Briefly Noted

Are Federal Agencies the Sole Judges of Their Own Authority?

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It is no secret that federal agencies incrementally expand their regulatory power by adopting statutory interpretations that go beyond the underlying legislation's plain meaning and purpose. Unfortunately, courts — the branch of government charged with checking such overreach, even in the age of the modern administrative state — increasingly defer to agencies' own "discretion" in exercising their authority. One case that recently made it to the U.S. Supreme Court's doorstep, *National Corn Growers Association v. EPA*, is a case study of this alarming trend.

Under the Federal Food, Drug, and Cosmetic Act, the Environmental Protection Agency establishes limits, or "tolerances," for pesticide residues on food. If a pesticide residue exceeds an established tolerance, it is deemed "unsafe" and the product is removed from interstate commerce, effectively banning it from use. Under the requirements of the act, the EPA must modify or revoke a tolerance it deems unsafe, and the agency would do this through the "notice and comment" process. Then, once the EPA issues a final rule, any party may file an objection. Moreover, both the act and its implementing regulations require the EPA to hold a public evidentiary hearing if any objections raise a "material issue of fact." These requirements are an essential tool for preventing the EPA from unlawfully depriving the public of useful products and entrepreneurs of the value of their innovations without access to independent judicial review.

In 2008–2009, the EPA determined that a pesticide called carbofuran — first registered in 1969 and safely used for pest control on a variety of crops for more than 40 years — posed an unacceptable risk to human health due to aggregate exposure in drinking water. To make this determination, the EPA relied on a new worst-case groundwater model and assumed the admittedly unlikely event "that 100 percent of crops that could be treated with carbofuran would be so treated."

The National Corn Growers Association fiercely disputed this conclusion, submitted extensive comments and evidence on the proposed revocation, and raised four issues in objection to the final revocation. But the EPA ruled that the information submitted by the Corn Growers was incomplete, ignored the serious concerns raised by the group, and revoked all tolerances for carbofuran without a public hearing.

Unfortunately, such a result is not uncommon. In the nearly 40 years that the EPA has been required to hold public hearings under the Federal Food, Drug, and Cosmetic Act, no such hearing has ever been held. The agency has refused time and again to comply with regulations that were designed to prevent the type of abuse exemplified in this case.

And yet again this year, in a decision giving the EPA unbridled discretion in its regulatory domain, the U.S. Court of Appeals for the D.C. Circuit — the federal appellate court that reviews executive agency action — held that courts must defer to the agency in this matter. Although the D.C. Circuit acknowledged that a legitimate dispute existed as to the extent carbofuran is applied to soils vulnerable to leaching into groundwater, it found that such a "dispute between experts" was "fatal" to the Corn Growers' request for a hearing because "we will not overturn an agency's finding [that] there is no material issue of fact upon '[m]ere differences in the weight or credence given to particular scientific studies.'"

The court gave no explanation or review of the factors listed in the EPA's implementing regulations to determine if the material submitted requires an evidentiary hearing. Instead, the court

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Shapiro and McCarthy signed Cato's amicus brief supporting the petition for review in *National Corn Growers Association v. EPA*.

reiterated the EPA's findings and upheld the hearing denial. Furthermore, by declaring that differences in scientific studies are insufficient to trigger judicial review, the court essentially wrote the "material issue of fact" consideration out of the law.

Sole authority | The effects of the D.C. Circuit ruling are not limited to carbofuran or pesticides alone. It also sets a precedent for other products regulated under the Federal Food, Drug, and Cosmetic Act, including "prescription drugs, medical devices, agriculture, food products and additives, and many other consumer products." That precedent is that EPA determinations are effectively not subject to judicial review. The court essentially gave the EPA carte blanche to determine the fate of thousands of products already on the market.

The D.C. Circuit is then supposed to determine whether the EPA properly denied the objectors a hearing, using a summary judgment–type standard of review (evidence considered in a light most favorable to the objecting party and inferences drawn against the EPA). But the court has not applied such a heightened level of review, refusing to question EPA findings in these cases.

The upshot is that under longstanding EPA practice and the court's deferential review, no one has the opportunity to obtain a public hearing.

Indeed, to make the relevant determination regarding carbofuran, the D.C. Circuit analyzed whether "the agency has given adequate consideration to all relevant evidence in the record." But such a standard ignores the clear and unambiguous language of the Federal Food, Drug, and Cosmetic Act, which expressly states that the purpose of a hearing is to "receive factual evidence." In other words, the court that is the principal arbiter of administrative procedure failed to execute the level of judicial review required by law, effectively depriving the Corn Growers of due process.

