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“Amending Executive Order 12866: Good Governance or Regulatory Usurpation?”

Mr. Chairman and members of this subcommittee, I appreciate this opportunity to share with you some observations on the Bush Administration’s amendments to Executive Order 12866, particularly Executive Order 13422. I have studied and taught administrative and environmental law – and regulatory policy – for over a decade; published articles in leading scholarly journals on the subject of OIRA review and the use of cost-benefit analysis; and benefited from sustained participation in work of the Administration Law Section of the ABA, where I have co-chaired both the Regulatory Policy Committee and the Committee on e-rulemaking. I have served as Special Counsel to the Deputy Administrator of EPA during the Clinton Administration and as Assistant General Counsel of USTR. And I practiced administrative law in the private sector. So I have had a chance to observe these issues from a number of different vantage points. My remarks today represent, of course, my own view of the matter.

Is EO 13422 good governance or regulatory usurpation? The answer to that all depends on whether you buy the premises – the theory of government – that animates it and that animated its forebears, the Reagan/elder Bush Executive Orders and EO 12866 itself. These Executive Orders embody a view of our executive agencies that is deeply skeptical of their competence, and certainly of their even-handedness. Certain regulatory agencies – particularly those in the field of health, safety and environmental regulation – are thought to be tunnel-visioned; obsessively focused on regulation regardless of cost; and unaccountable to the people. They need to be reined in and OIRA is just the agency to come to the rescue. OIRA will impose a broad perspective which once had been narrow; require cost-benefit analysis to force a more rational and even-handed balancing of costs and benefits in regulation; and bring political accountability to a process that otherwise would operate without popular or political check.

If you buy this vision, then EO 12866 is the order for you, and if you further buy that guidance documents are first and foremost tools of choice for agencies intent on exploiting “loopholes” to avoid the rationalizing benefits of OIRA review in the rulemaking process then EO 13422 is likewise for you.

But it is view right? Is it based on rigorous empirical observation and sound science? Or is it more like the widespread belief in Iraqi weapons of mass destruction circa 2003 – immensely plausible, boasting bipartisan support, but somehow a bit lacking in the evidence department? I investigated these questions systematically in two major articles, one published in the University of Chicago Law Review and the second in the Administrative Law Review. They

are long articles and I can only summarize them briefly here; but the main themes are clear.

Let's begin by clearing away some underbrush – an activity that now has strong bipartisan credentials. Regulatory critics such as the Mr. Kovacs who testified before this subcommittee in February not uncommonly point to the size of the Federal Register and the number and cost of rules as evidence of the “overwhelming regulatory burden” our industries face. 73,000 pages of Federal Register! 4000 new regulations each year! \$1.13 trillion cost! Horrors!

In fact, any perusal of the Federal Register quickly reveals that new rules comprise only a small fraction of its pages. Moreover, even the new rules published in the Federal Register typically consist of roughly 20 pages of preambular explanation for every page of rule. These 20 preambular pages are actually explanations and defenses of the rule, along with detailed responses to comments from the public that can run to the tens of thousands. Far from adding to burden, agency explanations lighten the load by easing understanding of the basis and purpose of the rule being proposed or promulgated. But they do add length to the Federal Register.

As for the rules themselves, length should not be confused with burdensomeness. Congress could reduce the environmental statute books (now 2 inches thick) to one line: “Thou shall not pollute.” Does anyone truly believe that this would make regulation less onerous? Much of the length and complexity of modern rulemaking stems from the desire to make it reasonable, not from some tunnel-visioned attempt to make it harsh.

Admittedly, four thousand rules per year does seem like a lot, at first blush. But a sophisticated user of numbers will ask, is this really a large number – given our \$12 trillion economy and population of 270 million, not to mention millions of businesses spanning hundreds or thousands of different kinds of activity? Remember also that it takes a regulation to ease a regulation. It takes a regulation to alter so much as a comma in a prior regulation. Many regulations are minor and technical. Others make changes in the direction of providing greater clarity or greater leniency. This being so, the mere number of “regulations” in itself tells you nothing meaningful about regulatory burden.

And what of the alleged \$1.13 trillion cost? That figure, if accurate, is a large figure even when viewed in context of our more than \$10 trillion economy. But that number comes not from OMB but from the Small Business Administration and I wonder whether it has been rigorously peer reviewed. The numbers I have seen commonly range from \$200 billion to \$700 billion, and even those numbers are derived not from actual measurements but from ex ante predictions of cost often supplied by industry. Moreover, most of these costs are accounted for by a relative handful of rules that also bring with them enormous benefits: like water safe to drink, air safe to breathe. No credible study yet done – even by OMB – has yet concluded that the net benefits of rules as whole are negative. In fact, all observers concede that benefits of regulations greatly outweigh their costs

overall. So what are we to make of the allegedly exorbitant aggregate burden of regulation?

