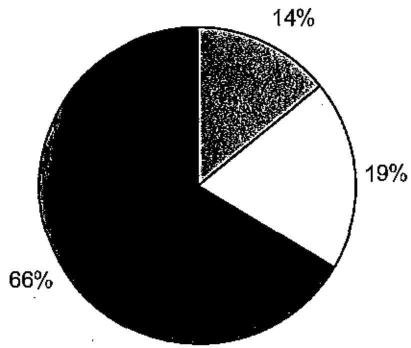
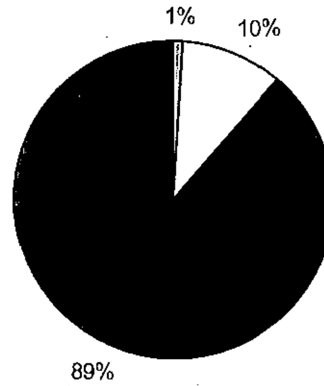
Table 15: Employment by firm employment size

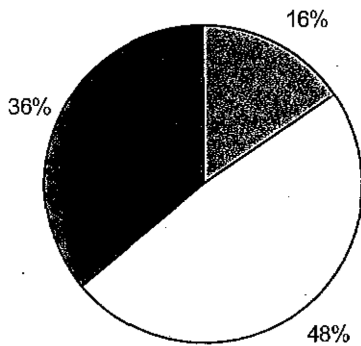
Nitrogenous Fertilizer Manufacturing

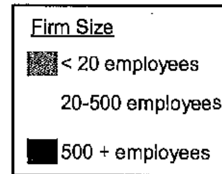


Phosphatic Fertilizer Manufacturing



Fertilizer (Mixing Only) Manufacturing





Source: *2006 County Business Patterns*, U.S. Census Bureau.

Table 16: Region definitions

Region name	Division name	State
Northeast	New England	Connecticut
		Maine
		Massachusetts
		New Hampshire
		Rhode Island
		Vermont
	Mid-Atlantic	New Jersey
		New York
		Pennsylvania
Midwest	East North Central	Illinois
		Indiana
		Michigan
		Ohio
		Wisconsin
	West North Central	Iowa
		Kansas
		Minnesota
		Missouri
		Nebraska
		North Dakota
		South Dakota
South	South Atlantic	Delaware
		District of Columbia
		Florida
		Georgia
		Maryland
		North Carolina
		South Carolina
		Virginia
		West Virginia
	East South Central	Alabama
		Kentucky
		Mississippi
		Tennessee
	West South Central	Arkansas
		Louisiana
		Oklahoma
		Texas
West	Mountain	Arizona
		Colorado
		Idaho
		Montana
		Nevada
		New Mexico
		Utah
		Wyoming
	Pacific	Alaska
		California
		Hawaii
		Oregon
		Washington

Table 17: Regional distribution of economic contributions, by census division

Division	All	Nitrogenous	Phosphatic	Mixing
New England	1%	4%	2%	3%
Mid-Atlantic	3%	11%	7%	9%
East North Central	19%	18%	8%	23%
West North Central	7%	11%	9%	14%
South Atlantic	29%	14%	41%	15%
East South Central	5%	5%	4%	5%
West South Centra	15%	15%	12%	12%
Mountain	8%	7%	10%	6%
Pacific	14%	16%	8%	12%
Total	100%	100%	100%	100%

