LETTERS

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

OIRA'S CONFLICTING DOUBLE ROLE

Jonathan Adler's article, "The EPA's Clean Air Mischief" (last issue), highlights how, in its newly adopted air quality standards, the EPA contrived both the science and the economics to support its predetermined conclusions, that the EPA did so despite reams of guidance from the OMB on how to conduct analysis properly. It also shows that, despite the EPA's serious analytic errors, omissions, and misrepresentations, the OMB's "review" was little more than a rubber stamp. Questioning the ability of executive oversight to curb regulatory excess, Mr. Adler recommends that, rather than delegating rulemaking authority to agencies, Congress should maintain responsibility for explicitly authorizing substantive regulatory actions.

I share Mr. Adler's concerns about the impact of the EPA's new air standards. And, as a former economist in the Office of Information and Regulatory Affairs (OIRA) at the OMB, I am also disheartened see the staff hobbled in their efforts to ensure that proposed regulations provide net benefits to society. I differ with Mr. Adler, however, on the solutions to those problems.

Mr. Adler observes that the EPA's new air quality standards for ozone and particulate matter may be the most controversial in the EPA's history. And they should be—by the EPA's own estimates, the costs of the rules could far exceed their benefits, and the science on which they are based is uncertain at best. Moreover, the President's Council of Economic Advisors noted that the EPA's "partial" compliance cost estimates understate true costs by orders of magnitude. My own analysis of the ozone air quality standard, conducted for the Regulatory Analysis Program at George Mason University's Center for Study of Public Choice, suggests its costs could exceed $80 billion per year. RAP's analysis of the particulate matter standard indicates that its costs would add at least an additional $55 billion per year.

In setting the standards, the EPA ignored not only their costs but significant public health and welfare considerations raised by OIRA and other agencies. For example, the EPA's own analysis suggests that the harmful effects of increased exposure to ultraviolet radiation could dwarf the positive benefits the EPA attributes to the ozone standard. That concern was raised by the Department of Energy and OIRA during the rule development process, but they were silenced by the EPA. Relying on the EPA and DOE analyses, I estimate that the negative health impacts of the ozone rule would exceed the EPA's best estimate of the positive health effects by over $300 million per year.

When the costs of the EPA's rules are considered, the negative impact on public health is even more dramatic. It is widely recognized that, as family income rises, health improves. Studies linking income and mortality find that every $9 million to $12 million decline in income induces one statistical death. In the early 1990s, OIRA asked agencies to use that relationship as a policy test when statutes only allowed them to consider health trade-offs. When applied to those rules, the policy test suggests the rules will result in an increase of more than twelve thousand deaths per year.

Why, if OIRA recognized such significant problems with the new air rules, was the EPA able to promulgate them with such seeming ease? Why was OIRA unable to delink the ozone and PM rules, despite the fact that the judicial deadline applied only to the PM standard while the ozone standard was wholly discretionary? How does one explain OIRA's timid conclusion that the EPA's analysis "did not fully conform" with the OMB guidance—a conclusion that as Mr. Adler noted, the EPA censored or the OMB withdrew to spare further embarrassment—when in fact it did not come remotely close to complying with elementary economic principles?

OIRA's first administrator, Jim Miller, once joked that because his office was the "biggest kid on the block," other agencies listened to OIRA's point of view. Mr. Adler's account of the events surrounding development of the EPA rules suggests that a more apt characterization of the current OIRA is as a sensitive, thoughtful, little weakling who, in trying to protect the well-being of his neighbors, routinely gets knocked aside by neighborhood bullies.

A further exemplification of the weak state of OIRA can be found in its recently released draft report to Congress on the costs and benefits of federal regulations, the Steven's Report. A strong, independent OIRA would have welcomed a request from Congress to evaluate regulatory costs and benefits and make recommendations for improving or eliminating ineffective programs. But the disappointing recently released report does little more than parrot agency estimates of costs and benefits.

OIRA's mandate for reviewing major regulations has not changed significantly since the office's inception. The objective of OIRA review has always been to ensure that rules do more good than harm and that they reflect the public interest, rather than the interests of single-issue-minded bureaucrats or vocal groups. So why has OIRA

become so weak? With the exception of its administrator, OIRA is staffed by career civil servants (including several who have been with the office since its inception), many of whom are well-respected scholars in the field of regulatory analysis. Neither OIRA's ineffective review of the Clean Air rules nor its milquetoast "Steven's Report" stem from a lack of knowledge regarding how quality analysis should be done. Thus, I concur with Mr. Adler that the mere establishment of more guidelines or review requirements is unlikely to improve the review process.

