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05 28'2002 06:04:44 PM

Record Type: Record

To: John F. Morrall III/OMB/EOP@EOP

cc:

Subject: Comments on Draft Report

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Mr. Morrall:

Please find attached my comments regarding the Draft Report to Congress on the Costs and Benefits of Federal Regulations.

If you have any questions or need further information, please feel free to contact me at this address, or at (202) 608-6244.

Sincerely,

James Gattuso
Research Fellow in Regulatory Policy
The Heritage Foundation

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Comments of

James L. Gattuso
Research Fellow in Regulatory Policy
The Heritage Foundation'

On

Draft Report to Congress on the Costs and Benefits of Federal Regulations

Submitted to

Office of Information and Regulatory Affairs
Office of Management and Budget

May 28,2002

In accordance with the notice published in the *Federal Register* on March 28 2002, I respectfully submit these comments on OMB's *Draft Report on the Costs and Benefits of Federal Regulations.*

In general, the Office of Information and Regulatory Affairs is to be commended for preparation of this comprehensive report. This annual publication, the fifth to be produced by OIRA, is an extremely useful document and a key tool for informing the public and policymakers on the scope and impact of the federal regulatory system. OIRA and its staff are also to be commended for their efforts, described in this draft report, toward reforming and reinvigorating the federal govemment's regulatory review process over the past year.[2]

At the same time, there are many improvements that could be made. Estimating the total benefits and costs of federal regulations – as OMB is required to do in this report – is no easy task. Regulatory accounting is still an evolving, and as yet imperfect, discipline. Yet, there are some changes that could usefully be made to provide a clearer and more complete picture of the impact of regulation. Among these:

1. **Report "best estimates"** of costs and benefits, in addition to ranges. Many cost-benefit estimates have extremely wide ranges. Benefits provided for rules adopted between 1995 and 2002, for instance, range from $81 to $121 billion, a range of some 50 percent. Such calculations, of course, are difficult to make, and there may be no one, clear result. However, the variance decreases the usefulness

[1] Heritage Foundation Research Assistant Erin Hymel contributed substantially to the preparation of these Comments.
[2] See *also* James L. Gattuso, "Regulating the Regulators: OIRA's Comeback," Heritage Foundation ***Executive*** *Memorandum* No. 813 (May 9,2002).

of the final result. Based on its own judgement or working with agencies, OIRA should develop "best estimate" calculations of costs and benefits.

This is not to say that range estimates should not also be provided. Knowing the range of possibilities is also important, especially in areas where precise estimates are difficult to make. Both figures should be provided in future reports.

2. **Provide an annual regulatory "scorecard" for each agency.** The information provided in the ***Draft Report*** indicates that the quality of analyses performed by agencies is very often inconsistent and inadequate. Monetized cost and benefit information, for example, was not provided for a significant portion of major rules. This is consistent with past findings regarding agency adherence to regulatory analysis standards.[3] To help policymaker's determine which agencies are conducting high-quality reviews of rules, and which are not yet up to par, OMB should publish a scorecard of each agency's performance, and publish it with this report.[4]

   This scorecard should include information on the number of major and minor rules proposed or promulgated by each agency, how many were supported by analyses, how many had quantified and/or monetized costs and benefits, and to what extent each adhered to OMB guidelines for analyses. This should be provided in table form, with textual analyses critiquing each agencies efforts.

3. **Require each agency to produce its own report on its regulatory performance.** In addition to OMB analysis of agency efforts, each agency should be asked to submit to OMB – as part of the preparation of this report – a report on its own regulatory efforts. These reports then should be submitted for public comment, along with OMB's government-wide ***Draft Report.***

   Such a requirement would provide several benefits. First, it would provide OMB, and the public, with detailed information on the agencies' regulatory program and analysis. Second, it would provide the agency with an opportunity to articulate its views and the purposes for its actions. Third, and perhaps most important, it would help focus the agency itself on the need to maintain a coherent and rational regulatory program. Improving regulation should be a goal of each agency – rather than solely the responsibility of OMB. Requiring agencies to report on their own efforts could help reinforce that responsibility.