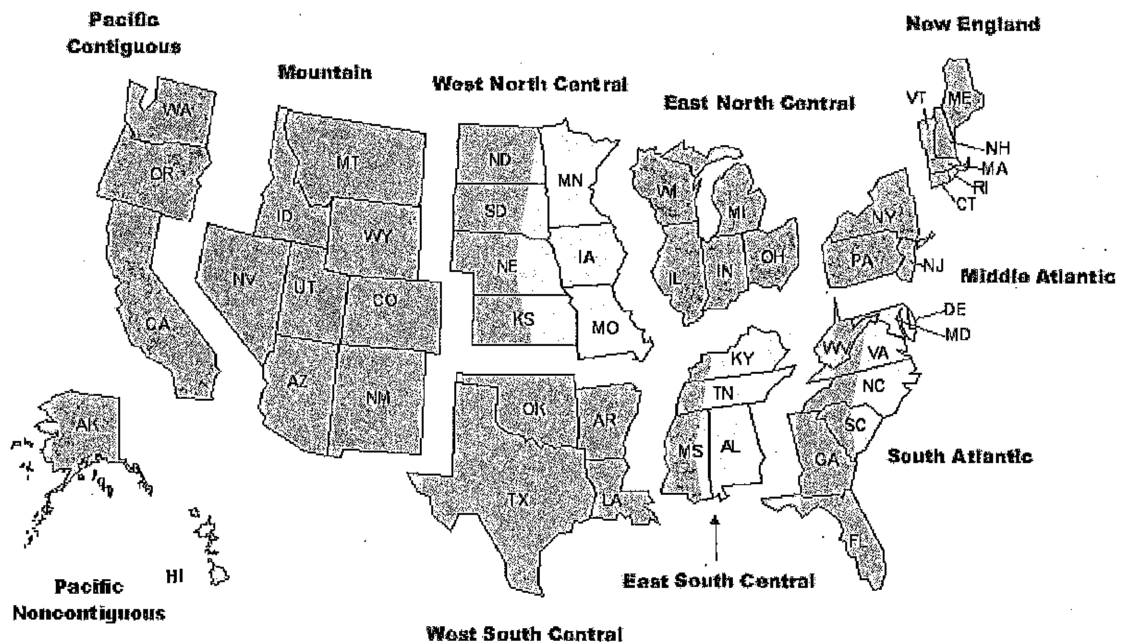


Table 18: Ammonia plant capacity by state

(thousand short tons per year)

State	Capacity	Percent
Louisiana	2,810	24%
Oklahoma	2,590	22%
Iowa	791	7%
Georgia	758	6%
Kansas	694	6%
Ohio	648	6%
Virginia	584	5%
Texas	540	5%
Mississippi	500	4%
North Dakota	391	3%
Illinois	306	3%
Nebraska	292	3%
Alaska	280	2%
Wyoming	196	2%
Alabama	175	2%
Oregon	111	1%
Grand Total	11,666	100%

Source: *North America Fertilizer Capacity*, International Center for Soil Fertility and Agricultural Development (IFDC), December 2008.

Table 19: World phosphate mine production, reserves, and reserve base (2005)

millions of metric tons

Country	Demonstrated Reserves	Currently Economic Recoverable Reserves	Mine production	
			2005	2007
United States	3,400	1,200	38.3	29.7
Morocco and Western Sahara	21,000	5,700	28.0	27.0
China	13,000	6,600	26.0	45.4
South Africa	2,500	1,500	2.0	2.6
Jordan	1,700	900	7.0	5.5
Australia	1,200	77	2.0	2.2
Russia	1,000	200	11.0	11.0
Israel	800	180	3.2	3.1
Syria	800	100	3.0	
Egypt	760	100	2.2	2.2
Tunisia	600	100	8.0	7.8
Brazil	370	260	6.4	6.0
Canada	200	25	1.0	0.7
India	160	90	1.2	1.2
Senegal	160	50	1.8	0.6
Togo	60	30	1.1	0.8
Other countries	2,000	800	4.9	10.6
World total	50,000	18,000	148.0	156

Source: U.S. Geological Survey, *Mineral Commodity Summaries*, January 2006.

APPENDIX C: STATE-LEVEL FOCUS

4.2.1. Louisiana

The state of Louisiana ranks first among states with ammonia plants in terms of economic contributions of the fertilizer manufacturing industry. In 2006, the direct economic contributions of the fertilizer manufacturing industry in Louisiana totalled $1.3 billion in output and over 1,100 jobs. The total economic contributions, which include additional contributions such as impacts on suppliers and spending by employees, were $2.4 billion and over 7,300 jobs. Table I shows the direct and indirect contributions of the fertilizer manufacturing industry to the state of Louisiana. The contributions are presented for each sector in the industry, with the exception of potash, which was not included in this analysis due to lack of suffficient data.