The problem is, OIRA review has always had necessarily conflicting roles. At the same time that OIRA is supposed to provide independent and objective analysis, it must also advance the president's policies and programs. When those functions conflict, the presidential agenda nearly always trumps independent and objective analysis. The Steven's Report and OIRA's "review" of the air quality standards simply show how severe that conflict has become.

Mr. Adler's prescription is for Congress to reclaim its constitutional responsibility for legislating, rather than delegating it to administrative agencies or the courts. The prescription makes perfect sense, except that when Congress clearly articulates environmental policy it often does worse than the EPA. Federal environmental law is replete with illogical requirements that Congress wrote and forbade the EPA to alter.

Before endorsing Mr. Adler's prescription, we ought to have evidence that Congress either makes better decisions when it does not delegate the details to administrative agencies, or that it is more accountable than those agencies when it makes a mistake. Unfortunately, evidence supporting either proposition is thin at best. Even though OIRA has shriveled to a ninety-eight pound weakling, some of the EPA's excesses still can be overturned in court. In contrast, when Congress errs it takes, well, an act of Congress to fix it. The EPA has faced withering (and deserved) criticism for its new ozone and PM standards, but who in Congress has accepted the responsibility to reconsider the fundamental goals of the Clean Air Act? How many other Clean Air Act requirements fail the tests of sound science, benefit-cost analysis, or simple common sense?

What is needed is an unbiased, independent review of regulatory proposals, and it might take various forms. In the pre-OIRA days, a small division of President Carter's Council on Wage and Price Stability (COWPS) would submit "filings" evaluating agency rulemakings during the public comment period. While the COWPS team was certainly not the "biggest kid on the block," its reviews were influential because they provided unbiased, careful analyses from a public interest perspective. Congress could make an agency like that stronger by granting it explicit statutory authority for its function, and a budget adequate to do the job, but it would still be an executive branch agency accountable to the President.

To balance that, Congress also needs its own regulatory review office. A Congressional Office of Regulatory Analysis, which Congress could establish by enacting H.R. 1704, could serve that purpose. Congress also must be willing to assert its authority under the Congressional Review Act to overturn misguided regulations.

Perhaps we should also look outside the government to a "shadow OIRA" to perform independent regulatory review. The Regulatory Analysis Program, a not-for-profit educational institution, may fit the bill. As part of its mission, that program produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. From its independent, academic vantage point at George Mason University, it is in an ideal position to function as a shadow OIRA, improving public awareness of regulations and their impacts and making regulators more accountable to the public.

Mr. Adler is right. It would be great if Congress stopped delegating important policy decisions to minimally accountable bureaucrats and appointed officials. It would be even better if Congress had the time and expertise to make those decisions itself. There may be less revolutionary and more practical ways to enhance public accountability however. Getting serious about independent regulatory review is an important first step. Regulatory review bodies in the executive branch, the legislative branch, and academia could all provide constructive review. Then, for the independent reviews to have an impact, Congress must be willing to assert its authority under the Congressional Office of Regulatory Analysis.

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PAIN AND PLEASURE IN FINANCIAL SERVICES

In his article, "Financial Services Modernization" (last issue), Bert Ely, president of Ely & Company, states that "financial institutions should be free to offer whatever financial services they wish." He further describes current interest group and regulatory agency turf battles as obstacles to overcoming the regulatory excesses governing the financial services industry. He predicts that "Congress will truly harm America if it does not enact reforms that allow this country to have an integrated and efficient financial services sector for the twenty-first century."

While I generally agree with Mr. Ely's premises and conclusions, it is useful to look behind the positions of the competing sectors of the financial services industry and their regulators to ascertain their respective motivations. While I am not competent to assess the other parties in the debate and do not speak officially for The Bankers Roundtable or any particular banking organization, I can provide some insight into the thinking of the banking industry.

Once the motivations of all the various players are understood, a method by which to construct agreeable solutions to the issues that divide the industries and their regulators may become more apparent. Building on that theme, all individu-

als and organizations, public and private, are subject to a universal law of behavior: they move toward what they link to pleasure and avoid what they link to pain. What is linked to pain or pleasure, of course, depends upon the priority and value assigned by the decision-maker to all relevant factors. The balancing of the individual calculations is what determines an individual's, organization's or industry's reaction to new events. If there is more pleasure than pain associated with the event, they will support it; if there is more pain than pleasure, of course they will avoid it.