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[3] See. Robert W. Hahn, Jason K. Burnett, Yee-Ho I. Chan, Elizabeth A. Mader, and Petrea R. Moyle, "Assessing the Quality of Regulatory Impact Analyses," AEI-Broolungs Joint Center for Regulatory Studies ***Working Paper*** 00-01 (January 2000), and Robert W. Hahn, "Regulatory Reform: Assessing the Government's Numbers," AEI-Brookings Joint Center for Regulatory Studies ***Working Paper*** 99-6 (July 1999).

[4] This proposal was also recommended to OMB in prior years by many commenters. ***See, e.g.,*** "Comments of Mercatus Center on Office of Management and Budget's Draft Report to Congress on the Costs and Benefits of Federal Regulations" (2001), Robert W. Hahn and Robert E. Litan, AEI-Broolungs Joint Center for Regulatory Studies ***Regulatory Analysis*** 01-01, "An Analysis of the Fourth Government Report On the Costs and Benefits of Federal Regulations" *(July 2001).*

4. **Present key information in more useful format.** While OMB's draft report provides a wealth of information, much of it is unnecessarily difficult to extract. The most important information – including total regulatory costs in the aggregate and by agency and annual incremental costs should be clearly provided in tabular form.

5. **Provide more contextual information.** In addition to the raw numbers, additional efforts to put this information in context would be useful to policymakers. Historical information, for instance tables showing year-to-year incremental changes in the number and cost of major regulations, would be particularly helpful. Other information, comparing the cost of rules to such things as Gross Domestic Product, federal budget levels, tax revenues, and the like (and changes over time in the ratios) would also be helpful in conveying the scope and impact of regulation.

6. **Include other measures of regulation.** Although the Regulatory Right-to-Know Act only requires OMB to provide information on the costs and benefits of regulation, there are also a number of other statistical measures that provide information on regulatory trends. While each of these is imperfect, they can be useful to filling in the regulatory picture. These statistics include: number of rules published in the Federal register, the total number of Federal Register pages, number of pages devoted to final rules, total number of rules in the Unified Agenda pipeline, economically significant rules in the pipeline, total budgets of regulatory agencies, total staffing of regulatory agencies, and more.

   This information could be readily compiled by OMB, and included in each year's report, along with tables showing year-by-year changes in these figures, in the aggregate and broken down by agency.'

7. **Include discussion of non-economic costs of regulation.** Cost-benefit analysis is a critical tool, but often does not convey to the public the real costs of regulation. Presenting the picture *only* in monetized form too often leaves the impression that concerns about overregulation are based just on dollars. In reality, those monetized costs are just a proxy for the real human costs of regulation – whether they are goods and services made unavailable to citizens, or reductions in health and safety costs.

   OMB should devote at least part of its report to a discussion of these underlying non-economic effects. This could include such things as the unintended safety consequences of regulations (such as fatalities caused by CAFE standards), or

[5] Most of this information is already compiled in two annual non-government reports. ***See,*** Clyde Wayne Crews, Jr., "Ten Thousand Commandments: An Annual Policymaker's Snapshot of the Federal Regulatory State," (Competitive Enterprise Institute, 2001), and Melinda Warren, "Federal Regulatory Spending Reaches a New Height: An Analysis of the Budget of the U.S. Government for the Year 2001," Center for the Study of American Business ***Regulatory Budget Report*** 23 (June ***2000).***

reductions in quality of life due to increased costs or reduced incomes. Such a discussion could allow this annual report to provide a fuller picture of the effects of regulation.

8. **Provide information on returned regulations. As** stated above, OMB is to be commended for its efforts toward reforming and reinvigorating the regulatory review process. Of particular significance is the increased number of regulations returned to agencies for further work.[6] The reasons for each return are now made publicly available through formal "return letters" drafted by OMB. However, the final outcome of each action is not yet so readily available. It would be helpful if, in this report, OMB included information on post-return agency actions, indicating if the intended rule was resubmitted, how and if it was changed, how and if the regulatory analysis was changed.