Table I: Fertilizer manufacturing industry economic contributions to Louisiana (excluding Potash)

Output	Direct Contribution				Total Contribution	
	Louisiana total	% of US total	US rank	*multiplier*	Louisiana total	% of US total
Nitrogenous Fertilizer Manufacturing	$833	8%	# 1 *	*1.6*	$1,323	6%
Phosphatic Fertilizer Manufacturing	401	6%	# 4	2.2	902	4%
Fertilizer Manufacturing, Mixing Only	39	1%	# 27	5.2	202	2%
Total	$1,273	6%			$2,427	4%

Employment	Direct Contribution				Total Contribution	
	Louisiana total	% of US total		*multiplier*	Louisiana total	% of US total
Nitrogenous Fertilizer Manufacturing	603	8%		*5.6*	3,397	4%
Phosphatic Fertilizer Manufacturing	444	6%		*7.4*	3,274	4%
Fertilizer Manufacturing, Mixing Only	76	1%		*9.1*	689	1%
Total	1,123	5%			7,360	3%

* ranks first among states w/ ammonia plants

Additional data on the fertilizer manufacturing industry's direct employment in Louisiana is provided in Table II. The table shows employment by sector, including output and compensation per employee.

Table II: Louisiana's fertilizer manufacturing industry employment and compensation (excluding Potash)

	Nitrogenous	Phosphatic	Mixing	Fertilizer Total	Louisiana Average
Employment	603	444	76	1,123	
Output per worker	$1,382,792	$902,970	$509,229	$1,133,961	$167,671
Compensation per worker	$112,124	$111,496	$62,603	$108,535	$37,112

The industry's compensation per employee was considerably higher than the Louisiana average, at $108,535 per employee vs. a Louisiana average of $37,112 across industries.

These higher salaries, wages, benefits and other forms of compensation were a result of a very high output per employee ratio. The fertilizer industry in Louisiana generates over $1.1 million in output per worker, which is over seven times the Louisiana average across industries. .

The significant economic contributions of the fertilizer manufacturing industry in Louisiana are primarily the result of the productivity of the ammonia plants within the state. In 2006, the state had the greatest ammonia plant capacity in the country, with 24% of the US total. While the majority of plant capacity is located in Ascension Parish, there are economic contributions throughout the state, especially through supplying industries and the spending by employee households. Table III shows the value added and sector inputs into Louisiana's nitrogenous fertilizer manufacturing sector.

Table III: Value added & sector inputs: Louisiana's nitrogenous fertilizer manufacturing sector

	Value (millions)	% of Output
Value Added by the sector in Louisiana	**$166**	**20%**
Inputs from outside Louisiana	**$438**	**53%**
Inputs from Louisiana's sectors not in fertilizer manufacturing industry		
Oil and gas extraction	$49	6%
Petroleum refineries	34	4%
Pipeline transportation	23	3%
Natural gas distribution	12	1%
Management of companies and enterprises	9	1%
Wholesale trade	8	1%
Power generation and supply	6	1%
All other miscellaneous professional and technical	4	1%
Legal services	3	0%
Truck transportation	3	0%
Other	32	4%
Total	**$183**	**22%**
Inputs from Louisiana's fertilizer manufacturing sectors		
Nitrogenous fertilizer manufacturing	$46	5%
Total	**$46**	**5%**
Sector Ouput	$833	

4.2.2. Florida

The state of Florida ranks first among states in terms of economic contributions of the phosphatic fertilizer manufacturing sector. Over half of the direct output in the US from this sector is produced in Florida. In 2006, the direct economic contributions of the entire fertilizer manufacturing industry in Florida totalled $4.3 billion in output and almost 5,000 jobs. The total economic contributions, which include additional contributions such as impacts on suppliers and spending by employees, were $8.2 billion and over 32,800 jobs. Table IV shows the direct and indirect contributions of the fertilizer manufacturing industry to the state of Florida. The contributions are presented for each sector in the industry, with the exception of potash, which was not included in this analysis due to lack of suffficient data.

Table IV: Fertilizer manufacturing industry economic contributions to Florida (excluding Potash)

Output	Direct Contribution				Total Contribution	
	Florida total	% of US total	US rank	*multiplier*	Florida total	% of US total
Nitrogenous Fertilizer Manufacturing	$627	6%	# 6	*2.1*	$1,290	5%
Phosphatic Fertilizer Manufacturing	3,292	50%	# 1	*1.8*	5,971	29%
Fertilizer Manufacturing, Mixing Only	412	10%	# 2	2.2	896	7%
Total	$4,331	21%			$8,157	14%

Employment	Direct Contribution				Total Contribution	
	Florida total	% of US total	US rank	*multiplier*	Florida total	% of US total
Nitrogenous Fertilizer Manufacturing	515	7%		*9.5*	4,904	6%
Phosphatic Fertilizer Manufacturing	3,666	49%		*6.5*	23,690	27%
Fertilizer Manufacturing, Mixing Only	781	10%		*5.4*	4,205	8%
Total	4,962	20%			32,798	13%

Additional data regarding the fertilizer manufacturing industry's direct employment in Florida is provided in Table V. The table shows employment by sector, including output and compensation per employee. Not that the direct employment totals do not include jobs in supporting industries (such as phosphate mining), which are accounted for in total employment.

