

Although EPA will not complete its screening by the scheduled date of November 1979, decisions have been made to eliminate three solid waste and one motor vehicle fuel economy regulation. Of the remaining 23 regulations which have been screened, nine have been scheduled for short term revision and another nine for long term review.

Major statutorily required reviews completed during the last year include:

--Review of the ambient air quality standard for ozone. EPA estimates that final standard will result in cost savings of about \$2 billion annually when compared with the previously existing standard.

--A cost effectiveness review of existing effluent guidelines for conventional pollutants. EPA estimates cost savings of \$200 million annually for the several affected industries.

EPA has improved several existing programs through revisions of regulations not included in the screening and statutory review. Leading examples include:

--A thorough revision of its regulations for sewerage treatment grants. This will speed up processing time for several water and sewer grants by more than a year and achieve a 30-40% reduction in the paperwork requirements for a small town's grant application.

--A complete rewriting of regulations for issuing water discharge permits, consolidating them where possible and making them much less confusing to regulated firms. EPA is also consolidating permit regulations for five programs, designing a single application form, and designating a single unit in each EPA regional office to reduce delay in the application process.

EPA also deserves credit for experimenting with new and innovative approaches for improving enforcement efficiency and the cost effectiveness of existing regulations. Examples include:

--Noncompliance Penalties. In the Clean Air Act Amendments of 1977, Congress gave EPA the authority to use economic disincentives as a supplement to traditional regulation. Under section 120 of the new law, EPA will collect from each violator of air pollution standards the amount of

money which the violator has saved by not installing pollution control equipment. EPA issued proposed regulations to implement noncompliance penalties in March 1979. Final regulations are due in August 1979.

--Offset Strategy. One of the most complex and difficult issues under the Clean Air Act is whether and to what extent the national ambient air quality standards permit new industrial growth in nonattainment areas where pollution exceeds the standards. In December 1976, EPA issued a rule allowing the construction of a source of air pollution if specific requirements are met. One of the requirements is that emissions from existing sources be reduced enough to more than offset the expected pollution from the new source. In January of this year, EPA revised its 1976 ruling to allow industry and State and local governments to bank emission reductions for future use or sale.

--Bubble Concept. Under their current policies, EPA and State agencies set separate pollution control standards for each polluting process in an industrial plant. Under the bubble concept, EPA gives a company some flexibility to adjust its control efforts on different processes (e.g., reducing pollution where the control is easiest and cheapest, and allowing more pollution where the control is more difficult and expensive) so long as total pollution from the plant would not exceed the current standards. This concept offers the potential of meeting pollution standards at a lower cost. EPA had begun implementing the bubble concept for air pollution programs in January 1979 and is studying its applicability to water programs.

#### PLAIN ENGLISH

Before the Executive Order, EPA acknowledged that the clarity of EPA regulations was not much different from the bureaucratic norm. The agency has since instituted several plain English measures. For example, it selected a new regulation in each of nine program areas and had an editor from the agency's Plain English project help to make it clearer. By February 1979, all these "model" regulations had gone to the proposal stage. Both the draft regulations and their preambles showed substantial improvements in clarity. In addition, the Plain English project prepared a report on how EPA could continue to improve its regulation writing. A style manual has been prepared for regulation writers and a full time editor has been hired to assist them.

Preambles to EPA regulations have generally shown a noticeable improvement in clarity. However, EPA has also issued several regulations for the control of water and toxic substances which are exceedingly complex and difficult to comprehend. Members of the public, for example, criticized EPA premanufacture notification rules for new chemicals in terms of their size, readability, structural complexity and level of detail (e.g., 6000 distinct provisions, 60 percent of which are exceptions to other provisions; sentences of 50 to 100 words; many multi-syllable words). The public has similarly criticized EPA's recently proposed consolidated permit and toxic water regulations for their complexity and level of detail.

#### CONCLUSION

Taken together, EPA's efforts demonstrate a solid and growing commitment to implement the five Executive Order goals. In coming months, EPA will:

--Further strengthen senior management oversight, emphasizing involvement by senior regional managers and will conduct a pilot effort to apply independent, expert review of the quality of agency decision documents.

--Augment resources for analyzing new regulations and inaugurate a major study effort for the analysis of benefits in EPA decisions. The Agency will also define a model regulatory analysis for use by work groups, better assess the impact of regulations on its own resource commitments, and engage a private consulting firm to implement an innovative program for evaluating all new significant regulations.

--Further expand its regulatory agenda and move ahead with a program to compensate the expenses of certain participants in regulation development.

## EXECUTIVE OFFICE OF THE PRESIDENT

The Executive Office of the President carries out a wide variety of functions that support the President in the execution of his duties. The components of the Executive Office are not commonly thought of as regulatory agencies, but three components--the Office of Management and Budget, the Council on Wage and Price Stability, and the Council on Environmental Quality--do issue regulations or directives that frequently have widespread effect. These three components have embraced the spirit of the Order, established procedures to implement it, and shown improvements, particularly in public participation.

## OFFICE OF MANAGEMENT AND BUDGET

The Office of Management and Budget (OMB) is not generally considered a regulatory agency. OMB rarely issues rules that directly require compliance by those in the private sector. It does issue directives that are applicable to all executive branch agencies. When agencies apply these directives, the effect upon the public is sometimes similar to that of a regulation. OMB circulars govern a wide range of Federal agency requirements including administrative requirements for grants with universities and hospitals, policies for acquiring commercial or industrial products, and paperwork controls.

OMB published its draft implementation plan for complying with E.O. 12044 on May 22, 1978, and its final plan on February 28, 1979.

## POLICY OVERSIGHT

Implementation of the Order has made policy oversight of circulars more systematic. OMB Associate Directors are responsible to notify the Director of decisions to initiate or revise an OMB circular. Proposed directives are required to be approved by the Director, and the Director approves OMB's agenda. The Director and Deputy Director have made clear by order and action that they are most concerned with adherence to both the letter and spirit of the Executive Order.

## PUBLIC PARTICIPATION

OMB has made its greatest progress in this area. In the past, OMB has not usually sought public comment on its

draft instructions to agencies. Now, OMB has committed to undertake "a systematic effort to increase public participation in the development of circulars and bulletins that are likely to have a significant impact on the public, on State and local governments, and on public and private institutions." As an example of the effectiveness of its new procedures, OMB cites its revision of Circular A-21, "Cost Principles for Educational Institutions," which prompted much public reaction and was revised to reflect many expressed concerns. In addition, OMB held special briefings on this revision with university representatives and Congressional staff members, and invited public attendance at these briefings. Finally, OMB has decided to place a listing of all its circulars in the Code of Federal Regulations to allow for easy public access.

#### REGULATORY ANALYSIS

Although few, if any, OMB directives have economic consequences that exceed \$100 million annually, OMB will use discretionary authority provided in E.O. 12044 and require analyses for proposals that will have a significant direct effect upon the public.

#### REVIEW OF EXISTING REGULATIONS

In its draft implementation plan, OMB indicated that it would conduct "a fundamental review of the structure and content of its entire system of circulars. Circulars that are outdated, not clearly written, unnecessarily burdensome, or do not deal with significant government-wide policy matters will be updated or eliminated." Although this statement did not appear in OMB's final implementation plan, OMB did promise a periodic review of existing directives. OMB's semiannual agendas have identified directives being revised.

#### PLAIN ENGLISH

OMB acknowledges that this area requires much greater attention. There are few examples of efforts to revise circulars for clarity. OMB should give this area higher priority.

## COUNCIL ON WAGE AND PRICE STABILITY

The Council on Wage and Price Stability (CWPS) implements the President's voluntary wage and price program and monitors and analyzes inflationary developments throughout the economy. The Council clarifies policy through regulations or voluntary standards.

The Council has set forth procedures for the public to observe in supplying or requesting information, responding to notices of probable noncompliance and requesting removal from the Council's noncompliance list.

Voluntary standards are the Council's form of "regulations." They set forth the voluntary wage and price guidelines for the public to follow. These standards are voluntary; they do have an effect similar to regulations on many people. Accordingly, after initial reluctance, the Council agreed to follow the Order for these standards.

CWPS published its initial E.O. implementation plan for comment on July 18, 1979.

## POLICY OVERSIGHT

Under the Council's proposed implementation plan, the Director will approve all significant proposed rules prior to publication.

## PUBLIC PARTICIPATION

Commentors have complained about the lack of sufficient time CWPS has allowed for response to some of its most important actions, including the wage and price guidelines. CWPS will expand its public comment periods to 60 days according to the implementation plan. On occasion, public hearings will be held. CWPS has recently established two advisory committees (Wage Advisory Committee and Price Advisory Committee) with representatives of industry, business associations, and organized labor to advise the Council on the implementation of the wage and price guidelines.

## REGULATORY ANALYSIS

No regulatory analyses have been done or are presently contemplated. However, the implementation plan provides for such analysis.

## REVIEW OF EXISTING REGULATIONS

The Council claims to review its existing regulations regularly. However, the proposed implementation plan does not provide for a formal "sunset review" program.

## PLAIN ENGLISH

The original wage and price standards were criticized for being confusing and complicated. However, CWPS is consulting with a variety of affected groups to make the standards as clear as possible.

## COUNCIL ON ENVIRONMENTAL QUALITY

The Council on Environmental Quality (CEQ) is responsible for two regulations: rules implementing the procedural requirements of the National Environmental Policy Act (NEPA) and the National Oil and Hazardous Substances Pollution Contingency Plan regulations. Although the Council was at first reluctant to apply the Order, this attitude has changed and it is now following the Order's provisions. CEQ published its plan for implementing E.O. 12044 on November 20, 1978.

## POLICY OVERSIGHT

Because the Council is a small organization, policy oversight is very direct. The Council's Chairman approves regulations and agendas before they are published and participates directly in their preparation.