More broadly and more importantly than specific changes in the content of this annual report, OMB should continue to improve the regulatory review process itself. The ***Draft Report*** cites several steps that have already been taken toward this end, such as refining analytic guidance and forming a Scientific Advisory Panel to OIRA. These are good steps and should be commended. But more should be done. Among the steps that should considered:

1. **Require stricter adherence to OMB guidance in the preparation of regulatory analyses.** As noted above, the *Draft* ***Report*** indicates that despite increased scrutiny by OMB, agency regulatory analyses by agencies still often lack consistency and quality. This problem, which has been highlighted in many comments on previous reports[7], reduces the individual value of analyses, and makes cross-comparisons difficult. While perfect uniformity of analyses would be difficult to achieve, OMB needs to further raise the analytic floor, requiring agencies to follow its guidelines more strictly.

2. **Ask independent agencies to prepare analyses.** Independent agencies are explicitly exempted from regulatory review and analysis requirements. This is more than a minor gap in the regulatory process. During the period covered by this ***Draft Report,*** nearly ***20*** percent of major federal rules were promulgated by independent agencies. The overall impact of these agencies is even greater, as they cover some of the economy's most dynamic and vital sectors, from telecommunications to securities. Yet, these agencies' rules are not subject to executive review, and only rarely are their costs and benefits analyzed. Of 19 major rulemakings by independent agencies during the period of this ***Draft Report,*** information on costs or benefits was produced for only eight, costs and

[6] Although it should be noted that a change number of returns is not necessarily a sign of a successful review process, since it could simply indicate changes in the quality of agency rulemaking. In this case, it is one sign among many of improved OMB processes.

[7] See, e.g., Angela Antonelli, "Comments on the Office of Management and Budget's Draft Report to Congress on the Costs and Benefits of Federal Regulation" (2000), and "Comments of Mercatus Center on Office of Management and Budget's Draft Report to Congress on the Costs and Benefits of Federal Regulations" (2001).

benefits were monetized for only three. Some key agencies, such as the Federal Communications Commission, virtually never conduct formal regulatory analyses.

This problem could be resolved by putting independent agencies under the requirements of Executive Order 12866.[8] At the moment, however, such a step would be politically difficult. That does not, however, preclude independent agencies from voluntarily participating in some or all of the process. To facilitate this, OMB (or more preferably, the President) should formally ask all independent agencies to prepare regulatory impact analyses of all planned significant rules, and to forward them to OIRA for non-binding review.'

3. **Designate regulatory coordinators in each agency. As** mentioned above, the job ensuring that regulations are as least burdensome as possible should not be OMB's alone – each agency should also have this as a goal. Yet, often no specific individual at an agency has been charged with making this a priority, meaning regulatory analysis and review is left almost as an afterthought. To help counter this tendency, one official at each agency should be designated as a regulatory coordinator." This coordinator would be responsible for ensuring that regulations are cost-justified and impose no more burdens than necessary. In addition to ensuring that analyses meet OMB minimums, the coordinator could be an advocate at the agency for regulatory reform, and initiate internal reviews of existing rules as well as those sent to OMB."

The *Draft Report* also specifically asks for nominations regarding regulations and guidance documents that should be reformed. Below is a description of nine such rules. These recommendations are based the work of analysts at Heritage and elsewhere in a broad number of fields.[12] The list is by no means exclusive, and is not meant to be a comprehensive litany of all problematic rules. Instead, it includes selected rules in need of review, with an emphasis on issues that have not already been the subject of extensive debate and/or can be practicably achieved. It also avoids areas, such as rules by independent agencies, not currently within OMB's jurisdiction.[13]

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[8] ***See*** Robert W. Hahn and Cass R. Sunstein, "A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis," AEI-Brooking Joint Center for Regulatory Studies *Working* ***Paper*** 02-4 (March 2002).

[9] While independent agencies have never been part of the Executive Order process, there is precedent for their voluntary participation in executive branch review processes upon White House request. In 1992, for instance, most or all independent agencies participated in an Administration 90-day regulatory freeze and review, upon the specific request of the Vice President.

[10] Executive Order 12866 already provides for agency representatives to serve on the "Regulatory Working Group." The duties of the regulatory coordinator would go much beyond this.

