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Environmental Regulations, the Economy, and Jobs

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Chairman Shimkus, Ranking Member Green, thank you for inviting me to testify before your committee on environmental regulation and the economy.

In the forty years since the Environmental Protection Agency was established, EPA regulations have imposed enormous costs on the American economy and purchased enormous benefits. Some of the costs and benefits have been in the form of jobs lost and gained—the favorite political metric of economic impact. But many other consequences have been important as well. On the cost side, these include higher prices; the loss of many good things outside the realms of environmental quality and employment, such as the quality and reliability of some products and services; and an increase in litigiousness and the uncertainties and delays of the legal system, translating in many cases into lower property values. On the benefits side, they include substantial improvements in public health; recreational values and opportunities; the amenity and aesthetics of life, especially in cities and industrial areas, translating in many cases into higher property values; and the quality and diversity of fish, plants, and wildlife.

A simple but fair summary of the economic record of environmental regulation, based on a large literature of academic research, is as follows:

- Environmental regulation has been one of the success stories of American government, producing large and palpable public benefits;
- But it has been, in retrospect, much less cost-effective than it could have been—we could have achieved the same environmental quality at lower cost or more environmental quality at the same cost (or some or each);
- It has generally become less rather than more cost-effective over time;
- There is a wide variation in the effectiveness of EPA's various authorizing statutes for controlling air, water, and land pollution; and
- Based on what we have learned, we could revise the EPA statutes to greatly improve their environmental and economic results.

To understand these propositions and what might be done to improve current policies, it is useful to consider two singular features of government regulation, features of environmental regulation and also of many other programs of health, safety, energy, and economic regulation. The first is that the costs of regulation are largely "off budget." Almost all of the costs of environmental regulation are realized in the private sector in response to EPA mandates (the agency's budget is a tiny sliver of the costs of complying with its rules). These very large expenditures, incurred privately but for government purposes, are subject to none of the political and managerial disciplines that apply to direct government spending—authorization, appropriation, budgeting, and taxing or borrowing to raise the funds. In an era of hundred-billion dollar spending authorizations and trillion dollar budget deficits, one may wonder whether the formal spending restraints amount to much anymore. Yet large spending bills, deficits, and debt are often front-page political controversies—they played a large and probably decisive role in the 2010 elections—while regulatory costs seldom receive equivalent attention. The costs of environmental policies are, as a political matter, relatively stealthy: they take the form not of taxes or scary headlines about public spending, but rather of higher prices for private goods and services and foregone employment and other opportunities. And these costs, while they may be estimated in the aggregate, are usually invisible to citizens and voters. The higher prices are not revealed in the way that (say) sales taxes are, and the lost opportunities are usually completely insensible. The exception is when specific plants are closed in response to environmental edicts—which is why such cases are so controversial and why EPA avoids them whenever possible. Plants that are never built in the first place, or that slowly decline as production moves to other nations with less costly environmental rules, may involve equivalent costs but will attract little political attention.

That regulatory costs are largely unbudgeted is an important reason why single-purpose agencies such as EPA often "go too far," or otherwise take insufficient account of costs, in pursuing their statutory goals. The regulatory agency's institutional interest in economizing on the resources at its disposal is much more attenuated than that of the spending agency, whose resources are fixed by appropriations and budget controls. This also helps explain the curious phenomenon that regulatory programs may become incrementally less rather than more effective over time. Consider the Transportation Security Administration's new, highly intrusive airport pat-down procedures. One would think that, with a decade's experience following 9/11, TSA would have discovered new and better ways to ensure airplane safety at less delay and inconvenience to passengers. Instead it is moving in the opposite direction: it takes much less account of the billions of dollars of costs its procedures impose on travelers than if it had to fight for those resources at its appropriation committees and the Office of Management and

Budget. Similarly, EPA regulations appear to have been much more cost-effective in the 1970s and 1980s—when its initial rules were achieving massive reductions in air, water, and land pollution from a high "baseline"—than in more recent years. In both cases, the single-purpose agency, having achieved (say) a 90-percent reduction in risk or pollution, will then wish to tackle another 8 percent, then another 1.5 percent, and so on. But without much of a budget constraint, the agency has little counterbalancing incentive to consider the increasing marginal costs, and decreasing cost-effectiveness, of pursuing ever greater levels of its assigned goal. In other words, it will be disinclined to take account of the claims of social goods other than those it is responsible for promoting (which is the economic function of budgeting). And so it pushes ever onward until the political hue and cry generates sufficient legislative resistance to slow things down. The current, unusually heated controversies over EPA's efforts to tighten many of its pollution standards yet another notch are probably a reflection of these tendencies. Although the criticism of these proposals has focused on their employment and other costs at a time of high unemployment, an equally striking feature is their very low benefits relative to those of earlier initiatives.