After applying that method of analysis to financial modernization, it becomes easier to understand the position of the parties on pending legislative proposals. For example, the banking industry obviously believes that the pleasure linked to market, regulatory, and judicial approaches to financial services modernization outweighs the pain associated with the relevant legislative proposals.

The banking industry, for instance, of late has achieved great satisfaction from the marketplace. The earnings of the banking industry for the first quarter of 1997 set a record high at $14.5 billion dollars. Moreover, stock prices for the banking sector have outperformed the S&P index over the last six month period. Similarly, the banking industry has been the beneficiary over the last two years of several rulings by both the Federal Reserve Board and the Office of the Comptroller of the Currency that have fundamentally improved its ability to compete. The Federal Reserve Board's decision to raise the revenue limits and modify the firewalls applicable to the securities operations of Section 20 subsidiaries of bank holding companies has enlivened that line of business for bankers. Just recently, the *American Banker*, a banking industry trade paper, listed three banking organizations among the top ten managers of long-bond issues in the country. In a parallel vein, regulatory rulings by the Office of the Comptroller of the Currency allowing national banks to act as agents for the sale of insurance on a broad geographic basis, have spurred bank insurance business. In the second quarter of this year, banks sales of annuities collectively were calculated at over $3 billion. Moreover, pending plans by the Comptroller to authorize expansion of the business lines of operating subsidiaries of national banks and the Fed's consideration to enlarge the merchant banking and foreign activities of bank holding companies reinforces the notion that bankers have much to gain from continued dealing with the regulators.

The same conclusion obtains when the results of recent judicial decisions dealing with the efforts of the banking industry to modernize itself in the face of competitor opposition are reviewed. That is, over the past two decades, the banking industry has been the undisputed victor in numerous lawsuits brought to contain the modernization efforts of the banking industry. In the securities area, those favorable rulings extend back to the 1970s and 1980s, when the courts repeatedly rejected efforts by the securities industry to contain banks. Those cases, involving efforts to overturn the authority of banking organizations to engage in discount securities brokerage, securities underwriting, and full service brokerage activities, are legendary. Likewise, the courts have smiled upon banker efforts to engage in the insurance business. In the last four years, the U.S. Supreme Court sanctioned bank modernization efforts in the insurance arena in the *U.S. Bancorp* (town of five thousand insurance sales), *VAUC* (fixed and variable rate bank annuity sales), and *Barnett Banks* (preemption of state antiaffiliation laws) cases. Those outcomes definitely have incentivized the banking industry to look for judicial solutions to their financial modernization aspirations.

On the other hand, federal legislative solutions, both historically and currently, have been judged by the banking industry to be less desirable relative to market, regulatory, and judicial alternatives to modernization. It is almost axiomatic that banking legislation has been enacted in reaction to a crisis. To wit, the National Bank Act of 1864 during the Civil War; the Federal Reserve Act of 1913 following the Economic Panic of 1907- 08; the Federal Deposit Insurance and Glass Steagall Acts of 1933 during the Great Depression; and the Federal Deposit Insurance Improvement Act of 1991 during the savings and loan crisis, provide examples of such reactions. Also, even in those situations in which legislation was initially introduced to assist the banking industry, the legislative process often turned it into a negative for the industry. Recent examples of that include: the Glass-Steagall Act of 1987, that resulted only in the restrictions on affiliate transactions embodied in 23B of the Federal Reserve Act; financial modernization that turned into the excessive regulatory provision of FDICIA, and the regulatory relief bill of 1996 that brought with it the obligation of the banking industry to shoulder the bulk of the multimillion dollar interest payments on the savings and loan FICO bonds. No wonder bankers associate negatively with federal legislative action.

The banking industry brings that framework of analysis to pending legislative proposals for modernizing the financial services industry. While some benefits are contained in the legislation as now drafted, there also are some negatives. The largest aversion that bankers have to the pending legislation is the belief that by favoring the holding company over the universal bank as the model for delivering financial services, the proposed legislation restricts the discretion of bank managers and saddles them with a suboptimal operational structure relative to their nonbank and international competitors.

In conclusion, by identifying and understanding the motivations of all the players in the financial services industry, legislative decision-makers might be able to fashion a new framework that considers the powerful effect of the pleasure/pain approach. If that is not accomplished, the market regulators and courts will continue to play the most significant role in modernizing the financial services industry. While that might be the path of least resistance, it certainly has not proven to be the most logical, consistent, or efficient strategy

for designing the nation's financial service framework.

