U.S. House Committee on Science, Space, and Technology

Hearing: "Making EPA Great Again"

February 7, 2017

Questions and Responses for the Record

Submitted February 23, 2017

1. **"EPA will often bury the costs of its regulations while inflating benefits. Do you think it would improve regulations if EPA were more transparent in its benefit-cost analyses?"**

Every agency, including but not limited to EPA, has powerful incentives to understate costs and overstate benefits. I saw this routinely during my tenure at the Office of Management and Budget, and I have seen it routinely since I left OMB in 1998 – nineteen years ago.

The reason is very simple. Agency analysts (and their contractors) work for the program offices that have decided to propose or promulgate a regulation. Regardless of their education, training, skill or intellect, the analysts' job is to provide an economic justification for what program managers want to do. If analysts fail to support program managers, they will be denied promotion and encouraged to resign (and if they are contractors, they will not be rehired). Program managers may not have to work very hard to secure analysts' cooperation, either. Analysts (and contractors) are recruited with a keen eye for candidates who are comfortable with this role.

There is a "market" for benefit-cost analysis in regulatory decision-making. On the demand side, there are agency program managers, agency lawyers, agency appointed leadership, OMB and the rest of the Executive Office of the President, Congress and the public. Agency program mangers hire the analysts who prepare regulatory benefit-cost analyses, so they have functional control over supply as well as demand.

From the perspective of agency analysts, by far the most important of these "customers" are agency program managers. They want benefit-cost analyses showing substantially greater benefits than costs, and often they do not care what analysts must do to achieve this. An agency economist once told me that his job was to find three times as much in benefits as he found in costs. His work was not complete until he had done so, and if he failed to accomplish

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this objective, he'd be relieved of his duties and replaced with someone who could succeed, by hook or by crook. Needless to say, this environment is not conducive to honest work.

In short, there is a market failure in the production of regulatory benefit-cost analysis. For many market failures, government can, through regulation, play a decisive role by providing what the market will not. But the market for regulatory benefit-cost analysis is unlike all private markets. The government cannot solve by regulation a problem of its own creation. An agency is both the sole buyer and the sole seller of a regulatory benefit-cost analysis. This enables agency program managers to choose whatever level of quality they want. If they expect to have to defend a regulation in court and high-quality analysis is required by law, program managers will set and ruthlessly enforce high quality standards. But if they expect not to be challenged in court, or if they expect courts will defer to them on matters of analytic quality, then program managers will choose the lowest level of quality sufficient to satisfy an undemanding judge.

Transparency is a key attribute in regulatory benefit-cost analyses, but whether it's a desirable or undesirable attribute depends on whose interests are considered. It's certainly ironic that agencies practice transparently rarely, but they demand it without reservation from those they regulate. Transparency is a highly undesirable attribute from the perspective of many agency program managers, and oftentimes agency appointed leadership as well. During my years at OMB, I sought to improve transparency at every opportunity. However, I encountered implacable resistance from agency program managers. I also encountered resistance from agency lawyers, for whom transparency threatened to undermine their ability to defend agency actions in court.

Congress can try to mandate transparency through legislation, but it appears to be impossible to directly overcome the myriad internal agency incentives arrayed against it. An information quality approach is more likely to be successful. That is, Congress can act to reward agencies that rely on transparent regulatory benefit-cost analyses. Congress would need to create a straightforward legal pathway whereby an agency's lack of transparency (and failure to adhere to substantive information quality standards, such as objectivity) is justiciable in federal court. To further reward agencies that are transparent, Congress should consider making prospective litigants eligible to recover their attorneys' fees if they prevail. And, if Congress really wants to encourage transparency, it could direct that attorneys' fees be paid from the agency's budget rather than the Treasury Department's Judgment Fund. (Agencies do not care about the award of attorneys' fees if they are paid by the Judgment Fund.)

Agencies can be rewarded for practicing transparency other ways, as well. For example, an agency seeking constructive input from the public would publish an Advanced Notice of Propose Rulemaking well before it is ready to publish a proposal. That ANPRM would be accompanied by a transparent preliminary analysis of benefits and costs. If public review led to

a consensus that effects are unlikely to exceed $100 million in any one year, then Congress could exempt the agency from performing a benefit-cost analysis along with a proposed rule (unless, of course, the proposed rule was materially different).

Agencies that fully disclose all their data, assumptions, models and the like could be rewarded even more. First, they would save money by enabling interested parties to prepare benefit-cost analyses for them. While competing interests might produce significantly different work products, they would be held to the same transparency and information quality requirements. Agencies could summarily discard third-party analyses that are not transparent or fail to comply with key information quality principles, such as objectivity. (Agencies that relied upon substandard third-party analyses would face serious legal risk.)

Second, agencies would be able to promulgate higher-quality regulations – regulations that achieved their statutory purposes cost-effectively. This would significantly reduce public controversy over rulemaking, which would benefit almost everyone. That includes a reduced propensity to litigate final rules and a greater likelihood that agency actions would withstand judicial review.