The Corn Growers thus filed a petition requesting that the Supreme Court review the lower court's ruling, arguing in large part that the D.C. Circuit undermined the act's legal requirements. The Cato Institute joined the Pacific Legal Foundation in filing an amicus brief supporting that petition because the case sets a precedent for other regulated products and allows government agencies to unlawfully deprive citizens of their property without adequate access to judicial review.

The act's hearing requirement was promulgated for the specific purpose of protecting the public from agency abuse of the kind revealed here. While district court hearings involve a neutral arbiter (a federal judge), that is not the case in an agency setting, where administrative proceedings have inherent biases toward the agencies that convene them. And the EPA has openly expressed its disfavor of the hearing requirement, calling them "time-consuming" and "unnecessary."

Unfortunately, the day before this article went to press, the Supreme Court denied the Corn Growers' petition. The Court thus declined the opportunity to curtail abuse of the administrative process and establish that complete deference is incompatible with proper judicial review. But greater checks on administrative procedures are essential to ensuring that decisions to destroy valuable innovations and deprive the public of useful products are not taken without full independent review.

Indeed, the right not to be deprived of one's property without fair process is a bedrock principle of American jurisprudence. The Court should in some future suitable case reinforce this principle and ensure that agencies and lower courts enforce the statutory safeguards intended to protect this right. R

ILLUSTRATIONS BY KEVIN TUMA

Forty Years on the Regulatory Commons

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On January 18, with much fanfare that included a *Wall Street Journal* op-ed (a rare act for a sitting president), President Obama announced Executive Order 13563. The order set in motion yet another presidential effort to exert control over the federal government's regulatory Leviathan, an estate with 280,000 workers and a $60 billion budget that turns out 3,000 new rules annually.

With noteworthy innovations, the order contains some of the same logic for improving regulation found in President Richard Nixon's October 1971 order that established in the Office of Management and Budget a Quality of Life review for major federal regulations. From Nixon forward, there has always been an executive order requiring some kind of White House review of new regulations. And over the years, regulatory review orders have evolved in an apparent effort to free up the economy by reducing regulatory burdens.

With 40 years of accumulated executive order wisdom to draw on and knowledge tapped from turning out some 2.5 million pages of *Federal Register* rules since 1970, President Obama looked the Leviathan in the eye and called for a review that will "root out regulations that conflict, that are not worth the cost, or that are just plain dumb." His order calls for renewed efforts for agencies to conduct benefit-cost analysis of new rules, asks agencies to identify and eliminate regulations that serve no meaningful purpose, and instructs regulators to conduct retrospective reviews of rules and make beneficial modifications. The president also initiated an expanded web-based process that opens windows for those who wish to see what is going on inside the regulatory process. While emphasizing that strenuous benefit-cost analysis must be applied where possible to justify regulations, the order also allows for softer considerations that include "equity, human dignity, fairness, and distributive impacts."

But in spite of the complex administrative machinery described

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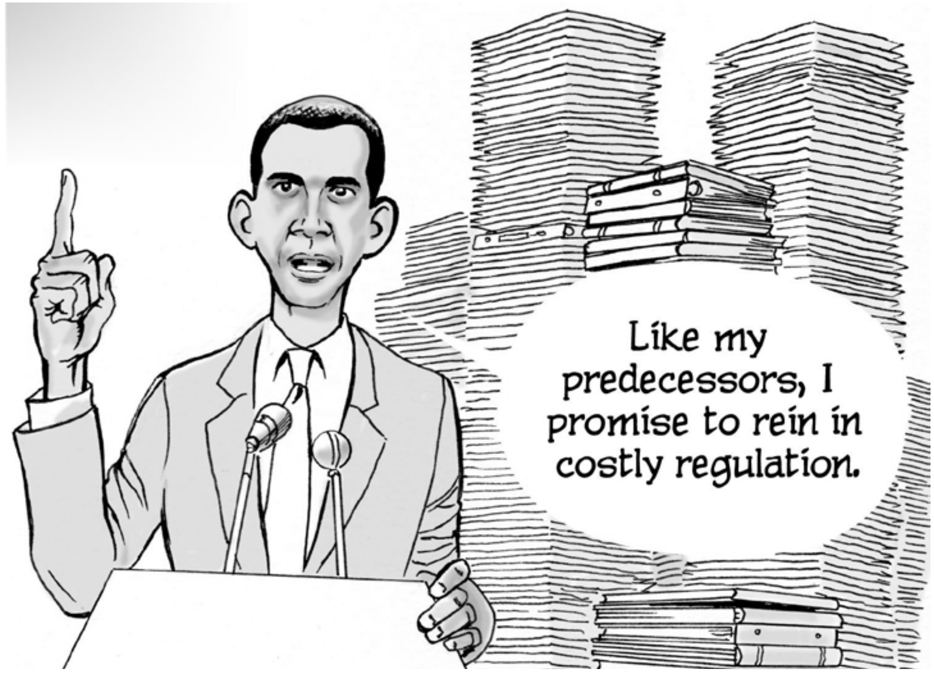
in the Obama order, human incentives still matter most, and incentives for regulators and the regulated have changed over the past four decades. There is nothing in EO 13563 that recognizes that the U.S. economy in the 21st century is very different from Nixon's 1971 economy.