Table V: Florida's fertilizer manufacturing industry employment and compensation (excluding Potash)

	Nitrogenous	Phosphatic	Mixing	Fertilizer Total	Florida Average
Employment	515	3,666	781	4,962	
Output per worker	$1,217,409	$898,025	$528,240	$872,994	$115,357
Compensation per worker	$62,674	$106,715	$73,364	$96,897	$38,537

The compensation per employee was considerably higher than the Florida average, at $96,897 per employee vs. a state average of $38,537 across industries. These higher salaries, wages, benefits and other forms of compensation were a result of a very high output per employee ratio. The fertilizer manufacturing industry in Florida generates over $870,000 in output per worker, which is almost 8 times the Florida average across industries.

The significant economic contributions of the fertilizer manufacturing industry in Florida are largely attributable to the phosphatic fertilizer manufacturing in the state, which in turn is a result of the state's economically accessible deposits of phosphate. In 2006, 60% of the phosphate rock mining capacity in the country was located in Florida. While the majority of plant capacity is located in central Florida, there are economic contributions throughout the state, especially through supplying industries and the spending by employee households. Table VI shows the value added and sector inputs into Florida's phosphatic fertilizer manufacturing sector.

Table VI: Value added & sector inputs: Florida's phosphatic fertilizer manufacturing sector

	Value (millions)	% of Output
Value Added by the sector in Florida	**$397**	**12%**
Inputs from outside Florida	**$1,651**	**50%**
Inputs from Florida's sectors not in fertilizer manufacturing industry		
Truck transportation	$298	9%
Wholesale trade	115	3%
Other basic inorganic chemical manufacturing	84	3%
Management of companies and enterprises	76	2%
Oil and gas extraction	42	1%
Rail transportation	39	1%
All other miscellaneous professional and technical	28	1%
Power generation and supply	26	1%
Pesticide and other agricultural chemical manufact	22	1%
Other	243	7%
Total	**$973**	**30%**
Inputs from Florida's fertilizer manufacturing sectors		
Phosphatic fertilizer manufacturing	$139	4%
Nitrogenous fertilizer manufacturing	132	4%
Total	**$271**	**8%**
Sector Ouput	**$3,292**	

January 19, 2011

Darrell E. Issa
Chairman
Committee on Oversight and Government Reform
United State House of Representatives
2157 Rayburn House office building
Washington, DC 20515-6143

Dear Chairman Issa,

Thank you for your letter of December 10, 2010 regarding your request for assistance in identifying existing and proposed regulations that negatively impact the U.S. economy and job creation. The Financial Services Forum is of the view that accelerating economic growth and job creation should be our nation's topic domestic priorities. We appreciate the focus and energy that you have brought to this critical effort.

As you may know, the Forum is a financial and economic policy organization comprised of the chief executives officers of 20 of the largest financial institutions with operations in the United States. Issues comprising the Forum's recent policy agenda include: reform and modernization of the U.S. framework of financial supervision; enhancing the competitiveness of U.S. capital markets; educating policymakers regarding the importance of private capital in fueling economic growth and development around the world; preserving the 50-year consensus for free trade by promoting policies that help more Americans participate in the gains of globalization; financial sector modernization and expanded market access in China; and encouraging cross-border investment and the free flow of capital.

Responding to your request, the attached documents were provided by a few members of the Forum. In forwarding these observations to you, the Forum wishes to emphasize that these provided comments and observations may not reflect the collective view of all 20 members of the Forum.

As a general comment, regulatory uncertainty remains a major obstacle to greater lending and investment and, therefore, faster economic growth and job creation. With specific regard to the financial services sector, significant uncertainty persists stemming principally from still-emerging new requirements with regard to capital and liquidity, as well the hundreds of new regulations being written by financial regulators to implement the Dodd-Frank Act. How these regulations are written will have a tremendous impact on the stability, profitability, innovative capacity, and competitiveness of the financial sector – and, therefore, on the availability of the capital and credit that American businesses depend on to invest, grow, and create jobs.

Again, thank you for the opportunity to contribute to your important efforts. Please let me know if you have any questions about the attached comments.

