Marginal Excess Tax Burden as a Potential Cost Under E.O. 13771

For regulations that implement federal spending or otherwise have substantial federal or non-federal government budget impacts, the accompanying regulatory impact analyses (RIAs) should, following standard principles for benefit-cost analysis, include estimates of the extent to which real resource use changes as a result of the policy revisions. Those changes would be categorized as costs, costs savings or benefits (as appropriate), with only the remainder of the budget effect being called a transfer (representing the resources that would be used in the same manner with or without the regulation, but paid for by a different entity in society). However, the vast majority of federal budget impacts have traditionally been categorized as transfers—and thus omitted from E.O. 13771 accounting, per the implementation guidance OMB issued in 2017.

In addition to the under-assessed impacts experienced in the markets directly affected by budget-focused regulations, government spending must eventually be funded by taxes, and such taxation causes social costs. For example, income taxes act as a disincentive to work or to employ workers, and the amount by which the disincentivized labor exceeds the value of alternative leisure is a cost, sometimes referred to as marginal excess tax burden (METB). Circular A-94—OMB's guidance on cost-benefit analysis of federal programs—states that this category of costs should be included in supplementary analyses, using a cost-to-revenue factor of 25 percent.[1,2] Other empirical research has yielded estimates of the ratio of this distortionary impact of roughly 40 to 50 percent of the revenue collected.[3] Given the availability of these estimates, any regulatory impact analysis that includes a quantification of federal budget impacts is, theoretically, a simple multiplication operation away from monetizing the costs associated with the marginal excess tax burden.

While OMB's accounting procedures under E.O. 13771 have focused primarily on the costs of regulations that establish private sector mandates, we are, per the recommendation of the Council of Economic Advisers, considering trying to capture in future-year E.O. 13771 accounting part or all of the real resource burden associated with regulations that have government budget impacts. However, including excess tax burden in E.O. 13771 accounting would necessitate more expansive analysis in a number of dimensions; below are a few considerations surrounding this expansion and the associated accounting decision.

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[1] Although Circular A-4, OMB's guidance on regulatory impact analysis, and multiple OMB Reports, submitted to Congress in accordance with the Regulatory Right-to-Know Act, provide general support for the assessment of the costs and benefits that accompany transfer impacts, Circular A-94 represents the agency's clearest public statement on the METB issue. The directive to include METB in supplementary analysis is not extensively explained in Circular A-94, but we note that if secondary or tertiary costs—such as tax burden would be in the context of spending rules—are included in RIAs, then secondary or tertiary benefits must be as well, in order to avoid inappropriately skewing the net benefit results; introducing marginal excess tax burden in supplementary cost analyses would provide some acknowledgement of this potential imbalance.

[2] METB has received substantial attention in the economics literature, and empirical estimates ranging from 6 to 43 percent are reported in Boardman, Anthony E., David H. Greenberg, Aidan R. Vining and David L. Weimer, *Cost-Benefit Analysis: Concepts and Practice* Fifth Edition, Cambridge University Press, 2018.

[3] For more discussion and references, see the section "The Cumulative Economic Impact of Regulation" in Chapter 2 of the 2019 Economic Report of the President.

We intend to seek feedback from the public on the inclusion of METB in E.O. 13771 accounting, and toward that end, we will reopen the docket through which we received public comment that informed the drafting of our E.O. 13771 implementation guidance. We would welcome input on relevant topics, including but not necessarily limited to the following:

- Of the range of available METB scaling factors (25% per Circular A-94, 50% per the 2019 Economic Report of the President, etc.), which estimate should be highlighted as primary? Does one rule of thumb suffice across regulations and agencies? Should the same METB scaling factor be applied for impacts experienced by federal, state and local governments?[4] How might context, such as deficit spending vs. balanced budgets, affect the choice of an METB estimate?
- Agencies implement, often on a yearly basis, very large spending amounts associated with statutory programs that may overwhelm the impacts currently tracked through E.O. 13771 (which to date has primarily focused on private sector mandates). Only including discretionary changes may usefully focus agency deregulatory efforts where they have discretion. On the other hand, the omission of statutorily-mandated METB costs would be inconsistent with the handling of other categories of costs already included in E.O. 13771 accounting.[5] If METB is included in E.O. 13771 accounting, should only the portion associated with agency discretion be included, or should the statutorily-mandated portion be included as well? If inclusion is limited to discretionary METB, what general guidance can be provided in cases where there is ambiguity regarding the extent of agency discretion?
- What guidance can OMB provide to agencies to facilitate assessment of the portion of compliance costs or costs savings that are experienced by the government and that are manifested as budget changes?[6,7]
- Should OMB supplement our guidance for standardizing E.O. 13771 accounting, particularly on time horizons (current required to be perpetual), to help extrapolate from the shorter time periods often used for budget spending analysis?
- Should accounting changes (if any) be phased in, with METB immediately included for rules both proposed and finalized after any revision of the E.O. 13771 implementation guidance and omitted for rules previously proposed (but finalized relatively soon after guidance revision)?[8]
- Given that regulations can address both collection of government revenue (e.g., rulemaking by the Internal Revenue Service) and government spending, should double-counting be a concern in the presentation of government-wide aggregate E.O. 13771 results? Are there accounting options that might help mitigate such concerns?

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[4] More generally, what guidance can OMB provide to agencies to facilitate assessment of the impacts that federal regulations have on state and local governments?

[5] OMB Circular A-4 emphasizes pre-statutory baselines. However, multi-baseline analysis is encouraged where it provides transparency about the extent to which regulatory impacts are attributable to agency discretion.

[6] For example, in federal contracting regulations some, but potentially not all, regulatory cost impacts could be passed through to the government via changes in bids and award amounts. Similar cost pass-through issues would arise in regard to Medicare conditions of participation and in various other contexts.

[7] Opportunity costs not reflected in budgets (e.g., shifting workers between tasks), which are not separately tracked under E.O. 12866 or Circular A-4, would need to quantified and removed from total government cost estimates for purposes of METB quantification.

[8] Circular A-4, issued on September 17, 2003, illustrates this type of phase-in, having had an effectiveness date of January 1, 2004, for draft proposed rules submitted for interagency review and January 1, 2005, for draft final rules submitted for interagency review.

- To what extent are there unintended consequences—for example, the shifting of implementation of federal spending programs from notice-and-comment rulemaking to less transparent options—that should be considered in regard to the potential inclusion of METB in E.O. 13771 accounting?
- Because empirical estimates of METB reflect the amount of distortion existing in the markets where federal revenue is collected—especially the labor market—it may be possible to use METB estimates as inputs into the estimation of deadweight loss (DWL) changes associated with interventions in those markets. For example, if transfers between employers and workers can be quantified as an impact of a minimum wage regulation and relevant labor supply and demand elasticities are known, then via relatively simple algebra, METB's DWL-to-transfer ratio can be transformed into a minimum-wage DWL-to-transfer ratio and the deadweight loss (or DWL reduction) attributable to the regulation can be estimated. Although the employer-worker transfers would be (and are) omitted from E.O. 13771 accounting, the DWL changes would be included. Beyond this example, how can the METB concept be used to foster innovation in quantifying the distortionary costs experienced in the markets directly affected by regulations (e.g., labor markets)?