Regulatory commons | In a world where everything can be regulated, requiring agencies to act on better benefit-cost analysis is a wonderfully important idea and requiring retrospective reviews of mossy rules is to be celebrated. But as good as they are, those ideas and others in EO 13563 do not take account of our regulation-driven capitalism and the incentives playing throughout it.

Ours is a regulatory capitalism where regulators and the regulated are intertwined in symbiotic cartel-forming ways that often make working the halls of Congress and regulator offices far more profitable for firms and organizations than struggling in labs, stores, and service organizations to earn consumer patronage. EO 13563 gives commands to an army of regulators who operate as if they are external to the economy they seek to fix, while in fact they are a part of it.

The transformation of the U.S. economy into regulatory capitalism began around 1970, which was the start of the modern regulatory era. It was then that regulation became highly centralized at the federal level, that newly formed social regulators such as the Environmental Protection Agency, Occupational Safety and Health Administration, and Consumer Product Safety Commission joined older economic regulators like the Federal Communications Commission, Securities and Exchange Commission, and Federal Trade Commission to form a new legal environment that ultimately transformed the United States from a common-law to a code-law country.

Inspired by statutes directing action, our 60-plus federal regulatory agencies are somewhat like sheep with legislative guiding shepherds grazing on a regulatory commons, a resource space where there are no systematic limits on the number of rules that can be produced, the time required to read and abide by them, or the economic resources consumed in meeting the rules. Fed by growing budgets and expanded duties, the regulators write more rules. While budgets, congressional directives, executive orders, and benevolent forbearance partially constrain the commons, there is always room for one more bite by the sheep, one more regulation.

The regulatory commons parallels its brother, the fiscal commons. Deficits are the inevitable tendency on one; excessive regulation on the other. In fact, across the years 1970 to 2010, regulatory agency budgets were fed by deficit dollars; they grew faster than federal revenue.

What is it like on the regulatory commons? When one puts on a pair of externality-visualizing glasses, one sees endless opportunities to internalize external costs and maybe even render the world Pareto safe. Whether it be dealing with lead paint, mandatory inspection of catfish, energy efficiency for refrigerators and furnaces, minimum standards for drivers licenses, diesel engine emissions, advertising over-the-counter drugs, marketing practices of funeral homes, or ridding the market of noisy Hickory Dickory Dock pounding toys, the world is full of unhappy and dangerous situations that need fixing.

But with externality glasses, it is much easier to see the flaws than to determine if all people taken together are made better off after the regulatory repairs are in place. And who has time to check? As a result, in the post-1970 period, regulations affecting processes — product design, marketing, personnel, purchasing, finance, manufacturing, and waste disposal — began to affect each and every industrial sector. In a chaotic sense, industries such as autos, food, steel, construction, paper, chemicals, banking, insurance, health care, and higher education were transformed to a new kind of public utility, but without the usual regulatory commission to look after them — and be captured.

On rare occasions over the last 40 years, government analysts made a back-breaking, overall-industry assessment to describe and analyze the cumulative effects of all federal regulations imposed on a single industry. But most of the time, no one has kept score. And even more rarely, regulators would conduct retrospective analyses to determine if indeed the regulations that appeared to be so strongly net-beneficial when imposed really turned out that way. As all of us who have been part of the regulatory establishment understand, there is seldom enough agency time to deal with business in the pipeline, let alone enjoy the luxury of self-examination. All of the incentives go the other way. The next *Federal Register* press run is waiting. In a way, the nature of our work as regulators made it far more important to turn out more regulation than to inquire about outcomes. It was as if no one really cared about outcomes; regulation was the only outcome that mattered. And if there are to be retroactive assessments, does it really make sense to let the regulators pick the ones to assess?