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QUESTIONABLE JUDGEMENT

The *Food Lion v. ABC News* decision (last issue) is disturbing, not because ABC was found liable, but because of the size of the judgement. It is hard enough to justify $5,000 in damages, much less $5,500,000.

Lying on a résumé, taking a permanent job when you have no intention of staying permanently, using company time for other purposes: those are all real costs that ABC should pay. But they are obviously rather trivial, as well as exceedingly common. How do we come up with a total that justifies a lawyer's time?

Trespass? Again, where are the significant damages? The property was not damaged. ABC did not sell secrets to competitors that would hurt Food Lion.

That it used the data in an exposé? The case assumed the charges were true, meaning Food Lion was engaged in fraud against its customers, which means it has no right to any of the lost business and no recoverable damages.

Emotional distress? A corporation may be a legal person, but it is hard to see how it could suffer any emotional distress or how that emotional distress comes from a minor entry instead of exposure (deemed proper for case purposes).

What did ABC do that justified a $5 million judgement?

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Note From the Author:

A clarification and an update. The jury found that Food Lion had only suffered $1,402 in actual damages, but awarded the supermarket chain with $5.5 million in punitive damages in order to punish ABC News. On August 29, 1997, a federal judge rejected ABC's arguments for overturning the verdict, but the judge did agree that the disproportionate size of the punitive damages award in relation to the compensatory damages award constituted a violation of due process as defined by recent Supreme Court rulings. The judge found that the punitive damages should be reduced to $315,000. The judge's page ruling included the following explanation as to why he thought punitive damages were justified: "Despite the many protections necessary for the proper operation of the press, it would be a peculiar rule indeed which immunized illegal activity, undertaken with a consciousness of wrongdoing, from punishment and deterrence." Both Food Lion and ABC News plan to appeal the ruling.

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COST-BENEFIT SMOKE SCREEN FOR WEAKER AIR QUALITY STANDARDS

In your Winter 1997 issue, Kenneth Chilton and Stephen Huebner, in advocating the incorporation of a cost-benefit test in the setting of national air quality standards ("Sound Standards Require Cost-Benefit Analysis"), suggest that setting national air quality standards is analogous to buying an automobile. Unfortunately, the American public does not have the option to "buy" healthful air quality the way they can choose automobiles.

The late Senator Edmund Muskie, one of the primary authors of the 1970 Clean Air Act, wisely noted that "the first responsibility of Congress (in setting national air quality standards) is not making the technological or economic judgements-or even to be limited by what is or appears to be technologically or economically feasible. Our responsibility is to establish what the public interest requires to protect public health." Senator Muskie and other key framers of the Clean Air Act recognized that, unlike buying an automobile, setting national air quality standards is constrained by the ability of science to identify, understand, and quantify the public health impact of air pollution's effects on human health. As much as our understanding of air pollution's effects on health and the environment has advanced over the past quarter century, it will always lag behind the ability to quantify pollution control costs.

Senator Muskie was also prescient in recognizing that society's ability to predict technological innovation and the cost of air pollution controls fails to keep up with the challenge of achieving more healthful air quality. The history of air pollution control is rife with examples of industries lamenting that they are being asked to undertake the impossible, or that the costs of achieving further pollution reductions are draconian, only to respond to the challenge with new technologies or approaches that cost a fraction of the original predicted figures. We need only look at motor vehicle controls in the early 1970s and again in the early 1990s, or recent efforts to reduce pollutants from power plants and provide cleaner gasoline as classic examples of that phenomenon.

Lastly, there are serious societal issues of equity in public health protection that would not be addressed by a cost-benefit approach to air quality standards-setting. As the bipartisan National Commission on Air Quality noted in its 1981 report on the Clean Air Act to Congress "If a national air quality standard were based in part on the cost of complying with it, the very high costs of meeting the standard in a few severely polluted areas would probably require that the standard be set at a less protective level than is achievable in a reasonable economic fashion in most areas of the country."

Chilton and Huebner raise several other issues related to the proposed ozone and particulate matter standards that deserve correction. First, they assert that an eight hour average ozone standard of 0.07 parts per million (ppm) "is very near background levels." However, the Environmental Protection Agency estimated in their Ozone Staff Paper, which was reviewed and approved by the EPA's Clean Air Scientific Advisory Committee (CASAC), that the maximum daily background, eight hour average ozone level during summer

months in the United States is 0.03 to 0.05 ppm. There is clearly a significant and important gap between the 0.07 ppm ozone standard that the American Lung Association and other health and environmental organizations advocate and summertime eight hour average ozone levels that can be truly ascribed as "natural background."