Sincerely,

Rob Nichols
President and COO

Insurance for the 21st century

By: Peter Ludgin
December 27, 2010 04:32 AM EST

Insurance regulation is in dire need of an overhaul. Agents and brokers, as well as the consumers they serve, are shortchanged by an antiquated state-based system, whose patchwork model is inefficient and costly.

The 56 state-based insurance bureaucracies (including the five territories and Washington) that regulate today's insurance market compel producers to jump through various hoops to serve customers — including barriers to entry, a lack of portability and price controls.

This system is a vestige of the 19th century, when states regulated most domestic commerce. The Supreme Court ruled in 1868 that insurance was not interstate commerce, giving states primary jurisdiction, which they maintain today.

Yet state-based insurance regulation can be discordant – creating onerous costs, redundant forms and headaches for producers, insurers and the consumers they serve.

The state-based system often lacks flexibility. For example, longtime customers, who move out of state, cannot continue with their familiar financial advisor in a seamless fashion. In addition, consumers do not understand why an annuity, long term care, disability or life policy is available in one state, but not another.

This state-based system can serve as a barrier to entry. It prevents products from being introduced in a timely fashion. And marketing to potential customers out of state, without a non-resident license, is forbidden.

Reformers support bipartisan legislation to address licensure hassles, speed to market issues and price controls by creating an optional federal charter. However, many opponents view this as a threat to their market share. In effect, they are opposed to additional competition. How does this help consumers? It doesn't.

Choice, competition and open markets are what help consumers. During the health care debate the issue of portability – selling products across state lines—was considered. In the Pledge to America, Republican leaders would allow individuals to buy health care coverage outside the state they live in. In many ways, these issues overlap.

Some supporters of the optional federal charter seek the elimination of price controls, saying that competitive market forces – good, old-fashioned competition – should determine the prices and terms of products.

For example, Illinois has allowed free market pricing since 1971. As a result, there are several hundred companies now competing in this market. States with price controls have far fewer options for their residents.

Unfortunately, the new Dodd-Frank Wall Street reform bill does not address these issues. But it does create a Federal Insurance Office, whose director is required to issue a report to Congress "on how to modernize and improve the system of insurance regulation." This new office must tackle these matters.

Supporters of an optional federal charter are not advocating the annihilation of the state regulatory system. Producers and insurers would have a choice to stay within the state-based system — or opt into a federal regulatory structure. We must protect against dual regulation.

An optional federal charter is not about less regulation – but better, efficient and consistent regulation across all states for all consumers.

The politics behind this issue are tricky – at stake is turf, revenue and market share. However, supporters of this optional charter and modernization are on the right side of this policy proposal.

Peter Ludgin is the executive director of Agents for Change, a grass-roots trade association of insurance agents and brokers from across all lines of insurance

Insurance Issues Stemming From Dodd-Frank

Appointment of Director

The Director for the new Federal Insurance Office (FIO) created by Title V, Section 502(a)(3) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 should be a person who has insurance experience and who is committed to and capable of creating competitive markets that benefit of insurance consumers. Candidates must not simply be evaluated on their willingness to proliferate regulation or penalize industry participants.

The new FIO Director must also be capable of representing the U.S. and developing federal policy on international insurance matters. This authority should exercised in a manner that ensures equitable treatment of domestic and foreign insurers and promotes job innovation and growth in the U.S. markets.

One of the first tasks of the new Director will be to conduct a study and to submit a report to Congress on how to modernize and improve the system of insurance regulation in the U.S. This report will require the Director to be objective and impartial when evaluating the effectiveness and efficiency of state regulation. For this reason, it is imperative that the Secretary avoid appointing a person who has staunchly defended state regulation or who will perceive any criticism of state regulation as a critique of his or her past record.

Designation of Systemically Important Non-Bank Financial Company

The new FIO Director will have the authority to recommend to the FSOC that an insurer be designated as systemically important. The criteria for such consideration have not yet been promulgated. Nonetheless, any company designated for heightened oversight by the FSOC will suffer from a competitive disadvantage.

For this reason, the FIO Director must exercise this authority in very limited circumstances. Furthermore, there must be some checks and balances on this authority to ensure that it is not used as a political lever against industry members. At a minimum, there should be an appeal process whereby companies can challenge the findings of the Director before the recommendation is formally presented to the FSOC.