Changing political economy | Years ago, when regulation was young, before we had published those 2.5 million pages of rules, economists spoke knowingly in tones of certainty about market failure and intervention to correct difficulties from such problems as market power, information asymmetries, failed institutions, and unspecified property rights. We spoke as though government and regulation were exogenous to the market process, that on occasions regulators would open a window, examine features of the economy, make some efficiency-enhancing adjustments, and then quickly close the window to leave the economy to operate in a more glorious way. Indeed, we used the word "intervention" and we referred sometimes to Michael Lantz's 1937 FTC statuary metaphor where a powerful free market horse is being bridled by a benevolent plowman who presumably serves the public interest.

But as regulatory windows opened and closed daily and agencies pumped out more rules, firms and industries became intertwined with government. Government was no longer exogenous to the behavior of firms in the marketplace; government became endogenous. While major regulations may have reduced some perceived market failure, they also cartelized industries and reduced competition. The strong horses and other special interests came seeking the plowman.

As the political economy has changed, so the words we use to describe and explain what we are doing have become obsolete. When banks become tantamount to regulated public utilities with rules at every margin, can we accurately refer to problems in the industry as evidence of market failure? Would we better say government failure? Or regulatory failure?

Our theories of regulation suffer as well. Long ago, we referred to public interest theory to describe what regulators sought to do when they opened and closed the regulatory windows. We then talked about capture — that happens when the window is open too long. Then came special interest theory that recognizes the competitive battles at play when multiple interest groups seek regulation to obtain well-packaged gains. And yes, there is bootleggers-and-Baptists theory that offers to explain how apparently opposing groups may struggle on the regulatory commons to obtain the same set of rules. But we must enrich our behavioral theories. We must focus on the process itself and how the regulatory process has affected the U.S. economy.

Final thoughts | Ours is an intertwined political economy where economic agents — public and private, always connected — interact on the commons. Cutting through the entanglement will be difficult. Each rule worth revising or repealing maintains wealth for members of the regulatory cartel.

While critically important, as EO 13563 makes clear, it is no longer enough to do benefit-cost analysis on a rule-by-rule basis in the belief that regulation is exogenous to the market process. In terms of improving the new rule, the following should be incorporated:

- Agencies should be required to conduct potential cartel analysis for every major industry rule. They should also identify industry winners and losers under proposed rules, account for the gains and losses that may result in a rule-induced regulatory cartel, and estimate deadweight losses imposed on consumers.
- The Antitrust Division of the Department of Justice and the Federal Trade Commission should be required to review major rules in cooperation with the White House's Office of Information and Regulatory Affairs, and should intervene as appropriate in regulatory proceedings that may have inefficient outcomes.
- In conjunction with the required retrospective assessments and industry reviews, Congress should hold annual hearings to review those reports, with an eye toward improving the competitiveness of the U.S. economy and identifying the economic gains obtained through regulatory review by OIRA.

Going beyond executive orders and OIRA review, Congress should exercise its sovereign responsibility on behalf of the people. This requires it to close the circle of accountability so that all regulatory agencies — executive branch and independent — meet the same accountability standard. To accomplish this, Congress must pass legislation that requires the Congressional Budget Office to:

- become a government-wide scorekeeper on regulatory burdens imposed by legislative mandates, and
- assess pending legislation that includes regulatory mandates and recommend cost-effective alternatives.

Congress must then hold annual hearings on the state of regulation in the economy and how regulation is affecting competitiveness in the U.S. economy. On the basis of those hearings, Congress should take action to set constraints on the amount of regulatory cost that can be imposed annually on the U.S. economy.

Two and a half million pages of rules and 40 years later, it is time to enclose the regulatory commons and sharply revise the way we regulate. R

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Obfuscation at the EPA

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In a move reminiscent of the phantom "regulatory reform" of the Clinton administration, President Obama recently issued Executive Order 13563, calling on federal agencies to improve federal regulation and the regulatory review process. (See "Forty Years on the Regulatory Commons," p. 6.) In accordance with the order, dozens of agencies have solicited comments from the public on how best to "modify, streamline, expand, or repeal" onerous regulations that do not pass cost-benefit analysis or cannot be justified by accepted science.