## PUBLIC PARTICIPATION

The Council has taken steps to ensure extensive public participation in preparing and revising their two rules. A detailed analysis of more than 500 public comments was made for the Council's review in determining the final content of the NEPA regulations. The Council has published two notices in the Federal Register to inform the public on agency progress in streamlining the NEPA procedures. A 60-day comment period was allowed on the recent publication of Oil and Hazardous Substances Pollution Contingency Plan rules.

## REGULATORY ANALYSIS

No regulations requiring regulatory analysis have been issued. The NEPA regulations do require agency evaluation and comparisons of alternatives.

## REVIEW OF EXISTING REGULATIONS

With only two regulations in place, "sunset" review is only minimally applicable to CEQ.

## PLAIN ENGLISH

The Council has focused particularly on writing the NEPA regulations in plain language. It received numerous compliments on those rules from groups such as the National Governors' Conference, the Chamber of Commerce, and the National Wildlife Federation. CEQ is working with other agencies to make their individual NEPA procedures understandable.

## CONCLUSION

Although not regulatory agencies, the components of the Executive Office that issue regulations or directives having similar effect have made progress in implementing the procedures of the Order. As has been the case with several other agencies, the greatest improvement has been in providing for increased public participation. This is a very important achievement. There has been a firm commitment to writing regulations and directives more clearly and simply, but only the Council on Environmental Quality has made significant progress.



## GENERAL SERVICES ADMINISTRATION

The General Services Administration's (GSA) regulations chiefly give agencies procedures to follow in such areas as using real property and getting office space in buildings. GSA is not a major regulatory agency, but many of its regulations when applied by agencies do have an effect on the public.

Exclusions in the Executive Order relating to procurement and agency management exempt many of GSA's regulations from the Order's provisions. Still, GSA has tried to follow the spirit of the Order. Moreover, as the publisher of all Federal regulations, GSA has a unique leadership role, especially in improving clarity and simplicity of writing.

The agency's plan for implementing the Order was published in the Federal Register on December 4, 1978.

## POLICY OVERSIGHT

GSA claims that agency head approval of significant regulations produced no change from past performance. However, the Administrator now becomes routinely involved in the development stage by:

--Assigning staff members to task forces for implementing the Executive Order;

--approving the semiannual agendas before publication;

--approving all regulations regardless of significance before they are issued.

GSA also has found the agenda a useful tool to focus attention on important regulations and keep the Administrator involved in the rulemaking process.

GSA issues approximately 50 to 60 regulations a year, and about five percent of these are returned to the originating office by the Administrator for revisions.

## PUBLIC PARTICIPATION

GSA has complied with the spirit of the public participation provision of the Executive Order by soliciting public comment on non-significant regulations as well as significant regulations. The agency recently allowed the public more than 60 days to comment on a proposed rule, "Smoking in Public Buildings," which is a non-significant rule, but one of considerable potential public interest. In one

instance, GSA was forced to waive the 60 day comment period before issuing a final significant regulation. This regulation increased the rate per mile Federal employees are paid when they drive their own automobiles on government business, and was issued in response to a Congressional mandate. The preamble to the Federal Register publication explained that although the regulation would be effective on issuance, comments on the temporary regulation would be considered for possible inclusion when the regulation is made final.

#### PLAIN ENGLISH

GSA's regulations generally are clear and easy to understand. Its plan for implementing the Order was one of the easiest to read. GSA regulations are developed by program offices and reviewed by directives analysts or specialists who are not members of the originating office. This is intended to make regulations understandable to individuals who do not have background in the field covered by the regulations.

GSA also has issued rulemaking manuals, identified specific plain English substitutes for commonplace gobbledygook, developed model regulations, and established regulation writing courses to aid other agencies.

## VETERANS ADMINISTRATION

The Veterans Administration (VA) is not a major regulator, but it does issue important regulations concerning the administration of health, housing, and education programs for veterans.

Particularly relevant to the assessment of performance under Executive Order 12044 is the effect on the housing and education sectors, which are directly affected by the administration of the VA programs. The direct impact on the health sector of VA health program regulations is limited by the fact that the VA hospitals provide the principal delivery mechanism for VA health services.

## POLICY OVERSIGHT

Policy oversight in the development and review of regulations involves primarily the Administrator, Deputy Administrator, the General Counsel, and the Inspector General. Policy review occurs before the start of the developmental process, before proposal, and before final approval of the new regulation or change in existing regulation.

The principal change in procedures since implementation of the Order is inclusion of the Inspector General in the process. His function is to review regulations for their economic effects, Federal government costs, and protection against possible fraud and abuse. So far, no major proposals for change have been initiated by the Inspector General except in the area of abuse protection.

Additional attention should be given to the time lag in preparing significant regulations. The December 1978 agenda showed four out of nine significant new regulations under development for legislation passed prior to 1978, and the June 1979 agenda showed an additional seven significant new regulations for legislation passed prior to 1978. The agency should set timetables for moving from passage of legislation to proposed regulation for both significant and non significant regulations.

## PUBLIC PARTICIPATION

The Veterans Administration has established procedures for implementation of this aspect of the Order and some identifiable improvements have resulted. VA seeks public comment through publication in the Federal Register of

the semi annual agenda and through notices of proposed rulemaking (NPRM's). The usefulness of the agendas are limited, however, by the fact that VA fails to note the status of previously listed proposals. Except for the loan guarantee program, VA does not make use of advance notices (ANPRM's), principally because affected organizations are contacted for their ideas in the development of the legislation on which the new regulations are based. The VA does make use of other methods recommended in the Order, including public meetings and conferences, issuing news releases, and direct contact with veterans' organizations and organizations whose members are directly affected by the VA regulations, e.g., education associations.

Talks with representatives of some of the education associations indicate that they are being regularly consulted and that the VA has stepped up its efforts at meaningful consultations, including talks with top level VA officials. They believe that "concrete improvements in the VA regulations have resulted from these consultations."

Another direct impact of the Order has been the raising of the standard comment period from 30 to 60 days for all significant regulations. There have been few exceptions in practice to this new policy.

#### REGULATORY ANALYSIS

Because no new or revised regulations have been estimated to have an effect of \$100 million or more, no regulatory analyses have been performed. Changes proposed in existing regulations reflect the objective of reducing costs of regulation and burden on the public, but formal analyses of alternatives have not been developed. It would be in the spirit of the Order if analyses were performed for the most significant new regulations and proposed changes, even if none meet the threshold.

#### REVIEW OF EXISTING REGULATIONS

VA had a head start in this area by virtue of the Administrator's June 9, 1978, order of a base review of all administrative issuances, including regulations. This preceded VA implementation of the Executive Order but clearly reflects its explicit objectives.

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VA intends to complete the base review within a five year period. The regulations initially chosen for review have been those with known problems and particularly those that have been recent targets of complaint. For example, regulations are being reviewed that require at least 50 percent of VA-supported students in vocational schools to find employment in the occupational field for which they were trained. After review of this initial group, however, the VA will need to develop a strategy for reviewing the remainder.

Action is still incomplete for nearly all of the existing regulations under review, and no estimates for reduced burdens or costs are available.

#### PLAIN ENGLISH

Although implementation of the Order clearly has led to increased efforts to achieve clarity and simplicity, this also still appears to be an area that needs more attention. In particular, VA needs to reexamine the necessity of adhering strictly to statutory language even when it is difficult to follow.

The VA receives suggestions on a regular basis from the Federal Register staff. Internally, an additional review is now done for improvements in plain English. One example of a concrete improvement is the proposed revision of the regulation on reimbursement for independent study. Existing regulations have not provided sufficient definition of independent study to prevent ambiguities, and, as a result, VA allowances have been challenged in court. The proposed revision, although longer, does reduce ambiguity and increase fairness to beneficiaries by standardizing the basis of payment.

#### CONCLUSION

VA has consistently implemented the procedures called for in the Order, and public comments corroborate our evaluation that some improvements have resulted. After a good start, there is still potential for further improvement. In particular, VA needs to ensure that the potential of the plan for policy oversight is realized, develop a more comprehensive strategy for review of existing regulations, and take a more concerted effort at improving the clarity of regulations.

## SMALL AGENCIES

Many smaller agencies are also subject to the requirements of Executive Order 12044. Some of these small agencies issue a very limited number of regulations (for example, the Committee for Purchase from the Blind and Other Severely Handicapped and the Pennsylvania Avenue Development Corporation). Others, such as the Small Business Administration and the Community Services Administration, issue more regulations that affect large numbers of individuals and groups. Some small agencies issue primarily administrative requirements (American Battle Monuments Commission); others set conditions for financial assistance (Farm Credit Administration); and still others set rates and run utilities (Tennessee Valley Authority).

The variety of functions carried out by the smaller agencies and the generally limited nature of their regulatory responsibilities makes application of the Order to their decisionmaking processes uneven. Most agendas are small; few, if any, regulations require a regulatory analysis. Many of these agencies, however, are using the Order to improve public participation in rulemaking, strengthen policy oversight, and ensure agency review of existing regulations. Some agencies have not issued any new regulations since the Order, however, all indicated they intend to apply the Order in developing future regulations.

## POLICY OVERSIGHT

The smaller size and limited number of regulations issued by these agencies enables policy officials to maintain closer supervision of the regulatory process than is possible in larger departments. Although policy level oversight was generally adequate before the Order, it has been more systematic and formal in some small agencies since the issuance of the Order.

-- Work plans setting forth the need for the regulation, the legal authority, whether or not a regulatory analysis is required, and a plan for public involvement are now prepared for significant regulations of the Small Business Administration. This work plan must be approved by the Administrator. In addition, a new section of the General Counsel's Office has been established to oversee compliance with the Order.

-- The Administrator of the National Credit Union Administration now receives a "preliminary review memorandum" for each significant regulation. For example, a review memorandum was recently prepared for regulations permitting

Federal credit unions to act as agents for approved mortgage lenders. The Administrator noted that "through the use of this memo, I was able to oversee the development of this regulation (prior to the drafting of a proposed regulation) by providing comments on each of the eight issues presented."