Every President since Richard Nixon has required that agency regulations be reviewed for their economic effects by an office within the Executive Office of the President, originally the Council of Economic Advisors and the Domestic Policy Council.[1] Since 1981, when Ronald Reagan took office shortly after passage the Paperwork Reduction Act of 1980, these reviews have been governed by an explicit cost-benefit standard and conducted by the Office of Information and Regulatory Affairs in the Office of Management and Budget. President Obama's Executive Order 13563, issued last month, is the latest to elaborate on standards, procedures, and goals for this process. The process is intended to mimic OMB budget controls in the "off budget" regulatory context, but it is vastly less precise and constraining. Obama Administration OIRA reports assert, as did those of previous administrations, that federal regulations in the aggregate are yielding very large net benefits (benefits minus costs) for the

[1] The timing of the onset of central regulatory review was no accident. The early 1970s was the time EPA was established, the first modern air and water pollution statutes were enacted, and several other regulatory agencies were established as well—the National Highway Traffic Safety Administration, Occupational Safety and Health Administration, Consumer Product Safety Commission, and others.

economy. But most of the currently reported net benefits come from just two categories of rules—EPA rules reducing already low levels of fine-particulate air emissions to even lower levels, and the spate of energy efficiency regulations being issued under the Energy Independence and Security Act of 2007. The enormous benefits projected for these rules are the result of assumptions that are, at a minimum, subject to wide ranges of uncertainty—regarding the actual health benefits of further reductions in fine particulates, and the actual life spans of new energy-saving products such as compact fluorescent light bulbs. In addition, the benefits estimates for energy efficiency rules rely heavily on discount-rate arbitrage: they paternalistically assume that consumers, in weighing higher initial product prices against lower future energy expenses, systematically and irrationally over-discount the future energy savings. So these benefits are simply a matter of the government's saying that people spending their own money attach too much importance to current savings relative to future savings. Modest changes in these assumptions could turn the rules from net winners to net losers for the economy as a whole. Just recognizing the broad range of uncertainties would lead to the conclusion that we don't know whether the rules will be beneficial or not. Budget controls on agency spending do not depend on judgments such as these, which are irreducibly subjective to some degree.

The second distinctive feature of regulatory policy is that it involves large-scale delegation of lawmaking authority from the Congress to the Executive Branch. There are instances of precise regulatory standards laid down by statute; examples are the minimum wage, the CAFE motor vehicle fuel economy standards, and new light bulb energy standards. But for the most part regulatory statutes provide very general standards—"safe and effective" drugs, "reasonably available" or "best practicable" or "best available" pollution control technology, "reasonable progress" toward meeting regulatory goals. And here is the latest, the mandate of the new Consumer Financial Protection Bureau: "ensure that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive." Standards such as these give regulatory agencies wide discretion to make trade-offs among competing goods. Such trade-offs are the essence of lawmaking—except that, in the case of regulation, they are made not by elected representatives of diverse regions, interests, and opinions, but rather by single-purpose agencies unconflicted in their pursuit of one social goal above all others.

The original, formal rationale for broad regulatory delegation was "expertise." The idea was that regulation involved choices that were primarily technical rather than political, and that specialized agencies could make more informed judgments on such matters than generalist legislators. But the practice soon acquired a powerful political dynamic of its own: elected representatives could vote foursquarely for healthful air, swimmable water, safe products, and fair financial practices while leaving the hard and contentious decisions—that is, the real policymaking—to the agencies. Legislators could then take a wait-and-see attitude, approving or attacking the agencies' eventual decisions, routinely as individual members and occasionally through actual legislation. There are very few instances in domestic spending programs of such free-wheeling Executive Branch discretion (individual National Institutes of Health research grants are one example, but these are cabined by elaborate academic review procedures and are much less politically salient than environmental and most other forms of regulation).