While the administration may be saying what businesses want to hear on regulation, a less noticed change in its regulatory approach has the potential to undo any of its supposed efforts to improve the regulatory climate. Over the last year, the administration has quietly altered the calculus in its cost-benefit analyses by treating any worker hired by a business or government entity as a benefit to the economy because of the job created, and not as an additional cost of doing business. Such an approach stands the entire concept of cost-benefit analysis on its head. It threatens to remove the ability of the Office of Management and Budget — which is tasked to play traffic cop for regulations — to apply any sort of rigorous analysis to the raft of regulations promulgated by the various executive branch agencies every year.

The EPA's creative analyses | One agency exemplifying this confused thinking about costs and benefits is Obama's Environmental Protection Agency. According to the EPA's own Regulatory Impact Analyses (RIAs), regulations issued by the agency since the end of 2009 will impose $153.4 billion in new economic costs on businesses and result in an estimated 58,000 jobs lost. The agency estimates that compliance costs for new rules in 2011 alone will surpass $7.7 billion. Although these might sound like staggering numbers during an abbreviated period, the way the EPA produces its estimates suggests that the true figures are much higher.

Currently, several laws and executive orders require the EPA and most other administrative bodies to review new rules and conduct cost-benefit analyses, but none go so far as to spell out exactly how such analyses should be conducted. As a result of this omission, the administration appears to have carte blanche in its methodology.

For example, in the EPA's recent RIA covering Industrial, Commercial, and Institutional Boilers and Process Heaters, it found that "an increase in labor demand due to regulation may have a stimulative effect that results in a net increase in overall employment." This language was reprised verbatim in a RIA covering Commercial and Industrial Solid Waste Incineration Units as well as the revised Toxics Rule for mercury emissions. Put simply, this analysis confuses a cost for a benefit, an error that the agency seems intent on making in every new rule that has the potential to affect employment.

Economists agree that when regulations force firms to buy equipment and hire compliance officers, those burdens entail a cost. Though it may be true that, to use language from the Process Heaters RIA, "regulated firms demand workers to operate and maintain pollution controls within those firms," it is inappropriate to attribute the forced hiring of new workers as benefits or stimulative to the economy when businesses have to absorb the costs of hiring and training new workers.

Under the EPA's economic analysis, forcing firms out of business might be a boon to the struggling legal industry and bankruptcy attorneys. As the agency has suggested in its past RIAs, times of high unemployment are optimal for imposing regulations that "increase overall employment." President Obama's new order seems to have forced the wrong sort of innovative thinking among his agencies; the tone of most RIAs makes it clear that few EPA analysts are reading Frédéric Bastiat.

Furthermore, the EPA has repeatedly stated that forcing businesses to purchase pollution control equipment should be treated as a benefit, not a cost on production, for the same dubious reasons. In its Process Heaters RIA, the agency found that "in addition to the increase in employment in the environmental protection industry (increased orders for pollution control equipment), environmental regulations also create employment in industries that provide intermediate goods to the environmental protection industry." Once again, the EPA is conflating benefits with actual costs. It addresses the costs imposed on specific businesses as a result of buying pollution control devices, but then asserts that the increased business costs will benefit the overall economy.

A fair assessment of costs and benefits should be an industry-specific approach. The EPA should quantify the cost of having to hire more employees or purchase new goods for each particular business sector. If the agency also seeks to examine the macro effects of reduced profitability, lowered stock prices, and diminished wages and employment in a particular sector, then that analysis would be welcomed as well, provided the agency remains at least partly tethered to reality when performing the analysis.

Cost estimates of new regulations should provide a valuable guide to politicians and voters. In the past two years alone, the EPA has promulgated rules that will impose billions in new regulatory costs, which in turn could result in tens of thousands of lost jobs. It makes far more sense to publish an accurate cost estimate of proposed rules than to underestimate the costs due to semantic obfuscation and later discover that a regulation reduced economic growth and eliminated jobs from the private sector.

Revising current cost estimates | Besides discerning the difference between an economic cost and a benefit, the EPA should

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also review the original cost estimates of newly issued regulations where analyses of economic impacts are opaque for whatever reason. While lobbyists, think tanks, and a whole host of other interests pore over legislation, regulations often occur far from the public eye, with less scrutiny. The efforts of the OMB, Congressional Budget Office, and Congress's Joint Committee on Taxation are generally successful when estimating the impact of any piece of legislation that affects the budget; but the Office of Information and Regulatory Affairs and the agencies themselves do a poor job of communicating the actual cost of regulations to the public.