#### PUBLIC PARTICIPATION

Sixteen of the small agencies have published at least one semiannual agenda. Several agencies have noted that the preparation of an agenda has increased senior staff awareness of issues involved in developing a regulatory proposal. For example, the Administrator of the National Credit Union Administration (NCUA) reports that "I have used the semiannual agenda as a tool for more effective oversight of the development and review of NCUA's regulations by requiring quarterly updates." The Farm Credit Administration (FCA), on the other hand, uses the agenda to increase the involvement of its member organizations in "sunset" reviews. The staff noted that the response "was so great we have enough reviewing to do for the duration of the reporting period." In most of the smaller agencies, however, agendas have produced only a small increase in public inquiries.

Although the smaller agencies have generally extended their comment periods to 60 days, some regulations are still being issued without adequate time for the public to respond. For example, a proposed regulation on due process rights for applicants denied benefits under CSA-funded programs was originally given a 30-day comment period by the Community Services Administration. However, after several inquiries, CSA agreed that the regulation was significant and the comment period was extended.

Most agencies are trying to expand public awareness of and participation in their rulemakings.

-- The Pension Benefit Guarantee Corporation is issuing a quarterly update of "regulatory highlights to some 2,500 pension professionals.

-- The National Foundation on the Arts and Humanities provided a six-month comment period on its regulation to aid the handicapped. A special task force was established and included representatives from organizations of handicapped persons, arts service organizations, and the cultural fields. A special brochure was prepared to explain the regulations to the visually impaired.

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-- The Equal Employment Opportunity Commission experimented with a simple question and answer format in the preamble to its sex discrimination regulations in the hope that more members of the public would understand the intent of the regulation.

-- The Community Services Administration prepared a Spanish translation of one recent NPRM. Before the development of a proposed rule for its Community Food and Nutrition Program, a direct mailing was made to each grantee soliciting views on past operating experience. One of CSA's regional offices established a coordinating council with members representing community agencies, state economic opportunity offices, and local groups to review and critique the proposed rule.

#### REGULATORY ANALYSIS

Few regulatory analyses were expected from these smaller agencies because of their limited regulatory responsibilities. We are aware of only one small agency that has completed a draft regulatory analysis for a proposed regulation. The National Credit Union Administration has completed the draft analysis on the Central Liquidity Facility regulations. It is also working on one to accompany the regulations requiring Federally insured credit unions to maintain minimum liquidity reserves. NCUA reports that "as an example of the impact of the regulatory analysis, we decided to include U. S. Government securities (with maturities under one year) in the definition of 'liquid assets' because the analysis indicated that this broader definition would be less burdensome and result in a smaller potential reduction of income from adjustments required by the regulation."

The limited number and nature of small agency regulations is not, however, an automatic reason for asserting that a regulatory analysis is not required for their regulations. OMB and the Council on Wage and Price Stability disagreed with EEOC that recently proposed regulations on recordkeeping requirements did not require a regulatory analysis and EEOC has agreed to do a careful analysis of the potential costs.

#### REVIEW OF EXISTING REGULATIONS

Most of the small agencies have started a formal review of their existing regulations. Some early progress is being made:



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-- EEOC is reviewing its guidelines on religious discrimination and the procedures for filing an EEO complaint. These reviews may have a major impact on the effectiveness of the EEO programs.

-- The Small Business Administration's (SBA) procurement technical assistance regulations establishing policy and procedures for prime contracting, property sales, and sub-contracting assistance are undergoing a complete overhaul. Regulations governing SBA funding of small business investment companies to provide venture and equity capital are also being reviewed.

-- The CSA has reduced the number of its regulations by 16 percent over the past 18 months.

-- The Postal Service, which is complying voluntarily with the Order, has completed a major overhaul of its domestic postal services regulations. A report by a special task force established by the Postmaster General recently recommended that several regulations be revised and suggested areas where new regulations would be needed to improve transportation handling and timely delivery of mailings. Several of the recommendations have been adopted.

-- Existing individual agency procedures for the economic evaluation of water projects published by Interior, Agriculture, the Corps of Engineers and other agencies have been reviewed and consolidated by the Water Resources Council. The Council has proposed a single set of new procedures to replace the various agency procedures and standardized considerations necessary to complete an evaluation of costs and benefits in water resources planning.

#### PLAIN ENGLISH

Efforts to improve the readability of regulations issued by the small agencies are inconsistent. Some agencies are trying to do a better job but many have not concentrated their efforts on this aspect of the Order. We will be encouraging more progress in this area over the next six months.

## INDEPENDENT REGULATORY AGENCIES

Most of the eighteen independent regulatory agencies are hybrid organizations created to insulate certain regulations from undue political pressure. They carry out a mixture of executive, legislative, and judicial functions. Much of their responsibility involves adjudication on pricing or market share matters among individuals and companies. The Commissions are directed by Presidentially appointed and Senate confirmed commissioners who can only be removed for specified statutory reasons. Oversight of these agencies is carried out by both the President and Congress, and there is a continuing debate regarding the degree of independence they exercise.

When President Carter issued E.O. 12044, he was aware that applying the Order to these agencies might trigger strong objections from the Congress and provoke a confrontation that could obscure the fundamental objectives of the Order. Therefore, he asked the independent regulatory commissions to voluntarily pursue the goals of the Order. The President asked each of the independent regulatory commissions to report to him and to the Congress on their plans for voluntary compliance. Only one commission, the Federal Energy Regulatory Commission, has not responded to the President.

Adaptation of the Order by the independent regulatory commissions varies. Some agencies have reforms underway including the publication of agendas, the review of existing regulations, and the creation of more and earlier opportunities for public participation; others have taken smaller steps, such as the publication of agency procedural rules in more understandable terms to show compliance with the spirit of the Order.

The variety of responses to the President's request results, in part, from the nature of the regulatory responsibilities carried out by these commissions. Some commissions issue a broad range of regulations affecting members of the public (for example, the Federal Trade Commission (FTC), the Securities and Exchange Commission (SEC), and the Consumer Product Safety Commission). Other commissions focus on specific industries and issue regulatory decisions on matters such as charters, licenses, and mergers (Interstate Commerce Commission (ICC), Civil Aeronautics Board (CAB), Federal Home Loan Bank Board (FHLBB), Federal Communications Commission (FCC)); others carry out primarily adjudicatory functions and issue few, if any, generally applicable regulations (Occupational Safety and Health Review

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Commission, Federal Mine Safety and Health Review Commission). It is therefore difficult to compare, for example, the compliance of the Federal Trade Commission with the actions of the Occupational Safety and Health Review Commission.

To give a sampling of the government-wide response to Executive Order 12044, we are highlighting some of the initiatives being undertaken by the independent regulatory agencies in their voluntary compliance efforts. These examples have been provided by the agencies.

#### POLICY OVERSIGHT

Because most of the independent agencies are relatively small, oversight by senior policy officials is generally good.

In many of the independent agencies, members of the commission review and approve each proposed and final regulation before publication in the Federal Register. In response to the Order, however, informal decision channels are gradually being replaced by more formal regulatory procedures and systems. For example:

--The Federal Deposit Insurance Corporation (FDIC) has established a Task Force on Regulations headed by the Director.

--A monthly critical energy project status report at FERC outlines about 100 of the most significant projects at the commission.

#### PUBLIC PARTICIPATION

Six independent regulatory commissions have published agendas of regulations under review and development (CFTC, FDIC, FRB, FTC, ICC, and SEC). Of the remaining agencies, two intend to publish agendas shortly (CAB, FCC); and the other nine have either decided not to publish agendas or do not have "significant" regulations under development.

Some improvement has occurred in the use of 60-day comment periods for proposed regulations but it is not yet universal. The outreach programs of the commissions include a number of less formal techniques such as informal hearings, panel discussions, and regional meetings. The organizations and individuals regulated by many of these commissions tend to be fairly identifiable, and in many cases can be adequately reached through press releases, bulletins, and direct mailings.

Some examples of agency initiatives to increase public participation include:

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--FERC co-sponsored nine seminars on implementation of the Natural Gas Policy Act (NGPA) held in eight states. Four public hearings were held to review public comment on the NPGA's pricing provisions. A toll-free hotline was set up to respond to questions on FERC's implementation of the Act. To date, more than 12,000 calls have been answered by the staff.

--The CAB and FTC have instituted financial assistance programs to encourage greater public participation in their rulemaking proceedings.

--The FDIC issues a press release and/or bank letter for each proposed regulation to the 9,100 banks under its regulatory jurisdiction.

--The FHLBB has experimented with preproposal requests for comments on contemplated regulatory changes. A recent request for comment on whether interstate branching in the Washington, D.C. area should be allowed brought more than 5,000 public comments.

--The SEC has created an Office of Consumer Affairs which developed a nationwide uniform dispute resolution procedure for investors. This office also prepares educational brochures for the public and reviews complaints received by the Commission from investors.

--The FCC distributes a "Sunshine Agenda" to provide interested persons with brief summaries of items to be discussed at open commission meetings. This replaces the former public notices which listed only the titles of matters to be discussed.

#### REGULATORY ANALYSIS

Most of the independent regulatory agencies indicate that it is unlikely they will issue regulations that will require a formal regulatory analysis. However, several agencies (e.g., FRB, FTC, CAB) prepare a report which includes an assessment of economic effects and possible alternatives to a rulemaking, and three regulatory analyses have been prepared by the Nuclear Regulatory Commission.

#### REVIEW OF EXISTING REGULATIONS

Many of the agencies are committed to some form of systematic review of existing regulations. For example:

--The SEC has undertaken a large number of regulatory initiatives to increase small investor access to the securities market and simplify registration and reporting requirements.