[11] Again, there is precedent for this from the first Bush Administration. **As** part of the 1992 regulatory freeze and review, each agency was asked to designate one official to lead agency efforts. In many cases, that official – typically a general counsel or policy director – became an active internal advocate of regulatory reform.

[12] Included for each is a reference to a policy expert who can provide more information on the subject if needed.

[13] Although some IRS rules are included.

These recommendations include:

1. Individual health insurance rules.

Regulating agency: Department of Health and Human Services.

Citation: Program Memorandum issued by the Health Care Financing Administration, November 2000.

Authority: Part A of Title XXVII of The Public Health Service Act and The Health Insurance Portability and Accountability Act of 1996.

Description of problem. The structure of the health insurance market, shaped and driven by existing federal tax policy, is such that it frustrates consumer choice and competition. Congress has made very few changes to alter the current law, thus contributing to the problems of portability of coverage, access to coverage for those outside of the place of work, aggravated health care inflation and restriction on the supply and availability of different plans.

The Bush Administration is trying to expand coverage through the use of tax credits for health insurance. Today, however, if a consumer were to use a tax credit for the purchase of an individual policy and wants the employer to contribute to the purchase of this policy, she has a problem. The source of the problem: the former Health Care Financing Administration (HCFA), now called the Centers for Medicare and Medicaid Services (CMS). The HHS bureaucracy issued a memorandum, in the final days of the Clinton Administration, that holds that if an employer makes *any* financial contribution at all to the purchase of an individual health care plan, that very act by an employer, means that the policy will be deemed a "group plan" for the purposes of federal regulation, and all of the regulatory requirements that go with group plans. It thus has the effect - intended or not- of restricting access to products in the individual market. This means that health insurance carriers in the individual market would have an incentive to reject the person's application for coverage, and this undermines the efforts of an employer who wants to help his employees to get private coverage.

Proposed solution: Revoke the Memorandum. The Secretary of HHS should reverse the Clinton Administration's policies governing employer participation in the purchase of private health insurance in the individual market.

Estimate of economic impacts: Not aware of any formal estimates.

For more information contact: Bob Moffit, Director of Domestic Policy Studies, The Heritage Foundation.

2. Food identity standards.

Regulating agency: Food and Drug Administration.

Citation: 21 C.F.R. secs. 130-169.

Authority: Food, Drug and Cosmetic Act.

Description of problem: Recently, the Department of Agriculture proposed elimination of its "pizza identity standards," regulations that define the characteristics of various types of frozen pizzas. For instance, a "sausage pizza" must have a bread base, contain tomato sauce and cheese and have a sausage topping of not less than 12 percent of cooked sausage or 10 percent of a dry sausage. Meant to protect consumers, the regulation actually hurts them by limiting choice and variation: for instance, white pizzas without tomato sauce cannot be sold in stores. It also restricts the ability to buy healthier food – pizzas without cheese, for instance, are prohibited.

USDA was right to propose elimination of this rule. However, many more such food identity standards – imposed by the **FDA –** are still on the books. These cover the content of everything from cherry pies and sherbet to canned mushrooms. These standards also limit consumer choice, and may harm consumers in ways similar to the pizza standard.

Proposed solution: FDA should undertake a thorough review of these identity standards, and rescind those not found to be necessary.

Estimate of economic impacts: Not aware of any estimates.

For further information contact: Jennifer Zambone, Mercatus Center.

3. Alcohol labeling rule.

Regulating agency: Bureau of Alcohol, Tobacco and Firearms.

Citation: Policy outlined in 1993 Industry Circular *Health Claims in the Labeling and Advertising of Alcoholic Beverages.*

Authority: Federal Alcohol Administration Act, 26 U.S.C. sec. 291, et. al.
Description of problem: In recent years, a large and growing body of evidence has shown substantial health benefits from the moderate consumption of wine. Yet, the Bureau of Alcohol, Tobacco and Firearms, which has jurisdiction over

alcohol advertising and labeling has effectively banned manufacturers from providing this health information to consumers on wine bottles. Specifically, claims are "considered misleading unless they are properly qualified, present all sides of the issue, and outline the categories of individuals for whom any positive effects would be outweighed by numerous negative health effects." The agency concedes these requirements make claims on bottles generally impossible. Since 1999, a rulemaking has been pending to formalize this existing policy.