As a belated acknowledgement of this fact, Section 6 of EO 13563 calls for a retrospective analysis of existing rules. Agencies have been slow to formulate plans for carrying this out, but each agency must "periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed."

The EPA should start by reviewing its cost estimates for the Sewage Sludge Incineration Units Rule and the Greenhouse Gas Tailoring Rule. Both are considered major regulations but lack estimates on potential job losses. The current Incineration Units RIA estimates potential costs of approximately $132 million, but it nowhere mentions its potential impact on employment. The agency's cost estimates for using the Clean Air Act to regulate carbon emissions are similarly suspect, mentioning only the benefits of regulating major greenhouse gas sources and saying nothing of the impact on employment. In fact, the most recent RIA lists more than $193 billion in net benefits for final implementation, but categorizes potential burdens as "unquantified social costs" of foregone environmental benefits. According to the EPA, costs can be benefits and the cost of not enacting legislation would be lost benefits.

Improving future cost estimates | The EPA largely relies on its own assessments of costs and benefits or those of contractor RTI International, a private company in North Carolina's Research Triangle that receives a significant amount of federal funding. RTI has performed numerous environmental cost-benefit analyses and received $23 million in EPA funding during FY 2010.

RTI collects the lion's share of its $758 million in revenue from government agencies, including the EPA. With more than 80 percent of its funding in the form of federal payouts, it seems reasonable to question RTI's independence. It is not absurd to suggest that on some occasions private companies conducting federal research may strive to publish results that their client desires. Instead of solely relying on RTI, rotating between private economic firms should yield more accurate cost projections, or at least end the virtual monopoly that one company has for performing important cost-benefit analyses.

In addition, many Obama administration regulations that qualify as "economically significant" (compliance costs of more than $100 million) under EO 12866, President Clinton's regulatory executive order, do not contain actual cost estimates, in violation of that order. The OMB completed reviews of 41 economically significant EPA regulations in the past two years, but only 15 RIAs were issued during that period.

A recent Government Accountability Office report covering the 1995 Unfunded Mandates Reform Act (UMRA) underscores this problem. The GAO found that many rules are never characterized as federal mandates under the act because they supposedly qualify for one of its 14 exemptions. For example, among the major rules published in 2001 and 2002, more than half did not trigger UMRA. The GAO found that an "evaluation of existing rules through retrospective reviews has the potential of being able to better assess the effectiveness of UMRA, among other benefits." During the EPA's review of "obsolete, unnecessary, unjustified, excessively burdensome, or counterproductive" regulations, it should reexamine previous rules and determine whether they were excluded from scrutiny under UMRA.

Fostering transparency at the EPA | In addition to communicating with the public via cost estimates, the EPA should place transparency and accountability at the forefront. The agency's website for regulatory analysis, *Reg Stat*, is a good tool, but it is not enough. For instance, the agency could post dockets and comments it has received directly on its website rather than solely listing them in the *Federal Register*. In comparison, the Federal Communications Commission has a searchable database on its website of rulemaking dockets and public comments.

The EPA failed the basic transparency test last March when it established rules for power plant mercury emissions, but it mentioned only the benefits and not the costs of that rule in its press release and on its webpage. It neglected to note the estimated 45,000 jobs that could be lost as a result of the new regulations. The agency did, however, suggest that the rule might someday generate 35,000 jobs "in the directly affected sector."

Scholars can debate the merits of certain EPA regulations, but one thing is certain: these material omissions should not continue. Federal agencies are now operating essentially as propaganda outlets for the current administration. Whether it is Andy Griffith touting the supposed benefits of the new health care law or the EPA hiding the potential job losses from new regulations, only regulators benefit from reduced transparency. Legislative cost estimates from the CBO or JCT generally include nonpartisan employment consequences and total costs. The EPA should be no different.

Hope for change | The EPA is unlikely to change its practices drastically during the current administration. Even if President Obama fails in his reelection bid next November, his successor can only accomplish so much given the bureaucratic inertia.

It is no secret that the typical EPA bureaucrat has strong environmentalist leanings and is willing to err on the side of the environment when it comes to issuing regulations. Americans should at least insist that the agency perform something approximating an honest accounting of the costs and benefits of any regulation it issues and that the OMB act as a impartial judge when analyzing those regulations. And each should start off with a basic understanding of the difference between a cost and a benefit. R