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--The CAB has liberalized the condition under which charter flights are offered, including the elimination of five obsolete charter regulations. The pricing standards for the airline industry have also been entirely revised.

--The FTC has over the past several years eliminated 145 of 152 trade practice rules.

--A concerted review of all Federal Home Loan Bank Board regulations is underway. The clarification and simplification of approximately 50% of the Board's regulations will soon be completed. Actions so far have reduced the word count of the regulations by 40%.

--The Federal Deposit Insurance Corporation is committed to review each of its regulations within five years. The Commission has already eliminated regulations dealing with "inside trading" and bank service arrangements and has simplified the procedures for establishing remote service facilities.

--The FMC will soon begin its first systematic review of a large portion of its existing regulations and has already published a notice calling for suggestions and possible candidates.

--The Federal Reserve Board has established "Project Augeas" to review all of its regulations affecting the public. For example, the Board has abolished regulations governing the purchase of state and local warrants by state banks, the international banking regulations have been extensively revised and rewritten, some reporting requirements for banks establishing service corporations have been abolished, and a number of regulations governing disclosure to stockholders are being revised and combined into a single regulation.

#### PLAIN ENGLISH

Several agencies are attempting to be more attentive to clarity when writing regulations. One outstanding example in government is FCC's revision of its citizen's band radio rules. In addition, FCC publishes Feedback, a plain English, in-depth discussion of individual rulemaking items. Feedback has a distribution of 7,000 copies.

#### CONCLUSION

Many of the independent regulatory agencies are responding to the President's call for voluntary compliance with the Executive Order, but progress is uneven. These agencies impose

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major regulatory burdens on the economy and many more improvements in their regulations are needed. The President has proposed legislation which would enact the provisions of the Order into law and would, therefore, require mandatory compliance by the independent regulatory agencies. Full compliance by these agencies would be a major contribution to improving all of the regulations of the Federal Government.

THE CHAIRMAN OF THE  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON

November 15, 1979

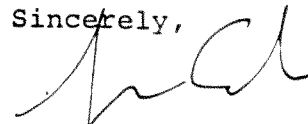
The Honorable Carl Levin  
Chairman, Subcommittee on  
Oversight of Government Management  
Committee on Governmental Affairs  
409 C Senate Courts  
Washington, D. C. 20510

Dear Senator Levin:

Enclosed for the record are my responses to the questions posed in your letter of October 24, 1979.

In responses to questions 1 and 2, I have selected just one example for each.

Sincerely,



George C. Eads  
Member

Enclosure

Q.1) Please describe a specific case where an agency did not prepare a regulatory analysis and RARG believed one should have been prepared

A. One example would be as follows:

In the Spring of 1979, the Department of Energy published a Notice of Proposed Rulemaking concerning the maximum permissible price differential between leaded and unleaded gasoline. DOE did not prepare a Regulatory Analysis to accompany the proposed rulemaking. Since a Regulatory Analysis was not prepared, the RARG could not conduct a formal review of the regulatory analysis, but did prepare a paper that was submitted into the public record. A copy is attached. .

At the present time, there is no indication that DOE will adopt gasoline pricing regulations to limit the price differential between leaded and unleaded gasoline.



EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON, D.C. 20506

May <sup>30</sup> 22, 1979

MEMORANDUM FOR DAVID BARDIN  
Administrator  
Economic Regulatory Administration  
U.S. Department of Energy

FROM: George Eads

Some Commentors on the May 7, 1979 "review and analyses" of the proposed retail price differential rule for leaded/unleaded gasoline have suggested that certain points raised in that review need clarification. This has been done in the attached revised analysis, which should replace the earlier version.

Attachment

EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON, D.C. 20506

May 22, 1979

Dear Mr. Bardin:

On April 11, 1979, the Department of Energy published in the Federal Register a Notice of Proposed Rulemaking concerning the maximum permissible price differential between leaded and unleaded gasoline and other matters affecting the Department's pricing rules for unleaded gasoline (44 FR 21651-21654). After reviewing these proposed regulations and consulting with the Department and the Environmental Protection Agency, the Executive Committee of the Regulatory Analysis Review Group has instructed me to write to you to express our concern that these rules might well be "significant" in the meaning of Executive Order 12044, to identify a number of issues we would hope would receive specific attention as you consider the proposed regulations, and to provide our preliminary evaluation of the available evidence on some of these issues.

The enclosed paper, while taking no position as to the advisability of the proposed rulemaking, is intended to accomplish the latter two objectives. Our analysis indicates that it is possible that DOE's gasoline pricing rules, especially the "one cent" rule, may provide a disincentive for the production of added volumes of unleaded gasoline, which may aggravate the shortage in this product. It may also be that an inappropriately-set ceiling differential at retail could lead to increased rates of misfueling.

The paper is not a formal RARG review, because the NPRM was not accompanied by a Regulatory Analysis. However, we do ask that it be placed in the public record.

Sincerely,

George Eads  
Member-Designate

Mr. David Bardin, Administrator  
Economic Regulatory Administration  
U.S. Department of Energy  
2000 M Street, N.W.  
Washington, D. C. 20461

Enclosure

EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON, D.C. 20506

May 30, 1979

MEMORANDUM

To: George Eads  
From: David Sibley, Robert Lurie, Vartkes Broussalian  
Re: DOE's Proposed Amendments to Unleaded Gasoline  
Price Rules

This memorandum discusses some of the significant issues involved in these regulations and identifies several key questions which the Department of Energy (DOE) should address as part of its rulemaking process.

First, we discuss the available evidence about the extent to which and reasons why drivers of cars equipped with catalytic converters, which require unleaded gasoline, use leaded gasoline, which harms the converters. There is evidence that "fuel switching" (i.e., use of leaded gasoline in cars equipped with catalytic converters) increases with the price differential between unleaded and leaded gasoline, but this evidence is rather weak and not conclusive.

Second, we analyze the possible effects of DOE's proposed rule to put a mandatory cap on the price differential between leaded and unleaded gasoline. The intent of this rule is to reduce fuel-switching, to the extent that fuel switching depends on the price differential. Use of a simple equilibrium model of the retail gasoline market suggests that such a differential, if improperly set, could well generate a shortage of unleaded gasoline, which itself could lead to fuel switching. Although the model is not sufficiently detailed to suggest precisely what the critical differences might be -- that was not its purpose -- the result would seem to be especially likely if refinery gate price rules do not provide sufficient incentive to manufacture unleaded gasoline.

Third, we review evidence on the effects of DOE's proposal to require posting of the price of unleaded gasoline at gas stations and conclude that such a rule may well reduce but not eliminate price differentials.

Finally, we discuss certain DOE pricing rules which affect the supply of unleaded gasoline; an increase in the supply of unleaded gasoline could well prove effective in reducing misfueling.

Based on this analysis, we believe that DOE should address the following questions during the course of its rulemaking:

- o What is the relationship between fuel switching and the size of the leaded-unleaded price differential?
- o What are the retail market equilibrium effects of a cap on the price differential?
- o What effect will posting requirements have on the size of the price differential?
- o How do these proposed regulations interact with other DOE regulations affecting the supply of leaded and unleaded gasoline?

I. Overview

In 1970 the Environmental Protection Agency (EPA) decided to implement the Clean Air Act for automobile emissions by setting standards which have been met, for the most part, by equipping post-1975 model year cars with catalytic converters. Cars so equipped must be fueled with unleaded gasoline; after more than two or three tankfuls of leaded gas, the converters cease to function. DOE and EPA have recently become concerned that the number of owners of catalyst-equipped automobiles who have used leaded gas is large and possibly growing. Given that lead damage to converters, once incurred, is irreversible, widespread misfueling could imperil a large share of the accumulated progress of EPA's auto emissions program since its inception. To put it another way, the nation's \$7 billion investment in catalytic converters may be at stake.

Based on several studies<sup>1/</sup> there appears to be general agreement that the present rate of misfueling lies in the range of 5%-10% of the entire fleet of converter-equipped cars in the United States. If we interpret the \$7 billion cost of existing catalytic converters as reflecting society's valuation of clean air, the current rate of misfueling has a social cost of roughly \$350 million to \$700 million.<sup>2/</sup> What causes this misfueling?

One influence is the widespread belief that leaded gas yields improved engine performance. This motivation is evinced by the fact that roughly 4% of drivers fuel-switch even when there is a zero price differential between leaded and unleaded gasoline and no shortage of unleaded.

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<sup>1/</sup> See Table 2.

<sup>2/</sup> Because the 5%-10% misfueling rate refers only to motorists who misfuel regularly, it probably understates the number of catalytic converters which are actually damaged.