Regulatory delegation has acquired a second important political function: it has permitted the Congress to accommodate the never-ending political demands for government intervention to a far greater degree than legislation alone could have accomplished. Hierarchical organizations can make decisions at a much faster pace and in much greater profusion than legislatures. Moreover our Constitution imposes deliberately cumbersome procedures on the Congress while saying little about the organization of the Executive Branch, which adds to the Executive's comparative advantage in high-volume lawmaking. The size, scope, reticulation, and minuteness of the modern "nanny state" is an artifact of regulatory delegation: it could not have been achieved and it could not be managed through direct legislation.

Regulatory delegation has reached new extremes in recent years. During the financial crisis of 2008, Members of Congress watched in amazement as the Treasury Department and Federal Reserve Board arranged multi-billion dollar private financial transactions with little evident statutory authority, and made de facto appropriations of hundreds of billions of dollars with no formal congressional involvement. Congressional exasperation reached its peak in

October 2008, shortly after Congress had finally and reluctantly gotten into the act with a major piece of legislation and huge spending authorization—the $700 billion Troubled Asset Relief Program. At this point the Bush Administration announced that it would use the law and money for entirely different purposes than intended—to make equity investments in selected financial institutions rather than purchasing their “troubled assets”. But the initial congressional outrage (which of course was thoroughly bipartisan) has since cooled. Congress has ratified the TARP turn-around through supporting legislation and, more generally, has continued to acquiesce in the Executive Branch’s decision-making superiority in dramatic fashion. The 2010 Dodd-Frank Act and Affordable Care Act have launched hundreds of new rulemaking proceedings, often with extraordinarily vague and open-ended statutory standards.

And Congress is now crossing a new constitutional Rubicon by ceding taxing authority along with lawmaking authority. Dodd-Frank’s new Consumer Financial Protection Bureau is funded by the profits of the Federal Reserve Banks rather than by legislative appropriations. That is the third time in recent years that Congress has created a regulator of independent means. The Public Company Accounting Oversight Board, established by the Sarbanes-Oxley Act of 2002, is funded by a corporation tax that PCAOB itself calculates, imposes, and revises as convenient. The Telecommunications Act of 1996 established a grant program administered by the Federal Communications Commission funded by a tax on telecommunications firms that the Commission itself calculates, imposes, and revises as convenient. These innovations have profound implications for the further erosion of constitutional structure and legislative accountability. The Constitution requires that the House—the chamber closest to the people—originate and therefore take responsibility for “all bills for raising revenue,” but the courts have so far declined to enforce the requirement (the judiciary also gains authority when Congress delegates policymaking to the Executive). Budget autonomy could easily be extended from financial and communications regulation to environmental regulation. Indeed it already has: the $20 billion Deepwater Horizon oil-spill compensation program, organized and administered by the White House and funded by BP, is another example of unilateral Executive Branch taxing-and-spending—this time without any congressional warrant to begin with.

The current state of regulatory policy summarized above is now producing a significant backlash in the Congress. The 2010 election is one important source. Many new Members were elected on promises to reduce the size of the federal government by reducing spending, and are now discovering that a large share of federal spending is accomplished through regulations beyond their immediate influence. But much of the congressional angst predates and is independent of last November's election results. Even before passage of the Affordable Care and Dodd-Frank Acts, the regulatory agencies—especially EPA and the Department of Energy—had launched a highly ambitious series of rulemaking proceedings, many aimed at establishing new or tightened controls at very high cost. Coming at a time of high unemployment and great uncertainty about the direction of the economy, these proposals have raised concerns on both sides of the aisle whether the regulators have become oblivious to the nation's most urgent economic priorities. An egregious instance of regulatory *inaction*—the Interior Department's de facto continuing moratorium on deepwater oil drilling in the Gulf of Mexico—is now adding to the impression. And one of the new regulatory initiatives, EPA's effort to control emissions of carbon dioxide and other greenhouse gasses under the Clean Air Act, has raised additional issues of agency autonomy and legality. In these proceedings, EPA is proposing to do by regulation what the Congress recently declined to do following extensive deliberation, and the EPA proposals depend on interpretations of the Act that would bend statutory language and expand its own discretion in breathtaking ways. Finally, the Obama Administration's appointment of powerful policy "czars" and commissions of unclear legal authority (such as the oil-spill compensation program) has dramatized the trend toward unilateral Executive government.