2. **"OMB issues guidance like "Circular A-4" on how agencies should perform benefit-cost analyses for regulations. How well has EPA adhered to such guidance? Do you have any other advice and thoughts?"**

Circular A-4 is generally not a helpful guidance document. It provides too little guidance for agency analysts who need help, and it imposes only a minimal barrier to agency analysts who willfully violate the established norms of benefit-cost analysis.

To give an obvious example where many agency analysts likely need help, Circular A-4 mentions "opportunity cost" 13 times. This is the fundamental principle of cost assessment. Circular A-4 correctly states that cost is properly measured in terms of the value of benefits that must be foregone in order to pay for a regulatory requirement. But the Circular provides little assistance to agency analysts who want to know how to do this. Guidance that correctly identifies the destination but omits any discussion about which highway to take (and where the potholes are located) is not particularly helpful.

Experienced agency analysts understand the opportunity cost principle, but they are free to ignore it without penalty. That's because nothing in Circular A-4, no matter how elementary or critical the provision, is actually required. Three hundred seventeen times, OMB says agencies "should" do something. As every regulator knows, "should" is hortatory and "must" is mandatory.

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Because Circular A-4 is so limited, some agencies have developed their own guidance. EPA, for example, has its own guidance, and it is a much richer and more complete work.[1] That's not to say the EPA guidance is technically superior on key principles; rather, the EPA guidance simply provides EPA analysts with much more guidance. (Problems arise where Circular A-4 and EPA's guidance conflict. In those cases, EPA analysts can be expected to treat the Agency guidance as mandatory and Circular A-4 as hortatory.)

Circular A-4 is out of date, having been published in 2003, and a case can be made that it needs a thorough updating. Whether this should be done deserves a benefit-cost analysis. On the cost side, the OIRA staff is very limited and fully occupied with other tasks, most notably implementing Executive Order 13771. Right now, what agencies need most from OMB is guidance on the estimation of cost savings from the deregulatory actions agencies are required to undertake pursuant to § 2(c), and which § 2(d) appears to direct OMB to prepare and issue. Redirecting scarce OIRA resources to revising the existing text of Circular A-4 therefore has high opportunity costs. On the benefit side, the potential value of revision to regulatory decision-making is unclear. OMB's authority to enforce Circular A-4 is delegated by the President. If President Trump wants OMB to rigorously enforce Circular A-4, OMB will do so.

When OMB began providing agency guidance on benefit-cost analysis in 1990, the available literature was not nearly as extensive as it is today. Agency analysts seeking high-quality guidance may be better served by consulting this literature. There are dozens of textbooks available for general use, and a rich scholarly literature is available to offer valuable insights on complicated issues or unique applications. On behalf of the Society for Benefit-Cost Analysis (benefitcostanalysis.org), Cambridge University Press publishes a scholarly journal (cleverly titled *Journal of Benefit-Cost Analysis*). The Society hosts scholarly meetings where agency analysts can learn from experts and present their own work. (The 2017 annual conference will be held March 15-17 at George Washington University, so few agency analysts are impeded from attending due to limited travel funds.) Another useful source of advice comes from a group of 19 (!) experienced analysts who recently published a *Consumer's Guide to Regulatory Impact Analysis*, which is undergoing peer review by the Journal of Benefit-Cost Analysis.

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[1] See U.S. Environmental Protection Agency. 2016. Guidelines for Preparing Economic Analyses. Available: https://yosemite.epa.gov/ee/epa/eerm.nsf/vwAN/EE-0568-50.pdf/$file/EE-0568-50.pdf [accessed February 23, 2017]. While the length of a document is not always a good proxy for quality, it is worth noting that Circular A-4 is 48 pages long and EPA's guidance is 302 pages long.

Agency adherence to Circular A-4, or more generally to accepted principle and practices in benefit-cost analysis, has been problematic for the reasons I explained in my answer to Question 1, and because presidential authority for enforcement has waxed and waned. To the extent that EPA has not complied with Circular A-4, it is because OMB has not enforced it administratively. Because it is guidance, it would be inappropriate for the courts to enforce it legally.

Congress can accomplish a great deal by requiring agencies to perform benefit-cost analysis, and creating incentives for them to comply. Congress does not necessarily need to legislate benefit-cost principles, and it should not legislate by reference a particular external authority such as Circular A-4 or ask the National Academy of Sciences to opine. The most important thing Congress can do is to incentivize compliance by making noncompliance a legally vulnerable position. Agencies should not be legally able to rely on analyses that are not transparent (i.e., they cannot be reproduced by qualified third parties) or objective (i.e., free of embedded policy preferences).

Finally, without reforms like this Congress cannot be assured of having before it the best available record of the benefits, costs and other effects of regulation. Congress needs this information, when it considers Joint Resolutions for Disapproval under the Congressional Review Act, of which by my count 48 have been introduced so far this session. Congress would need accurate information much more if it enacted H.R. 26 ("Regulations from the Executive in Need of Scrutiny Act of 2017"). Otherwise, Congress would be ill-advised to rely on the benefit-cost analyses that agencies would submit pursuant to proposed § 801(a)(1)(B)(i).

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