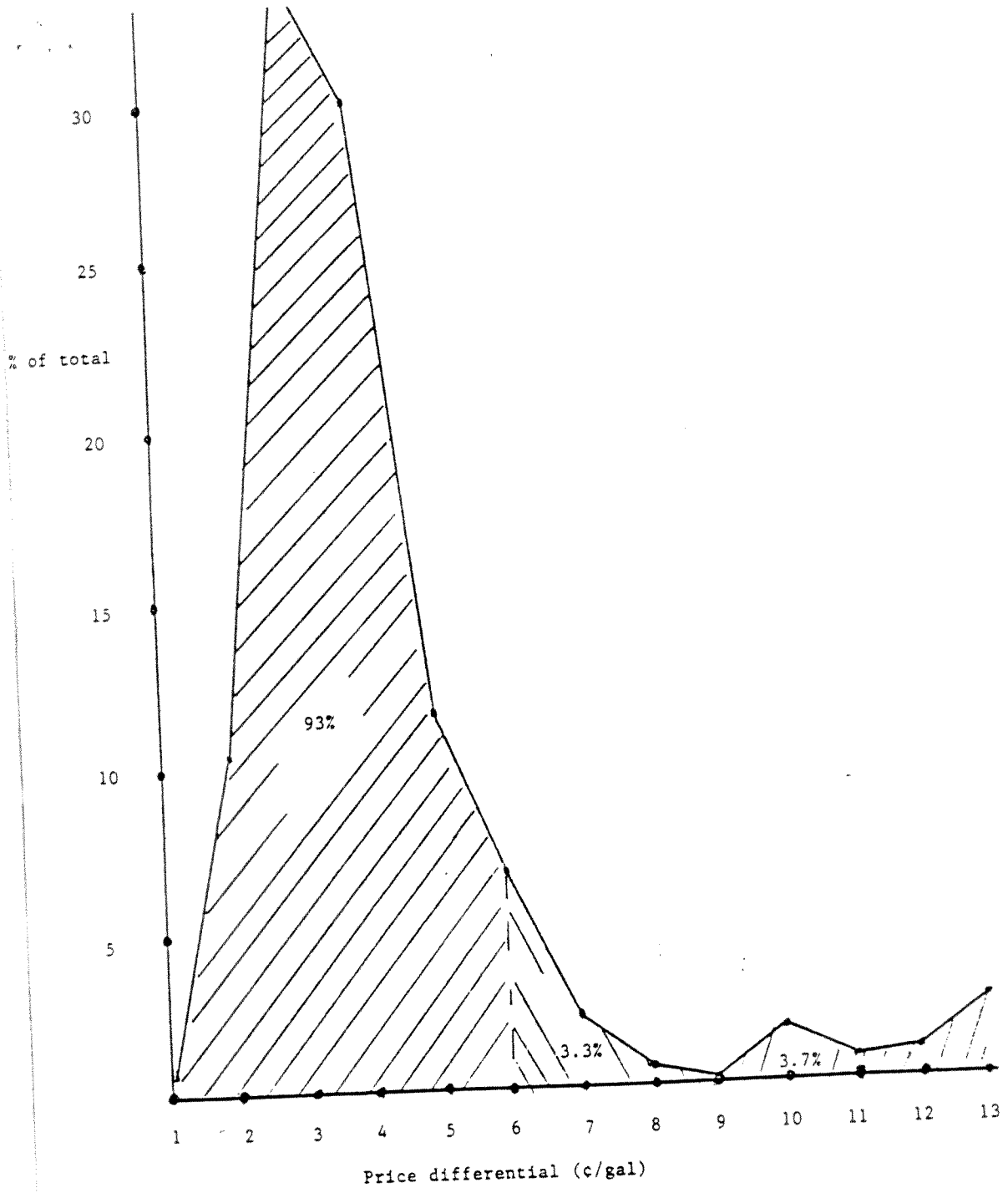


Figure 3

However, another influence is likely to be the price differential between leaded and unleaded gasoline. This differential is currently rather large on average and may be growing, as recent survey data suggest:

Table 1

Survey Date	Average Price Differential (\$/gal.)		
	Self-Service	Full Service	Combined
1/19	5.06	3.99	4.53
2/9	5.17	4.11	4.64
2/23	5.14	4.16	4.65
3/9	5.22	4.26	4.74
3/23	5.19	4.38	4.79
4/6	5.08	4.57	4.83

Source: EPA

Although the price differential for self-service has fallen in recent weeks to its January 1 level, the price differential at full-service stations has risen sharply, so much so that the average of both self-service and full-service has gone up, too.

It is claimed that this average price differential exceeds the difference in the marginal costs of the two types of gasoline at the retail level.

More worrisome, however, is the fact that instances of much higher price differences are fairly numerous. In Figure 1, for example, we present a frequency diagram of price differences from an EPA study which has the following cumulative distribution:

<u>Price Differential</u>	<u>Percent of Cases which Equal or Exceed Differential</u>
5c	13.6
6c	7.0
7c	4.6
8c	3.8
9c	3.7
10c	1.9
11c	1.2
12c	.2

We will survey available evidence on fuel switching and its relationship to price differentials below.

In response to this problem, DOE is proposing to amend its gasoline pricing rules.<sup>3/</sup> Most importantly, it seeks to impose a maximum

mandatory price differential between leaded and unleaded gasoline.

Additionally, it seeks to require service station owners to inform the public of outages of any grade or type of gasoline and to post the price of unleaded with equal visibility as they do the price of leaded.

Finally, the proposed rules allow resellers to recoup the costs of vapor recovery systems.

We will analyze these proposals below. Based on our analysis, we identify several issues that will require careful study before policy decisions are made about the regulations.<sup>3a/</sup>

- o What is the relationship between fuel switching and the leaded-unleaded retail price differential?

<sup>3/</sup> FR, Vol. 44, No. 71, pp. 21651-21654.

<sup>3a/</sup> Of course, there may exist other issues which merit attention.



- o What are the market equilibrium effects of a cap on the price differential between leaded and unleaded gasoline?
- o What effect will posting requirements have on the size of the price differential?
- o How do these proposed regulations interact with other DOE regulations affecting the supply of unleaded fuel?

II. Evidence Relating Fuel Switching to the Leaded-Unleaded Price Differential

There are five published studies of the prevalence of misfueling in the United States. General Motors, Exxon, and EPA's Mobile Source Enforcement Division all counted the number of people putting leaded gasoline into late model cars at sample service stations. Amoco and EPA sponsored mail questionnaires which asked people if they misfueled. Table 2 summarizes the findings of these reports.

In addition the Canadian Air Pollution Control Directorate found that 6.7 percent of 1,666 cars requiring unleaded gas were fueled with leaded gas, but did not examine sensitivity to price differentials.

Two things stand out in Table 2:

- o At least five and up to about 14 percent of cars equipped with catalytic converters have been, or are being misfueled.

Table 2

<u>Study</u>	<u>Sample of c.c. Equipped Cars</u>	<u>% of c.c. cars fueled with leaded gasoline</u>	<u>Statistically significant Relationship between Price Differential and % of Cars Switching</u>
General Motors <sup>1/</sup>	1,208	2.0%	No
EPA Mobile Source Enforcement Div.	987	10.0%	No
Exxon	2,700	10.0% (±2% with 90% confidence)	n.a.
EPA's Sobotka Study	1,266	6% <sup>2/</sup>	n.a.
Amoco <sup>3/</sup>	n.a.	5%	n.a.

<sup>1/</sup> Only GM cars were included in the sample.

<sup>2/</sup> Definite switchers; because of inconsistent responses to some questions, switchers were classified as definite, probable, and possible. A separate "sensitive question" survey (307 people with c.c. equipped cars were questioned) indicated a misfueling rate of 13.7%, with 90% confidence interval from 5.9% to 21.5%.

<sup>3/</sup> The results of the Amoco study have been published, but not the supporting statistics, because Amoco requested confidentiality.

Source: Motor Gasoline Deregulation and the Gasoline Tilt, Vol. 1, Final E.I.S. January 1979, Department of Energy, pg. III-27 to III-64.

- o There is not much evidence in the empirical studies about the relationship between actual leaded-unleaded price differentials and the rate of fuel switching, but what there is does not indicate a statistically significant or meaningful relationship between them.

A major study of the link between misfueling and the price differential has been done by Sobotka & Co., Inc. for EPA. On the basis of survey responses in the first part of their study SCI categorized the 1266 owners of converter-equipped cars as either definite, probable and possible fuel switchers and non-switchers. Table 3 contains data on the number of respondents that perceived a given price differential during their last purchase of gas, and on the number of these respondents that were also definite switchers. Table 4 presents this data in a different form. These tables suggest that:

- o Almost 80 percent of all definite switchers reported the price differential at their last purchase to be five cents or less, and 92 percent reported a price differential less than eight cents.
- o Misfueling rates in this part of the SCI study did not steadily increase with the price differential; rather they repeatedly rose and fell as the price differential grew larger. SCI states that this is "inconclusive" evidence about the relationship between misfueling and the price differential.
- o A regression by DOE of price differentials on misfueling rates using this data did show a slightly positive -- but statistically insignificant -- relationship between the two.

Table 3

Price Differential	Number of Respondents Perceiving Price Differential on Their Last Purchase of Gasoline	Number of Respondents Perceiving Price Differential That Are Also Definite Switches	Percentage of Respondents Who Switched on Their Last Purchase of Gasoline
0	6	0	0
1	18	0	0
2	204	8	3.9
3	246	13	5.3
4	247	15	6.1
5	199	14	7.0
6	85	5	5.9
7	44	4	9.1
8	33	0	0
9	14	1	7.1
10	43	3	7.0
11	4	0	0
12	3	0	0
13	2	0	0
14	2	0	0
15+	12	1	8.3
	1162	64	
No answer	104	8	
TOTAL	1266	72	

Source: Sobotka & Co., Inc. Conversation with M. Gottlieb.

Table 4 : Actual Misfueling at Different Perceived Price Differentials

<u>Price Differential</u>	<u>Percent of All Respondents Perceiving Price Differential That Are Also Definite Switchers</u>	<u>Percent of Those Respondents That Are Definite Switchers And Perceived The Price Differential</u>
0-2¢	3.5%	12.5%
3-5¢	6.1%	65.6%
6-8¢	5.5%	14.1%
9-11¢	6.6%	6.2%
11¢ +	5.3%	1.6%

Source: CEA and Sobotka & Co., Inc.

Table 5: Hypothetical Misfueling at Various Price Levels

<u>Price Differential</u>	<u>Percent of Respondents Choosing Leaded Gasoline</u>
0¢	6%
2¢	11
4¢	15
6¢	31
8¢	69

Source: Sobotka & Co., Inc.

In another part of their study, which did not rely on observations or reports of price differentials at particular stations, SCI collected "trade-off analysis" data by offering the respondents choices between hypothetical purchase opportunities. Their analysis of the results shows that hypothetical misfueling rates rise very rapidly as the price of unleaded rises relative to the price of leaded. See Table 4.