There are currently two leading proposals for restoring a degree of balance and discipline to the regulatory process. The first is the "regulatory pay-go" proposal associated with Senator Mark Warner, which would require regulatory agencies to eliminate regulations already on their books before issuing new ones of equivalent cost. The procedure would be complementary to the "retrospective analysis" procedure established by President Obama in Executive Order 13563—except that it would have legal teeth, putting the agencies on a budget with current compliance costs as the baseline. The second is the so-called REINS (Regulations from the Executive in Need of Scrutiny) Act, conceived and introduced by Congressman Geoff Davis and since introduced by Senator Jim DeMint. The REINS Act is modeled on the Congressional Review Act but changes the default rule: major new regulations could not take effect until approved by a joint resolution of the Congress and signed by the President, with expedited procedures guaranteeing up-or-down floor votes promptly after regulations were issued.

Notice that these two reforms are aimed at the two regulatory problems I have identified here: the Warner proposal at off-budget regulatory spending, the REINS Act at excessive lawmaking delegation. These are fresh approaches to regulatory reform, going well beyond the reform bills considered by earlier Congresses, which would have codified the cost-benefit and procedural standards in the successive regulatory review Executive Orders. Both proposals present complicated issues of political incentives, institutional capacity, and administrative feasibility. But they go to the heart of problems that lead to regulatory excesses such as those that your Subcommittee is hearing about today. The two approaches are complementary rather than competitive, and both are worthy of earnest consideration.

A great virtue of the Warner approach is that it focuses on regulatory costs, which are generally easier to estimate than benefits. (As I have noted, many of the benefits of environmental rules, such as aesthetic improvements of clean rivers and lakes and the distant-future benefits of improved land disposal practices, are intrinsically highly subjective.) By placing regulators on a compliance-cost budget, it would leave it to them to decide which among their established and prospective rules are providing the greatest marginal benefits in their areas of responsibility. It would also counter the tendency of regulators to conceive of their rules as ends in themselves—as bodies of controls to be continuously expanded and embellished, rather than as a means for achieving certain results in the real world. Finally, if the process was effective, it could ameliorate the problem of declining cost-effectiveness over time, as regulators were led to weigh the *benefits* of new proposals against those of established rules. But assessing the actual costs of established rules is itself a costly undertaking (more demanding than estimating the costs of proposed rules), and no matter how well done will involve many uncertainties and opportunities for budgetary gamesmanship. A particularly difficult issue will be who has the final word on cost estimates. If it is the agencies themselves, the procedure will quickly degenerate into a paperwork exercise with little real constraint. If it is OMB, there will be objections that the agency has acquired more authority over regulatory decisions than it exercises over spending decisions.

A great virtue of the REINS Act is that it would establish interbranch political accountability for major regulatory initiatives on a par with taxing-and-spending accountability. And, although the point is open to argument and speculation, I believe that such accountability would eventually result in a corpus of environmental (and other) regulations that was at once (a) smaller and (b) more focused, robust, and effective than the one we have today. Although the regulatory agencies are more efficient than the Congress in generating and issuing laws, this advantage comes at a price in what might be called "democratic quality." Freedom from legislative process means that agency rules are less likely to reflect a consensus of public sentiment. They are therefore more likely to be too aggressive—when an agency, lacking a budget of regulatory expenditures, pursues its mission too single-mindedly or self-righteously, or with too little regard for the competing public concerns of the day (the latter an obvious problem with EPA's current rulemaking surge amidst hard economic times). But they may also be too timid. Environmental initiatives are often highly popular, and EPA, beset as it always is by interest groups whose métier is exaggeration and alarmism, may find it difficult to see past the lobbying fog: it may underestimate as well as overestimate popular support in a way that constituency-minded legislators would not. And agency rules may contain subtle flaws, affecting their acceptability and durability, that the legislative gauntlet would have exposed.