Michael Porter of Harvard Business School is one of many prominent scholars who have joined leading businesses like 3-M and Dupont in pointing out that regulations don't just add costs. Regulations can create lucrative markets, promote technologies, build industries and enhance American competitiveness in producing the goods and services of tomorrow. Many companies discover important new money-saving efficiencies in the course of auditing their production process to comply with regulations. Yet *none* of these countervailing economic benefits of regulation are factored into (or subtracted from) the gloom-and-doom cost estimates that are routinely bandied about by leading regulatory critics.

In short, the case for more searching OIRA review cannot be made credibly by throwing out Federal Register page counts, or by tossing out aggregate cost statistics that are exaggerated and then offered in isolation without the context of their benefits. There is a need for sound science in regulatory criticism as well as in regulation itself.

If Federal Register page counts, and aggregate cost quotes do not make the case for the necessity and value of ever-expanding OIRA oversight, what then does?

My in-depth research of this question reveals that for decades, scathing critiques of government have been fueled by a stream of horror stories which are typically unverified and many (though not all) of which turn out, on inspection, to be either exaggerated, atypical or just plain false. My University of Chicago article offers a few anecdotes to illustrate the pitfalls of legislating by anecdote.

Secondly however, and much more importantly, regulatory skepticism and arguments for cost-benefit analysis and OIRA oversight of agency regulations (and now guidance documents) have been fueled by a group of studies called "regulatory scorecards," which examine a broad array of major regulations to conclude that while regulation overall may be beneficial in aggregate, the costs of many individual government regulations vastly outweigh their health, safety or environmental benefits.

For example, since at least 1986, a widely-cited table by John Morrall, an OIRA economist, has served as Exhibit A for the proposition that federal agency regulation – particularly regulation of workplace and environmental toxins – is pervasively over-zealous and irrational. He reported that over a third of the 44 regulations in his database cost more than \$100 million per life saved, and one infamous regulation, OSHA's formaldehyde rule, cost \$72 *billion* per life.

How can this be? Well, to begin with, I and other scholars have shown that he did not draw on a random sample of regulations in setting up his database, but

rather cherry-picked the toxin regulations that he deemed most problematic. Secondly, he freely acknowledges that he substituted his own preferred benefit numbers for agency benefit estimates whenever he found a supporting study (names of which he has yet to disclose) which he found more credible than the studies that agency scientists and science advisors had relied upon. For example, in 1985 OSHA estimated that its proposed formaldehyde exposure regulation would save from six to forty-seven lives over forty-five years. Morrall alters that estimate to one life saved every hundred years.

This is a rather significant change. One wonders what qualifies Mr. Morrall, an economist, to second-guess panels of agency scientists on the issue of the relative merits of different risk estimates. I dwell on this because the practice of altering or challenging agency science and scientific assessments is not confined to Mr. Morrall, or his table. It reflects long-standing OIRA practice that persists to this day. In fact, Administrator Graham has tacitly recognized the competence concern by hiring one or two toxicologists and other physical scientists to provide a scientific fig leaf for OIRA second-guessing of agency scientific judgments. But is that the way science is supposed to work? My understanding is that science works not by privileging the opinions of one or two particular scientists on the basis of their government position – or their appeal to a sympathetic economist -- but by seeking a consensus in the scientific community on how to evaluate the evidence.

Finally, my research shows that Mr. Morrall achieved his shocking figures in part by simply excluding – zeroing out -- benefits that did not conform to his procrustean template. Again, the infamous \$72 billion per life formaldehyde rule will illustrate the point. What Morrall's table conceals, but which the rulemaking record reveals, is that OSHA's rule -- beyond preventing about one cancer fatality per year (which, in Morrall's hands, becomes one-hundredth of a fatality per year, after adjustment and discounting) B was also expected to yield a host of unquantified but clearly substantial benefits of a non-life-saving nature.

Indeed, the rulemaking record makes clear that OSHA's formaldehyde rule was never justified as a life-saving rule at all. The non-life-saving benefits and purposes of the rule are delineated at length in the preamble to OSHA's proposed rule: reduced or avoided burning eyes or noses, sore or burning throats, asthma attacks, chronic bronchitis, allergic reactions, dermatitis and skin sensitization. OSHA notes that over 500,000 American workers are regularly exposed to formaldehyde at concentrations that have been found to cause one or more of these illnesses or discomforts.

The central policy questions for OSHA were, "Is avoiding such discomforts and health hazards for 500,000 American workers "worth" the expenditure of \$36 million a year by a \$30 billion dollar group of industries? Will installing ventilators in the workplace also reduce employee exposure to other irritating and possibly hazardous chemical vapors?" These questions are quite unlike (and are far more complex than) the question implicitly posed by the Morrall table: how could

OSHA be so stupid as to propose a rule that will cost \$72 billion for every life saved?