The issue of the relatively small percentage of total asthma hospital admissions in New York City avoided by compliance with the EPA proposed ozone standard is used to assert that the standard is not worth adopting. That argument is flawed for several reasons. First, it ignores the fact that several studies have linked ozone exposure to hospital admissions for nonasthma respiratory causes such as pneumonia and bronchitis. Thus, total respiratory-related hospital admissions related to ozone exposure would be almost double those cited by EPA for asthma alone. Second, hospital admissions represent just the tip of the iceberg of a host of other important adverse health effects associated with exposure to ozone levels below the current standard that Chilton and Huebner conveniently ignore. The other health effects include: premature death; emergency room and physician office visits for aggravated respiratory conditions; lost work and school days due to illness; and asthma attacks that require additional medication use. Finally, focusing on a limited analysis of health benefits from a national standard to one city of eight million people provides little insight into the benefits obtained from a strengthened national standard that would protect an additional 47 million Americans living in areas that meet the current ozone standard but would violate the EPA proposed ozone standard.

In discussing the need for a fine particulate matter standard, Chilton and Huebner erroneously assert that epidemiological studies have not found a link between fine particles and deaths due to respiratory disease and lung cancer. In fact, the opposite is true. The most recent analysis of the Harvard Six Cities study data (Schwartz 1996) found a greater risk of death due to fine particle exposure from chronic respiratory disease and pneumonia than for heart disease. The relationship between fine particles and mortality was found even when examining the daily fine particulate levels were half of the level that EPA has proposed. Other studies have found a positive relationship between fine particles and lung cancer, though in the Pope study, the lung cancer link was stronger with sulfate particles than with the broader category of fine particles.

EPA's proposal to establish a separate PM2.5 standard is not only supported by the health science, it was supported by nineteen of twenty-one members of the CASAC review panel. Similarly, it is also clear that a more stringent ozone health standard is warranted to protect the health of people with lung disease, children, and those exercising outdoors. The CASAC review panel unanimously supported a change from a one hour to an eight hour average standard, with a majority of the panel's health scientists supporting a more protective standard.

In conclusion, setting air quality standards based strictly on the current scientific knowledge of air pollution health effects represents sound public health policy. The appropriate place for considering costs remains in the speed and content of strategies selected to meet the standards.

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ACADEMIA USURPED

The fundamental limitation and ultimate futility of a politics of free enterprise based on academic game playing is surfaced neatly by John Shanahan's, "Regulating the Regulators: Regulatory Process Reform in the 104th Congress." (*Regulation,* Winter 1997).

The academics have spent roughly twenty-five years promoting "sunset" laws, "paperwork reduction" laws, "regulatory flexibility and "impact" laws" designed to make the bureaucrats spend more time counting the government's beans, thereby freeing the private sector beans. The end of the road was reached by the 104th Congress, which carried that approach to the highest level imaginable with the obvious effect of, well, nothing has happened . . . once again.

The source of legitimacy in the American government is the people; and their document, the Constitution, sets out what they have prescribed. That document, if read seriously, nullifies virtually all of the bureaucratic system. For instance, the U.S. Constitution requires that Congress alone issue any government regulations. (Article 1, Section 8, Clause 14; Article 1, Section 8, Clause 18). If we follow the U.S. Constitution rather than the neoclassical schools of economics, we find that the position of the activity of the bureaucrats is lawlessness and usurpation. The people's remedy for that is impeachment.

The people are right, the academics are wrong. No one can force a Federal agency to do something it doesn't want to do. Therefore, forcing Federal employees to fill out forms they haven't dreamed up on their own is no more likely to result in a restoration of individual liberty than having them wear Adam Smith ties and chant "Leave it to the Invisible Hand" three times a day standing at attention.

Anyhow, the people have little interest in the ideas of the professors of economics. It is nice that those professors, most of who are themselves state employees or who live on Federal donations, nowadays tend to support attempts to rein in the bureaucracy. But the people have little patience for academic incrementalism and less stake in the excessively cute laws concocted to make federal agencies do paperwork.

It is time for the proponents of bringing regulations under control to link up with the people. It is time to stop pretending that there is an academic "third way" that will result in less government regulation. The American way is to bring the people into the streets to oppose government regulations. Once that is done, the regulators will go the way of George III and the Dodo bird.

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