Notwithstanding the results of the tradeoff analysis, the paucity of empirical support for a stable relationship between fuel switching and the price differential make it hard to see how DOE can be confident of the effects of whatever maximum differential it chooses. Thus, DOE should investigate the relationship between fuel switching and the leaded-unleaded price differential after taking account of all factors which contribute to the incentive to fuel-switch.

### III. Preliminary Analysis of Policy Options

The principal options which DOE has proposed to deal with the misfueling problem deal with the demand side of the retail gasoline market: price and outage posting and the cap on the leaded-unleaded price differential. DOE does not focus on measures to increase the supply of unleaded gasoline. In this section we will analyze the implications of DOE's proposals and suggest the possible effects of DOE pricing rules which affect the supply side of the market.

#### 1. The Cap on the Price Differential

Given that existing price differentials may be causing misfueling, the effects of putting a cap on the price differential depend critically

on the structure of the gasoline market, whether it tends more closely to the highly competitive model or to the other extreme of monopoly power.

Some stations probably do possess some amount of monopoly power due to locational advantages and imperfect information about gasoline prices on the part of consumers. If an individual gas station owner does possess price-setting power, he can comply with a cap rule on the price differential by either lowering the price of unleaded, raising the price of leaded or both. The station's profit maximizing behavior will depend on demand elasticities, cost effects, etc., and the supply of unleaded gas could either rise or fall depending on the exact case at hand.

As a rough approximation to the retail gas market, however, the highly competitive model may have more to be said for it. For one thing, there are roughly 170,000 gas stations in the United States, many of them quite close to one another. Prior to the inauguration of price controls, they did compete on price, engaging in occasional price wars. Also, as we point out below, voluntary price posting of unleaded gas has been rising rapidly recently in some areas of the country, which also suggests that gas stations compete on price where adequate supplies exist. Therefore, we will conduct our analysis assuming that the standard economic model of a highly competitive industry captures the main features of the retail gas market well enough to serve as a basis for discussion of DOE's proposed regulations.

Various types of price ceilings affect both the refiners and retailers of gasoline. Since this analysis is intended as merely illustrative,

and in the interest of simplicity, we will focus entirely on the retail level. However, careful analysis of the equilibrium effects of refinery price ceilings is important, too, and we would urge DOE to consider such effects during its rulemaking. Given our focus on the retail gasoline market, we have four cases to analyze in a static equilibrium framework.

Case I: price ceilings not binding at retail, <sup>4/</sup> prices of leaded and unleaded clear both markets at retail;

Case II: leaded price at its ceiling, unleaded price clears unleaded market (takes into account the effects of the binding price ceiling in the leaded market);

Case III: unleaded price at its ceiling, leaded price clears leaded market (given the effects of the binding price ceiling in the unleaded market).

Case IV: both prices at ceiling levels.

In each of these cases, one can analyze the effect of introducing a cap on the price differential, that is less than the initial equilibrium differential. For brevity, we discuss Cases I and IV only.

More cases could be generated by varying assumptions about pricing rules affecting refineries; that is, one could analyze the effects of a price differential rule with and without refinery pricing rules which may discourage production of unleaded gasoline.

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<sup>4/</sup> Refinery gate prices may or may not be at ceiling levels; if they are at ceiling levels, numerical calculations of equilibrium prices and quantities at the retail level will be different than if they are not. The qualitative results of our analysis are unaffected by different assumptions about the constraining effects of refinery price controls such as the one-cent rule, the tilt rule, etc.



In modelling these cases, we use the following behavioral relationships:

Market Structure: retail market is highly competitive

Costs: industry costs are separable between leaded, unleaded; the retail marginal costs of leaded and unleaded increase with output and include any short run supply constraints, refinery pricing rules, dealers' markups, etc.

Demand: a rise in the price of unleaded, ceteris paribus, increases demand for leaded (i.e., fuel switching exists).

Needless to say, the entire analysis is meant only to point up issues for DOE to investigate further. The analysis is far too simplified to be taken seriously as a forecast of the effect of a price differential rule.

Case I: Neither Price Ceiling is Binding

Absent a cap on the price differential, market quantities of both types of gasoline are determined by equality of demand and supply, or equivalently, by the condition that price equal marginal cost in each market. With a cap  $\delta$ , the new static equilibrium is characterized by <sup>5/</sup>

supply of leaded = demand for leaded

price of leaded = marginal cost of leaded

price of leaded +  $\delta$  = marginal cost of unleaded

demand for unleaded exceeds supply of unleaded.

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<sup>5/</sup> See discussion in appendix.

Using hypothetical but suggestive values for demand and supply elasticities we have computed the effects of a 3¢ cap when the initial situation is the following (data are from December, 1978):<sup>6/</sup>

quantity of unleaded = 115.5 million gallons per day

quantity of leaded = 198.87 million gallons per day

price of unleaded = 71.7¢ per gallon

price of leaded = 67.4¢ per gallon

price differential = 4.3¢ per gallon.

In highly competitive gasoline markets, the price differential rule is met by a reduction in the retail price of unleaded below the market-clearing level. To the extent that lower retail demand for unleaded is eventually reflected in lower production by refiners, this reduces the supply of unleaded and increases the demand for it, causing a shortage. With the demand curve for unleaded calibrated to its December 1978 level, the shortage is 560,000 gallons per day (calculations in the appendix). Suppose, however, that the demand curve for leaded gasoline remains fixed, but the demand for unleaded gasoline grows rapidly at 1.3% per month over the period December 1978-June 1979 -- a not unreasonable assumption in light of recent experience. Supply remains fixed because the market price for unleaded is tied to the price for leaded, so the shortage of unleaded gas rises by the full amount of the increase in demand for unleaded. This could amount to 9 million gallons per day, or 7% of demand by the summer of 1979.

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<sup>6/</sup> Source: DOE Monthly Energy Review.

Case IV

The reasoning in Case IV is quite straightforward and leads to the same result. If both prices are at their ceiling levels, the cap can only be met by reducing the price of unleaded, cutting back supply and creating a shortage.

As a general case, it seems likely that any retail price differential cap which constrains differentials to be less than the marginal cost differential at refinery gate will exacerbate shortages of unleaded. In the long run, absent any supply constraints, a rule which allows differentials to be higher than differences in the marginal costs of the two types of gasoline should be innocuous.

\* \* \* \* \*

Although our calculations are too crude to be taken as forecasts of the effects of a cap on the differential, the Case I scenario indicates an important possible difficulty with the policy of trying to deal with fuel switching by putting a cap on the price differential. If shortages occur, the potential for misfueling is at least as great as any posed by price differentials because consumers driving into a gas station and finding no unleaded gas may well see no alternative to using leaded gasoline. Because two or three misfuelings deactivate the catalytic converter, this could imperil the accumulated progress of EPA's auto emissions program. This presents an issue which DOE should analyze carefully: what are the retail market equilibrium effects of a cap on the price differential?

## 2. Effects of Price Posting

Evidence in the July 14, 1978 Lungberg Letter suggests that posting the price of unleaded gasoline can reduce the spread between that price and the price of leaded regular by an average of 16 to 18 percent. Mandatory posting regulations will not fully solve the problem of a widening spread, but they can help slow, or possibly offset any increase.

In 11 gasoline markets in the Western U.S. the average spread between unleaded and leaded prices at service stations which did not post unleaded prices was 4.3¢/gal. in 1978 (3.3¢/gal. in 1977). At stations which did post unleaded gasoline prices, the average spread between leaded and unleaded prices was 2.7¢/gal. in 1978 (2.8¢/gal. in 1977). Thus posting may have reduced the spread between the two prices by an average of 0.6¢/gal., or 16%, in 1978, and by an average of 0.5¢/gal., or 18% in 1977.

Voluntary posting of the price of unleaded gasoline increased between 1977 and 1978. In nine western gasoline markets the average percentage of gas stations posting unleaded prices rose from 14.96 to 22.04, a rise of 7.08 percentage points.

Although these data are incomplete, they are suggestive, and DOE should carefully investigate the effect posting requirements could have on large price differentials.

## 3. Regulations Affecting Supply - Preliminary Analysis

Given the analysis above, it may be important for DOE to examine those of its pricing rules which affect the supply side of the retail

gasoline market. There seem to be two principal DOE regulations which affect the short-run supply of leaded and unleaded gas and one which affects the long-run supply. We analyze each briefly.

(i) Recovery of increased cost of equity capital -- DOE could allow the passthrough of cost increases now barred, principally the increased costs of (or return on) equity capital. This would encourage investment in capacity for unleaded gasoline.

This rule change, however, would not have much short-run effect.

(ii) The gasoline tilt rule -- The recently promulgated tilt rule allows refiners to pass through more of their post-1973 refining cost increases to gasoline. Therefore, a refiner that is up against its composite price ceiling should be willing to incur the costs involved in raising its unleaded (as well as leaded) output from existing facilities. However, because the basic allocable cost increases permitted under DOE price rules bias refiners toward producing leaded gasoline, the tilt rule has also a built-in bias in favor of leaded gasoline.

(iii) The one-cent rule -- DOE regulations provide that for calculating the base price for unleaded gasoline as of May 15, 1973, for a given class of purchaser, a refiner can either use the price of leaded gasoline of the same octane number plus one cent per gallon, or the price of unleaded gasoline which it sold to that class of purchase on May 15, 1973. It has been suggested that amending this rule to allow a two or three cent differential in the base prices (to reflect the true

cost differential at present output ratios) would encourage refiners to produce more unleaded gasoline.

Cost increases since 1973 have been substantial (perhaps over 30 cents). Under DOE regulations, refiners have the flexibility to allocate these cost increases to any grade or type of gasoline. The one-cent differential in the base prices has been dwarfed by the subsequent increased costs of producing gasoline. In the past refiners have allocated their increased costs to yield a differential between prices of leaded and unleaded gasoline at the refinery gate of about 3 cents per gallon. Thus, the one-cent rule may not have had a significant impact on relative prices throughout the period of time (until late last fall) when composite ceiling prices were not binding.