Proposed solution: ATF should modify its policy to allow truthful information as to the health benefits of wine and other alcoholic beverages to be provided on labels to consumers.

Estimate of economic impacts. Not aware of any estimates of the economic impact of such a change. The health impact, however, would likely be substantial, given evidence that moderate consumption reduces the risk of heart attack by 30-54 percent.

For more information contact: Sam Kazman, General Counsel, Competitive Enterprise Institute.

4. Pediatric rule.

Regulating agency: Food and Drug Administration.

Citation: 21 C.F.R. Parts 201,312, 314, & 601.

Authority: Food, Drug and Cosmetic Act, 21 U.S.C. 321 et. seq.

Description of problem: The FDA's pediatric rule, published in 1998, established a new policy under which FDA could require drug companies to perform pediatric testing for certain drugs even if pediatric uses were not part of the drug's labeled indications. The FDA claimed it was acting to protect children, but this additional requirement, by making drugs found safe for adults unavailable, increases the health **risks** of Americans overall.

Proposed solution: Rescind the rule.

Estimate of economic impacts: The FDA estimated total costs of approximately $80 million per year. More significant, however, is the likely negative health impact of the rule.

For more information contact: Sam Kazman, General Counsel, Competitive Enterprise Institute.

5. Organic food standards.

Regulating agency: Department of Agriculture.

Citation: 7 C.F.R. Part 205.

Authority: Organic Foods Production Act

Description of problem: In a rule promulgated in December 2000, USDA imposed a single national standard for organic production. (Under some circumstances, this standard could actually limit the ability to use higher, as well as lower, standards). This standard denies consumers the flexibility to choose between various organic production methods, and its restrictions on labeling by competing certifiers may be unconstitutional. There is considerable evidence that consumers of organic products would benefit fi-om being able to choose from an array of standards, and that the market is capable of providing such choices.

Proposed solution: Replace the standard with more flexible rules.

Estimate of economic impacts: Not aware of assessment of costs of rule as a whole, although Regulatory Impact Assessment includes estimates for various component parts of the regulation.

For more information contact: Greg *Conko,* Director of Food Safety Policy, Competitive Enterprise Institute

6. Title IX and single-sex schools.

Regulating agency: Department of Education

Citation: 34 C.F.R. sec. 106.35(b), 34 C.F.R. sec. 106.34.

Authority: Title IX of the Education Amendments of 1972

Description of problem: Title IX of the Education Amendments of 1972 prohibits sex-based discrimination in education programs supported by federal aid. The law states that no person can be excluded from participation in or be denied the benefits of a program or activity on the basis of sex. Current Title IX regulations generally prohibit single-sex classes or activities. Exceptions are made for physical education activities that require bodily contact, sexual education classes, remedial education, and affirmative action.

While regulations do not specifically prohibit same sex schools, they make it difficult for school districts to open and operate single-sex schools. For this reason, only 11 such public schools exist in the country.

Research suggests that single-sex schools and classes benefit girls and low-income and minority boys. Benefits include enhanced achievement, character development, and reduced disciplinary problems. Regulatory flexibility would enable more school districts to open additional single-sex schools and classes. The addition of new schools will give parents more options for their children's schooling and enable researchers to take a closer look at the benefits of single-sex education.

The No Child Left Behind Act of 2001 allows school districts to use Innovative Programs funds for same-sex classes and schools consistent with applicable laws. It requires the Department of Education to issue guidelines regarding the applicable law on single-sex classes and schools within 120 days of enactment. The Department of Education issued a notice of intent to regulate on May 3, 2002. The Department proposes greater regulatory flexibility and support for single-sex learning environments while continuing to prohibit discrimination in accordance with the spirit of the law.

Proposed solution: Replace existing Title IX regulations with regulations offering greater flexibility to school districts.

Estimate of economic impacts: None available.

For more information contact: Krista Kafer, Senior Policy Analyst, The Heritage Foundation.