By subjecting major rules to the test of attracting two legislative majorities, the REINS procedure would, at a minimum, cull out extremes of regulatory overreaching—almost certainly more reliably than the internal Executive Branch review procedures have done. At the same time, rules written with the aim of securing congressional approval could reveal areas of broad political support for certain initiatives. In all events, REINS-approved rules would treated with greater deference and less second-guessing over time by courts, regulated parties, lobbying groups, and the general public. Some of the most effective and durable regulations (in terms of achieving their purposes, whether worthy or not) have been statutory regulations and those written by agencies according to specific statutory directives. Examples include EPA controls on toxic water pollutants, automobile emissions (including unleaded gasoline requirements), acid-rain producing power plant emissions, and stratospheric ozone destroying chemicals.

But it is well to acknowledge that REINS is much more than an incremental rebalancing of rulemaking prerogatives or an expression of Republican opposition to Obama Administration regulatory ambitions. It is rather a frontal challenge to the central development of modern government in America and other politically advanced nations—the migration of policymaking authority from elected legislatures to special-purpose boards and agencies. The migration began in the United States with the creation of the first regulatory commissions during the Progressive and New Deal eras. It then resumed dramatically beginning in 1970, with the creation of EPA and other new regulatory agencies mentioned earlier. We now seem to be at a further stage in the evolution of legislature-free government, with the appearance of specialized mini-governments with increasingly comprehensive power to tax, spend, and regulate, and under leadership whose appointments are increasingly distant from legislative review and approval. These developments have been thoroughly bipartisan, with the greatest advances occurring during the Nixon and George W. Bush Administrations before more recent gains in the Obama Administration. And they have many analogues in other nations, including the proliferation of "quangos" ("quasi-autonomous national government organizations") in the United Kingdom and, in Europe, the migration of policy authority from national governments to the unelected commissions, councils, committees, and directorates of the European Union.

A shift in government structure so pervasive and continuous must reflect powerful political, economic, or technological forces. For Congress to reclaim the final say over dozens or scores of regulations each year is to throw itself athwart those forces, whatever they may be, in a central area of government policy. I do not know whether Congress will be willing to take this step, but do know that the debate over the measure is bound to be beneficial in its own right. When one asks the question, "Should elected representatives be required to stand and be counted on $100 million government initiatives?", it is difficult to avoid the affirmative answer. But when one turns to questions of legislative capacity and incentives, and the effect of the procedure on the substance of policy and the size and scope of government, one encounters the dilemma of the modern "democracy deficit" in the starkest of terms. If Congress decides to take a pass on the REINS proposal, this will itself be evidence of the intractable nature of the trend I have described, and will give the trend further momentum. If Congress adopts and makes good use of the proposal, that could be the beginning of a democratic Restoration.

The debate over the REINS bill would be greatly improved by complementary steps to demonstrate that Congress is willing and able to reenter the regulatory fray in substance as well as in process. REINS supporters must believe that there are established and proposed regulations that could not survive a vote of both houses. It would be most impressive if Congress were able to demonstrate this on its own. Determined efforts to repeal just one or two specific regulations, either under the Congressional Review Act or standard legislation, would be a vivid display of congressional seriousness about participating in regulatory policy as decision-maker rather than bystander-critic. Even more impressive would be if Congress began now the arduous process of rewriting the organic environmental statutes, which are dozens of years old and in many cases seriously out of date. The most well-developed, broadly supported proposals are those of the Breaking the Logjam project (www.breakingthelogjam.org). They are based precisely on the notion that Congress should enact basic regulatory standards of its own rather than leaving them to EPA—and combine them with economic reforms, such as performance standards and tradable permits, that have been championed by EPA under administrations of both parties but have run aground on court interpretations of the existing statutes.[2] The Warner and REINS proposals are excellent ideas but, at least in the area of the environment and the economy, are no substitute for reforming the underlying statutes.

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[2] The Breaking the Logjam proposals are focused on the Clean Air and Clean Water Acts, but the principles of legislated standards and market-based reforms could also be applied to such statutes as the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation, and Liability Act (Superfund) with tremendous environmental and economic benefits.