Given that composite price ceilings are binding, however, to allow two cents or three cents instead of a one-cent differential for base prices would make unleaded gasoline more profitable to produce compared to leaded gasoline. This is because with binding ceilings excess demand for both leaded and unleaded gasoline exists at the refinery gate, and a rise in the composite ceiling price would be necessary for additional production to take place. To relax the one-cent rule would allow a refiner to raise his composite price ceiling provided he produce more unleaded gasoline. This effect should work fairly quickly because it does not require the refiner to install new capacity.

The problem of misfueling and damage to catalytic converters is a near-term problem. To increase the supply of unleaded gasoline in the near term, changing the one-cent rule may be more effective than changing equity cost passthroughs if composite price ceilings for refiners become binding. Therefore, DOE should examine carefully the interactions between the proposed price differential rule and DOE's other pricing regulations which affect supply.

## Appendix

1. Demand and Supply Equations

Based on the published literature on gasoline demand, an own price elasticity of  $-.22$  seems reasonable for gasoline overall (both leaded and unleaded). Based on the frequent assertion that the demand for leaded gasoline is more elastic than the demand for unleaded, we assume that the own price elasticity for leaded was  $-.25$  and the elasticity for unleaded  $-.22$ . To obtain a cross elasticity we used the DEIS "worst case" assumption that a one cent increase in the differential would add one percentage point to the fuel switching rate. Assuming a 35/65 split between unleaded and leaded and an unleaded price of 71.7c per gallon, this implies a cross elasticity of  $.18$ . We assumed constant elasticity demand functions of the form

$$Q_i = A_i P_i^{\delta_i} P_j^{\phi}, j \neq i$$

where  $i$  = leaded, unleaded. Using

$$\delta_{\text{unleaded}} = -.22$$

$$\delta_{\text{leaded}} = -.25$$

$$\phi = .18$$

and the December 1978 prices and quantities

price of unleaded = 71.7c/gallon

price of leaded = 67.4c/gallon

quantity of unleaded = 115.5 million gallons per day

quantity of leaded = 198.87 million gallons per day

we compute the scaling constants  $A_i$  as

$$A_{\text{unleaded}} = 115.25$$

$$A_{\text{leaded}} = 191.54.$$

As for the supply curve, the literature often uses supply elasticities from .1 to .2 for total gasoline supply. We assumed a supply elasticity of .12 for both leaded and unleaded gas, so that supply curves are given by

$$S_i = \psi_i P_i^{.12}$$

$i = \text{unleaded, leaded.}$

The scaling constants  $\psi_i$  were chosen so that both markets are in equilibrium at December 1978 price and quantities.

## 2. Equilibrium Prices and Quantities

### A. The Nature of Market Equilibrium in Case I

Denote the initial equilibrium -- without the cap -- by  $(P_L^*, Q_L^*, P_U^*, Q_U^*)$  in Figure 2 and suppose that  $P_U^* - P_L^* > \delta$ . Now impose that cap  $\delta$ ; what must the new equilibrium be?

Try  $P_L^{**} = P_U^* - \delta$  and  $P_U^{**} = P_U^*$  as a candidate for a new equilibrium in Figure 2. That is, will a perfectly competitive industry meet the cap rule by keeping the price of unleaded at its pre-cap level,  $P_U^*$ , and raising  $P_L$  to within  $\delta$  of  $P_U^*$ ? At  $P_L = P_U^* - \delta$ , Figure 2 shows that excess supply would exist in the leaded market, which would bid down the price of leaded; to put it another way, if one gas station owner tried to meet the cap rule by changing  $P_U^* - \delta$  and  $P_U^*$  for leaded and unleaded, respectively, another gas station owner could compete away most of the



first gas station's business by charging  $P_U^* - \delta - \xi$  and  $P_U^* - \xi$  for leaded and unleaded (where  $\xi$  is a small, positive number). Therefore, the price of unleaded will fall as a result of the cap rule. This fall in the price of unleaded increases demand, but decreases supply, causing a shortage.

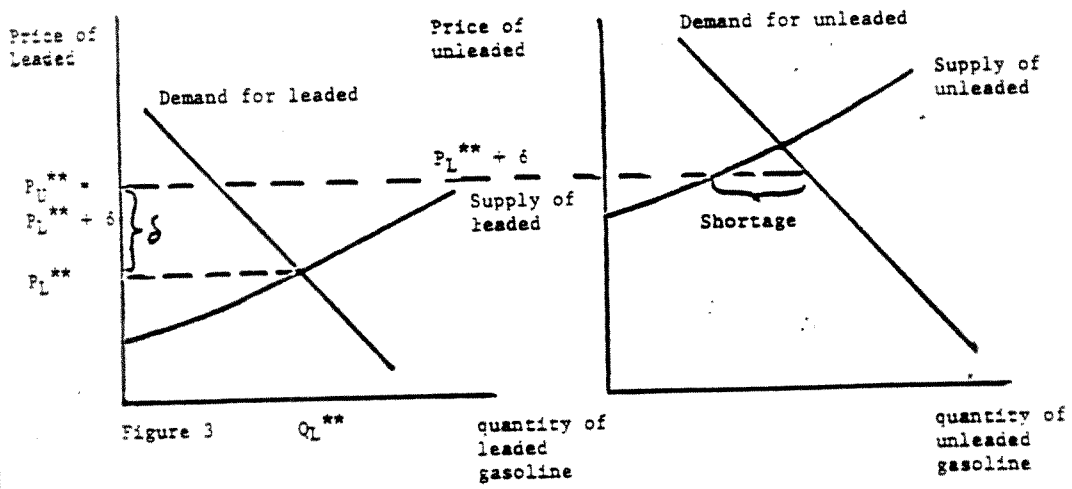
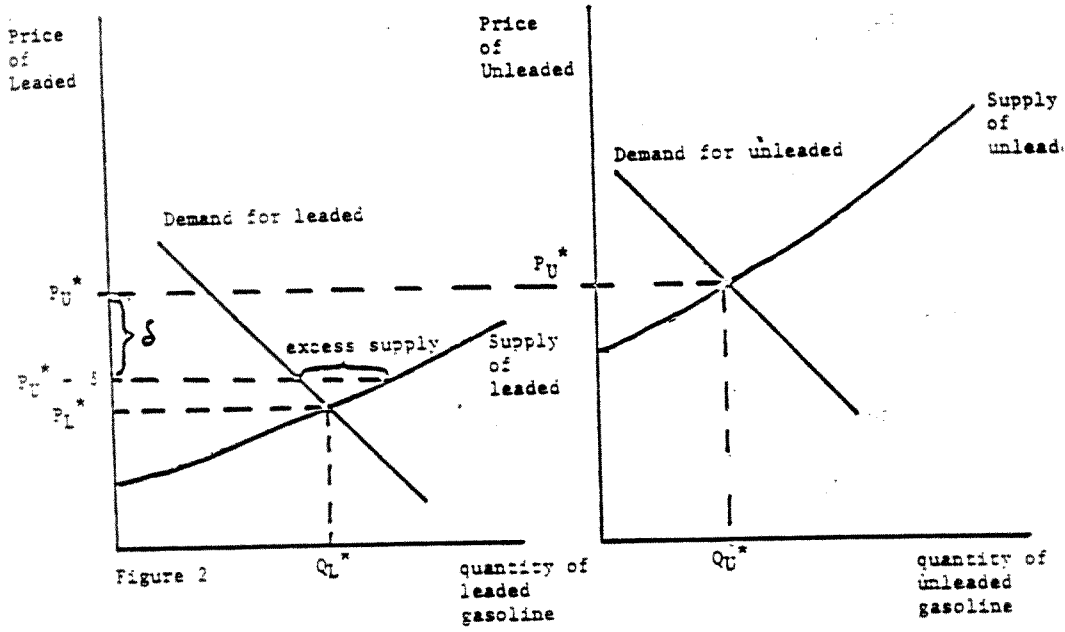
Now try as an equilibrium  $P_L^{**}$  and  $P_U^{**} = P_L^{**} + \delta$  in Figure 3. At this pair of prices, the supply of leaded equals the demand for leaded and excess demand exists for unleaded. If one were to look at  $P_L^{**} + \xi$  and  $P_L^{**} + \delta + \xi$  as candidates for an equilibrium, competition would force prices back down to  $P_L^{**}$  and  $P_L^{**} - \delta$  because one competitor, by shaving  $\xi$  down, could undercut another in both markets. Therefore,  $P_L^{**}$  and  $P_L^{**} + \delta$  are equilibrium prices given the existence of the cap. Therefore,  $P_L^{**}$  and  $P_L^{**} - \delta$  are equilibrium prices given the existence of the cap.

### B. Computation of Equilibrium Prices in Case I

The equilibrium price for leaded gasoline assuming a 3c cap is given by the equality of supply and demand for leaded with that the price of unleaded is 3c higher than the price of leaded. This leads to the following nonlinear equation in  $P_L$ :

$$.18 \ln (P_L + .03) - .37 \ln P_L - .0843 = 0.$$

where  $P_L$  is the price of leaded gas. The root of this equation is .669, so that  $P_U = .699$ . The shortage calculation is straightforward.



Q.2) Please describe a specific case where RARG conducted an outside review and found that a regulatory analysis was inadequate.

A. One example follows:

The draft regulatory analysis for the Office of Surface Mining's proposed permanent Regulatory Program was inadequate.

The RARG report stated that

Initially, the Regulatory Analysis Review Group (RARG) focussed its inquiry on OSM's draft Regulatory Analysis. In many cases, however, the Regulatory Analysis was framed narrowly, so that important issues were not addressed in any depth.

In several areas, OSM's regulations were more stringent than the Surface Mining Control and Reclamation Act required. This would not be a cause of concern if OSM provided supporting analysis showing commensurate environmental benefits. But in too many areas OSM did not provide adequate analysis to justify the proposed regulations. Given the importance of these regulations, the RARG recommended that OSM analyze carefully the entire set of regulations.