7. Title IX and collegiate sports participation.

Regulating agency: Department of Education

Citation: 34 C.F.R. Part 106

Authority: Title IX of the Education Amendments of 1972

Description of problem: The Title IX statute prohibits sex-based discrimination in education programs supported by federal aid. The law states that no person can be excluded from participation in or be denied the benefits of a program or activity on the basis of sex. The statute impacts participation in collegiate sports. According to current Title IX regulations, a college or university can comply with the law by meeting one of three criteria – by demonstrating that participation is proportionate to enrollment; by demonstrating program expansion to meet the interest and abilities of the "underrepresented" sex; or by showing that the school is fully accommodating the interests of the "underrepresented" sex. Because the

Office of Civil Rights has focused compliance efforts on the first criteria, it has forced colleges and universities to impose gender quotas on their sports programs.

Over the past thirty years, female participation in post-secondary education and collegiate sports has risen. Today, over half of all college graduates are women. Title IX enforcement has adversely impacted male participation in sports. Over the past 30 years, more than 170 wrestling programs, 80 men's tennis teams, 70 men's gymnastics teams, and 45 men's track teams have been eliminated. The test of strict proportionality denies men the opportunity to participate in sports if more men than women are interested in playing. The policy is discriminatory and contradicts the spirit of Title IX.

Proposed solution: Eliminate Title IX regulations demanding proportional representation. Review the second and third tests of compliance requiring colleges and universities make efforts to accommodate students' interests and abilities.

Estimate of economic impacts: None available.

For more information contact: Krista Kafer, Senior Policy Analyst, The Heritage Foundation.

8. Flexible spending accounts.

Regulating agency: The Department of Treasury.

Citation: Internal Revenue Service interpretations of Prop. Reg. S.1.125 issued on May 7, 1984.

Authority: Unclear.

Description of problem. Under current law, employees can put aside finds for health care expenses "tax free" under Section 125 of the Internal Revenue Code in what is called a flexible spending account (FSA). However, if they do not spend those funds, they lose the money. They cannot carry the money over from year to year tax free. This is the so-called "use or lose it" rule governing the use of flexible spending accounts. This is bad tax policy and worse health care policy, for it encourages unnecessary year-end spending, and inhibits individuals from spending wisely on medical services and carrying over monies to be used to offset medical expenses in the following year. Current policy affects millions of American workers and their families, union and non-union, enrolled in business and corporate benefits plans.

Current policy is not based clearly on statute, but on an Internal Revenue Service interpretation of the law and proposed rules, pursuant to that interpretation, first

issued on May 7, 1984. In 1989, the IRS further clarified its position that a carryover of funds within a FSA was prohibited. This interpretation has long been disputed, and the issue remains one that could be resolved solely by administrative action.

Proposed solution: Reverse the IRS interpretation and allow a rollover of funds in flexible spending accounts.

Estimate of economic impacts: There have been a variety of estimates, depending upon the assumptions and the amount allowed for a year-to-year roll over of funds. According to the Administration's Budget Blue Book, a $500 per annum roll over of FSAs would amount to a revenue loss of $8.4 billion over 10 years. (See www.treas.gov/taxpolicy/library/bluebk02.pdf)

For more information contact: Bob Moffit, Director of Domestic Policy Studies, The Heritage Foundation

9. Interest reporting requirements.

Regulating agency: Internal Revenue Service

Citation: 26 C.F.R. Parts 1 and 31 (proposed).

Authority: None cited

Description of problem: The IRS has proposed to "extend the information reporting requirement for bank deposit interest paid to nonresident alien individuals who are residents of other foreign countries." The proposed regulation flouts congressional intent. Lawmakers have chosen to exempt foreign bank deposits from taxation and not to require their reporting to the IRS. This makes America a safe haven for foreigners fleeing political and economic repression and has helped attract more than $1 trillion to the U.S. economy.

Proposed solution: The proposed regulation should be withdrawn.

Estimate of economic impacts: The regulation would lead to a significant loss of capital from the U.S. economy. A study commissioned by the Florida Bankers Association estimated that over 50 percent of foreign deposits might flee U.S. banks if the regulation was implemented. These funds provide capital for business expansion, home mortgages, and auto loans.

For more information contact: Dan Mitchell, McKenna Senior Fellow, The Heritage Foundation.