complexities of such an undertaking, perhaps only one or two specific areas impacted by regulatory activity should be addressed, such as workplace safety, air quality, or technology development.

Relevant to and in support of this proposed initiative, various institutions and think tanks, as well as some federal government agencies, have already conducted, or are conducting, detailed studies of the costs and benefits of regulatory programs. These undertakings should all be made fully transparent and publicly available to stimulate further public awareness and debate in this area. In particular, it is essential that the public and government agencies gain an improved understanding of the risks of regulatory options, how they are influenced by

uncertainties, and how this information can be better used to craft and use improved cost-benefit assessments to prioritize regulatory and budgetary initiatives.

At the end of the day, the public has a right to an honest assessment of regulatory options. Every private or corporate dollar spent on an unnecessary regulation is one that could instead have gone toward providing workers with better wages, better pensions, or improved health care. Likewise, public dollars spent on developing and enforcing ill-founded regulations are dollars that could have been used on improving medical research, education, or transportation infrastructure.

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Finally, the Chamber is grateful to have this opportunity to present its recommendations for your consideration concerning *Draft 2004 OMB Annual Report to Congress on the Costs and Benefits of Regulations* and how to improve regulatory accounting. During its debate over the nature of cost-benefit analyses and accounting methods Congress has a significant opportunity to identify measures that can strengthen and improve regulatory assessment procedures and their application in a manner that can provide greater and more efficient protection of human health and the environment while doing so in a cost-effective, scientifically sound, prioritized manner. The Chamber appreciates being able to be a part of this debate.