The RARG review raised questions about the regulations in five areas:

- o air quality requirements
- o regulations for mining on alluvial valley floors
- o fill regulations
- o permitting and bonding requirements
- o sedimentation regulations

The final regulations differed in some parts from the proposed regulations in ways consistent with analytic issues raised by the RARG filing. In addition, although the bonding and permitting regulations were not changed in the final rules, OSM has accepted a petition to change these regulations and recently proposed new rules.

Q.3) Has RARG or any other body studied the percentage of agency rulemaking proceedings where alternative proposals were adopted instead of the primary proposal?

A. For all the rulemakings reviewed by the RARG to date (for which final rules have been promulgated), the agency has adopted some alternatives based on the issues raised in the RARG's review of the Regulatory Analysis.

However, the impact of RARG filings should not be the sole justification for requiring Regulatory Analyses. There are probably many proposed rules that are modified even before publication in the Federal Register as a result of the information gathered in preparing a preliminary Regulatory Analysis.

Q.4) Is any government-wide guidance being prepared on how to measure the benefits and indirect costs of regulation?

A. Each Department provides guidance to its agencies for preparing a regulatory analysis. In addition, the Regulatory Council has several studies underway that may provide guidance to the various Departments.

In the past CEA, OMB, and CWPS have provided informal guidance as requested to agencies attempting to measure indirect costs and benefits.

Q.5) Please list and describe RARG studies currently underway or planned?

A. A RARG report is currently being prepared on proposed regulations to limit effluent discharges from leather tanning and finishing sources. The report will focus on the attached list of concerns.

No other regulations have been formally selected for review to date, but there are several proposed rules which may be selected for review in the future. These include:

- DOE: Outer Continental Shelf Profit Sharing Bidding System
- New Building Energy Performance Standards
- Emergency Natural Gas Regulations
- Review of Natural Gas Curtailment Priorities, Including Industrial Process Fuel Users
- EPA: Airborne Carcinogens Policy
- Prevention of Significant Deterioration Regulations
- Testing of Chemical Substances and Mixtures
- BAT Effluent Guidelines for Selected Industries
- HEW: Conditions of Participation for Skilled Nursing Facilities and Intermediate Care Facilities
- DOT: Fuel Economy Standards for 1982-84 Model Year Light-Duty Trucks
- DOI: Surface Management for Mineral Claims

In addition, a list of already-filed RARG reviews follows:

- OSHA - Acrylonitrile May 19, 1978
- EPA - Ozone October 16, 1978
- DOT - Handicapped Regs. October 20, 1978
- OSHA - Cancer Policy October 24, 1978
- DOI - Surface Mining November 27, 1978
- EPA - NSPS (Electric Utility Plants) January 15, 1979
- DOE - Coal Conversion March 12, 1979
- EPA - Hazardous Waste March 16, 1979
- DOE - Coal Conversion October 31, 1979
- HEW - Patient Package Inserts November 5, 1979

EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL ON WAGE AND PRICE STABILITY  
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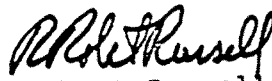
OCT 29 1979

Honorable Douglas M. Costle  
Administrator  
Environmental Protection Agency  
401 M Street, S.W.  
Washington, DC 20460

Dear Mr. Costle:

In my letter to you dated October 16, I informed you that the Regulatory Analysis Review Group had decided to review the proposed regulations to limit effluent discharges from leather tanning and finishing sources published in the Federal Register on July 2, 1979. The Review Group has asked me to advise you that its review is focusing primarily on the concerns outlined in the enclosed statement.

Sincerely,

  
R. Robert Russell  
Director

cc: Members of Regulatory Analysis Review Group

Mr. Donald F. Anderson  
Effluent Guidelines Division (WH-552)  
Attention: Proposed Leather Tanning Rules  
Environmental Protection Agency  
401 M Street, S.W.  
Washington, DC 20460

Regulatory Analysis Review Group  
List of Concerns  
Environmental Protection Agency Proposed  
Leather Tanning Industry Effluent Limits

The Regulatory Analysis Review Group (RARG) has initiated a review of EPA's economic analysis developed in support of its proposed effluent limits for discharges of both toxic and conventional pollutants by facilities involved in leather tanning and finishing. The proposed regulations for the leather tanning industry <sup>1/</sup> represent the first of the set of effluent standards issued in a new round of EPA rulemaking covering 36 to 40 industrial categories (including iron and steel, pulp and paper, organic chemicals, and petroleum refining). The primary concerns that the RARG is focusing upon in this review include:

(1) Cost-effectiveness.

The regulations provide effluent limitations for direct discharge from new sources, direct discharge from existing sources, discharge into publicly-owned treatment works (POTW) from new sources, and discharge into POTW from

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<sup>1/</sup> 44 FR 38746.

existing sources. Given the statutory mandate, does the control strategy chosen represent the minimum cost means of controlling the various toxic and conventional pollutants generated by the leather tanning and finishing industry? How were the control levels chosen? In addition, are standards established for different types of plants or production processes set to minimize the costs of control, or are other factors dominant?

(2) Benefits.

In determining effluent levels for conventional pollutants, EPA considers the relationship between the costs incurred and the effluent reduction benefits derived. Does the level of control for individual toxic substances (within the overall constraint of economically achievable) provide maximum protection given the degree of toxicity, persistency, etc. for each of the regulated toxic pollutants? <sup>1/</sup>

(3) Indicator strategy.

Because of the difficulties in monitoring various toxic pollutants, EPA proposes to limit "indicator" pollutants which are linked to the toxics. While an indicator strategy represents a reasonable approach, several potential problems may arise with this strategy. Has the connection between "indicator" pollutants and important toxic substances been sufficiently established? Would other

<sup>1/</sup> These pollutants are listed as toxic substances under Section 307(a) of the Clean Water Act and are subject to effluent limitations achieved with the application of best available technology economically achievable.



methods of control be more cost-effective in controlling important toxic substances than controlling the indicators?

(4) Inter-media considerations.

Elimination of discharges into water typically entails increasing discharges into the air or the solid waste stream. How are these transfers from one media to the other considered in the leather tanning regulations? Does the recommended solution represent the least cost (resource cost, including the residual environmental burden imposed on other media) method of control?

(5) Effects on technology and productivity.

Over time it would be desirable for regulations to encourage the development and introduction of new technology to control toxic and conventional pollutants. What effects will the standards proposed have on technological progress? In addition, will capital requirements for pollution control alter productivity by delaying investment in the leather tanning industry?

Q 6.) In May 1979, RARG released a list of 35 potential regulations for possible RARG review. It is our understanding that 25 of these regulations did not appear on the Regulatory Calendar issued by the Regulatory Council in February 1979. Is that correct? If so, shouldn't many, if not all, of these 25 significant regulations have appeared on the Calendar?

A. In fact, 21 did appear on the Calendar and 14 did not.

The Regulatory Council had very little time to gather all the information necessary for publishing the first government-wide calendar of regulations. In order to facilitate this task, the Council decided to allow the regulatory agencies to decide individually their own criteria for including regulations in the calendar; the Council relied solely on each agency to submit all major regulations.

This decision led to some variation among agencies as to what was considered a major regulation and how far into the future submissions should extend. For example, while DOE did not include many National Energy Act initiatives because they "are all in a very early stage of development, and we have not yet designated any as major for the purposes of the Executive Order," EPA included regulations planned through early 1980.

In addition, there were a few regulations that agencies inadvertently did not submit to the Regulatory Council that did appear in the agency's latest semi-annual regulatory agenda. Given the short lead-time for preparing the government-wide calendar, the Regulatory Council did not have adequate time to investigate all these errors. However, it appears that the Regulatory Council has provided enough agency guidance so that the second calendar will be more complete.

Q.7) Based on your experience under the Executive Order and at RARG, what suggestions, if any, do you have for amendments to the proposed regulatory analysis legislation before the Governmental Affairs Committee, S.262 and S.755?

A. The Regulation Reform Act proposed by the Administration (S.755) reflects our experience under Executive Order 12044. Of course, it extends the requirements of E.O. 12044 to the Independent Agencies. In addition, S.755 differs from E.O. 12044 in two major ways:

1. The legislation underscores more explicitly than does Executive Order 12044 that, in its final regulatory analysis, the agency issuing a major regulation should either show that the alternative approach chosen achieves the objectives of the action with the least adverse economic effects, or the agency must explain why another alternative was selected.
2. The legislation establishes a somewhat more vigorous requirement for periodic review of existing regulations. Executive Order 12044 requires that each agency review at least one regulation per year. The legislation requires that each agency publish a 10-year schedule, setting out the order in which it will review all its major rules, policies, and practices.

These differences reflect the changes we would make.



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

DEC 14 1979

Honorable Carl Levin  
Chairman, Subcommittee on  
Oversight of Government Management  
Committee on Governmental Affairs  
U.S. Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

It was a pleasure to appear before you in October to discuss agency compliance with E.O. 12044, "Improving Government Regulations." As I said in my testimony, we believe the report demonstrates the Administration's commitment to improve agency procedures for managing the regulatory process.

At the hearing, you asked several questions relating to agency workload under E.O. 12044. In addition, to complete the hearing record, you asked for answers to six additional questions in your letter of October 24. I regret that it has taken us so long to respond. However, to give you complete answers, we have polled the agencies and developed a comprehensive response. We have now received the necessary information from the agencies and answers to all your questions are attached. Also attached is the regulatory analysis of stone crab fishing I mentioned at the hearing.

We appreciate your interest and support for this important reform effort. I hope our answers provide the information you sought. If I can be of further assistance, please let me know.

Sincerely,

Wayne G. Graquist  
Associate Director for  
Management and Regulatory Policy

Enclosures