I dwell on this point because, again, the Morrall table is not an isolated case. Unfortunately, it is all too typical of the approach that OIRA has taken, particularly in this Administration, to regulatory oversight and cost-benefit analysis. Widely accepted principles of cost-benefit analysis call for the inclusion of non-quantifiable or non-monetizable benefits. In principle, non-quantified benefits are recognized and respected. EO 12866 calls for qualitative benefits to be included and described in all regulatory impact assessments. Qualitative benefits are often described, at least perfunctorily, in OMB's Reports to Congress on the Costs and Benefits of Regulation.

It is the practice wherein the problems lie. In practice, agencies know that any benefits that cannot be quantified are likely to be zeroed out in the mill at OMB. They know that basing a decision on un-enumerated *judgment* that the costs of a policy or action are "worth" the benefits is perfectly fine for foreign policy, perfectly fine for defense procurement, perfectly fine for most areas of government and perfectly fine for most decisions in daily life -- but it means rough sledding for health, safety or environmental regulations at OMB.

The problem is that you can't make regulatory policy by the numbers any more than you can draw or paint by the numbers. Many benefits are either hard or impossible to quantify and monetize in a scientifically defensible way. How do you put a monetary value, for example, on a procedure that aids enforcement, or deters wrongdoing, or provides useful information to consumers? How do you put a value on the benefit on a policy that itself will not solve a problem, but that forms a part of a mosaic of responses and diplomatic initiatives needed to address that problem effectively? How do you put a value on preserving the environment, when our understanding of ecological risk and benefit is so extremely limited, and our methods for valuing environmental amenities so crude? In practice, OIRA insists on viewing regulatory policy through the prism of numbers. Yet many health, safety and environmental regulations cannot be evaluated sensibly on the basis of numbers alone.

Nowhere are the consequences of this flawed approach to policy more apparent than in the analysis proffered by Robert Hahn of the AEI-Brookings Joint Center for Regulatory Studies, a leading regulatory critic and a leading proponent of not only enacting EO 13422 but extending it further to require cost-benefit analysis of agency guidance documents as well as rules.

The prevailing approach to regulatory critics to regulatory assessment is evident in his much-heralded and influential studies – one in 1996 and another in 2000 – which purport to show, based on a wide-ranging analysis of over 130 major rules spanning a ten-year period, that 57 percent of all major environmental regulations "fail a neutral economist's cost-benefit tests." This is a powerful indictment of health, safety and environmental regulation – until one learns that

41 of the 136 major regulations appearing in Hahn's tabulation are assigned a *zero benefit*. Not a zero net benefit, but a zero benefit, meaning the regulations have no use whatsoever. The list of zero-benefit rules includes:

- a rule to protect 3.9 million agricultural workers from exposure to harmful pesticides;
- a rule requiring that owner/operators of tankers develop plans to respond to large oil spills;
- a rule to require that air polluters hold comprehensive permits which lay out their pollution control obligations;
- a rule requiring the public reporting of releases of certain toxic chemicals from large manufacturing facilities;
- a Clean Water Act rule aimed at protecting sensitive coastal areas from non-point-source water pollution;
- three rules establishing national primary drinking water standards to limit public exposure to toxic pollutants in drinking water; and
- an FDA rule establishing requirements for the safe handling of seafood in commercial processing operations.

Moreover, and this point bears emphasis, even rules that show a positive number in the benefits column have had whole categories of benefits excluded from the tally.

What is going on? Again, the answer requires careful understanding of what benefits are included and excluded in the underlying cost-benefit tabulation. It turns out that this study, with a few narrow and limited exceptions, again has assigned a zero value to any benefit which the government's regulatory impact assessment does not quantify and monetize. It even zero-values benefits that are quantified and monetized in an agency RIA, unless they happen to fall into one of his select categories of recognized benefit – even as he insists that he is using the government's numbers.

Included, therefore, are benefits of reducing physical accidents, cancer, heart disease and a range of known ailments resulting from exposure to five named air pollutants. Zeroed out, however, are all ecological benefits not monetized by the agency. Also zeroed out are all benefits of avoiding acute poisoning – hence the zero value for rules aimed at avoiding acute pesticide poisoning and seafood poisoning. Also zeroed out are all procedural and enforcement benefits since they are intrinsically non-monetizable.

In short, the studies that purport to expose tunnel visioned over-zealousness in regulatory agencies – and the need for expanded OIRA review – have failed to make their case on the facts. Rather than illustrating the benefits of cost-benefit

analysis in bringing clarity, transparency and rigor to regulatory analysis they expose the capacity of such analysis for concealing methodological icebergs and delivering skewed and misleading results. Far from establishing that OIRA oversight is needed to correct tunnel vision in the agencies, they simply suggest a dangerous tendency towards tunnel vision within OIRA itself.

It is true, of course, that cost-benefit analysis need not be done this way – it can be done in a way that does not over-ride inconvenient truths delivered by science, that is sensitive to qualitative costs and benefits, and that is properly cognizant of relevant uncertainties. Cost-benefit analysis can prompt regulations as well as embarrass them. And OIRA is not always anti-regulatory. Indeed, OIRA, under Mr. Graham's leadership, has prompted a few quite valuable regulations that might not otherwise have been forthcoming, such as the trans-fat labeling rule.

Overall, however, it must be said that cost-benefit analysis in OIRA's hands – applied within the framework of EO 12866 and EO 13422 – is generally not a particularly "fair and balanced" test. It is applied, for the most part, only to regulations and proposals to regulate – not to proposals to de-regulate or failures to regulate. It privileges quantity over quality, and numbers over judgment. It tends to conceal uncertainty behind the façade of a few summary statistics. It assumes, without basis, that maximizing monetary net benefits will also maximize social welfare – when economists themselves acknowledge that this assumption only holds if the losers from non-regulation or weak regulation are actually compensated by the winners, an event that in the real world very seldom happens. It reports as actual costs and benefits figures that are at best *ex ante* guesses – adopted in advance of regulation – as to what those regulatory costs and benefits are likely to be.

Moreover, we are now in a position to see that the cumulative cost-benefit analysis mandated by EO 13422 is the worst of the worst, methodologically. For even if you can manage to preserve some nuance – some attention to qualitative variables, dynamic effects, asymmetric uncertainties – in the analysis of individual rules, these nuances are completely squeezed out in the ringer of cumulative analysis. In cumulative cost-benefit analysis – as in regulatory scorecards – only summary statistics survive.

Meanwhile, applying OIRA review and cost-benefit analysis to guidance documents makes even less sense than applying it to proposed new rules, because guidance documents are very often adopted *because* the agency's knowledge of the facts is so limited that it feels it is not ready to propose a comprehensive rule. The purpose of guidance is to provide regulated entities some clarity while preserving some flexibility to change course and make exceptions when the facts of a particular case reveals that the policy is wrong. By encumbering guidance, EO 13422 will either deter it (thereby impeding clarity) or else ossify it, thereby hampering flexibility. And the uncertainty that often calls

forth guidance documents – as opposed to rules – in the first place, does not augur well for the application of cost-benefit analytical techniques to guidance.

Let me conclude on a more affirmative note by asking what then should be done? I have challenged the evidence and analysis under-girding studies which purport to show that regulatory agencies are pervasively irrational and biased in favor of unreasonably costly regulation. That said, I certainly do not maintain that agency regulation is pervasively rational, on any plausible definition of that term. I have not proved that, and I readily concede that I cannot prove it. The question, I submit, is an open one.

I *expect* that what careful investigation would show is that agencies vary. Some favor industry, others favor regulatory beneficiaries. Moreover, their slant changes over time, depending on who occupies the White House and the front office and that agency. Agency predilections may even vary from office to office and from rule to rule. On balance, I expect the evidence will show that under-regulation is as much a problem as over-regulation – an insight that Mr. John Graham evidently shares. But I also conclude that quantitative cost-benefit analysis *as currently practiced* in OIRA and by its chief outside supporters is more contributor to that problem than cure – a stance he most emphatically does not share.

But all this is speculation. What is needed both to resolve this speculation and to improve agency regulation, I argue, is not more quantitative cost-benefit analysis and ever expanding OIRA review of first rules and now guidance. That is the wrong path and the wrong direction. The right way is, first, to undertake some strategically targeted retrospective analyses of the actual costs and benefits of actual rules to provide a “ground truth” of how accurate, if at all, ex ante analysis has been in a variety of regulatory situations, and to reveal the kinds of hitherto unanticipated factors that may arise to defeat ex ante expectations.

Second, agencies might be asked to engage -- not OIRA – but relevant experts and the public more fully in the development of guidance documents. One might imagine an abbreviated consultation process commensurate with the magnitude of the guidance issues and their difficulty of resolution which agencies might be asked to undertake to better guide their guidance. The advent of the Internet makes such a process not only conceivable but easy to imagine and design, and OIRA might well apply its energies to working with agencies to develop such a process – remembering also that guidance is intrinsically tentative.

Finally, agencies should think about exploring innovative ways to harness the power of the Internet to make rulemaking more expert, more participatory and more efficient. The Administrative Law Section of the ABA has undertaken a project on e-rulemaking, and while none of the views expressed here today should be attributed to the participants in that project, I think I can say with conviction that all of us in the project would be happy to work with OIRA, with public interest groups, regulated entities and not least the members of this

committee and their staff in a collaborative effort to achieve wiser rules by improving the rulemaking and guidance development process.

Thank you for the opportunity to address you today. I would be happy to try to answer any questions you might have.