Underserved communities, minorities and low and moderate income persons

The FIO Act directs the FIO to monitor, and presumably report, the extent to which traditionally underserved communities, minorities and low and moderate income persons have access to affordable insurance products regarding all lines of insurance. The premise of this section of the FIO may be flawed. To our knowledge Congress did not present any findings that suggest that the groups listed in the subsection are underserved. It will be imperative that the FIO work with the industry to understand the business of insurance and the need to charge actuarially

appropriate rates to maintain vibrant and competitive markets for all insurance consumers.

Data Collection: Minimum Company Size Threshold

The FIO Act authorizes the FIO to collect data from insurers to carry out its functions. It further directs the FIO to establish a minimum size threshold beneath which insurers would be exempt for the requirement to submit data to the FIO.

First, we urge the FIO to exercise its data collection powers judiciously and to avoid placing unnecessary and duplicative reporting burdens on companies. Second, we believe that, in order for the FIO to have a complete understanding of the insurance marketplace, the FIO must collect data from the entire insurance marketplace. This, of course, requires data collection from the thousands of "small" insurers writing business in the U.S.

Furthermore, the costs of responding to data calls can be disproportionately high for larger insurers. These additional costs will create a competitive advantage for those insurers who are excepted from these data calls. Therefore, we urge the FIO to issue no threshold for data collections. In the alternative, we believe very low threshold is necessary to allow the FIO gain a full understanding of the marketplace and maintain a competitive level playing field.

FIO Study and Report

Regarding the reports the FIO Director is required to produce for Congress, active engagement with the insurance industry during the drafting process is important. The reports include one on improving U.S. insurance regulation and another on the breadth and scope of the global reinsurance market and the critical role the market plays in supporting insurance in the U.S. Making sure these reports incorporate industry input and provide objective analysis of these respective issues is key.

Department of Labor Initiative Regarding Definition of "Fiduciary"

The Department of Labor ("DOL") recently issued a proposed rule that would redefine the term "fiduciary" with respect to retirement plans and IRAs. The proposed regulation would greatly expand the definition of a fiduciary, so that many more entities and individuals would be fiduciaries.

It is important to note that the existing regulatory definition has been in place since 1975 and the statute has not changed.

If a person is a fiduciary with respect to retirement plans and IRAs, the person is generally precluded from giving any advice that could have any effect on the person's compensation. So, for example, many routine transactions performed by a broker or dealer would become illegal unless completely restructured. This has caused great concern among the investment community, since the result of the new regulation would appear to be an enormous restructuring of an entire industry without any basis in the record of a need for restructuring. And there would be a corresponding decrease in investment information being provided to investors, as advisors seek to insulate themselves from the enormous new liabilities created by the regulation.

DOL is moving forward despite a similar initiative by the SEC, which focuses appropriately on disclosure. The unfortunate and very disruptive result could be that broker/dealers would be subject to two sets of inconsistent rules, creating unnecessary costs and confusion for them and their customers.

The costs associated with industry restructuring and compliance with inconsistent rules will only serve to drain resources from the creation of new jobs and the stimulation of the economy. The decrease in the investment information available to investors will also undermine both savings and investment in the economy. At a minimum, the DOL and SEC should coordinate on a single fiduciary rule.

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Financing America's Economy

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January 19, 2011

The Honorable Darrell Issa
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Issa:

The Financial Services Roundtable (the "Roundtable") appreciates the opportunity to provide you with our comments regarding current and contemplated federal regulations that negatively impact our economy and job growth. Presently, the Roundtable is focused on implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We are committed to make the regulatory changes that follow from the Dodd-Frank Act work for the American economy. The Roundtable, however, remains concerned that certain regulations, as outlined below, must be implemented with the restraint required by the Act, in a commercially reasonable manner, and that they not go beyond the original intent of Congress.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.6 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

Paramount among the Roundtable's concerns with the Dodd-Frank Act is the debit interchange fee restrictions (the "Durbin Amendment") contained within Section 1075. Interchange fees are the fees merchants pay to card issuing banks to have the ability to accept card payments. The Dodd-Frank Act compels the Federal Reserve Board (the "Board") to regulate interchange fees through price controls. The Durbin Amendment, and the subsequent Board proposed rule, falls substantially short of capturing the costs associated with providing the debit service. Left unaltered, these proposed rules will not only drastically change the way consumers are accustomed to paying for goods and services, but will threaten the safety and soundness of well capitalized financial institutions that participate in the payment system.

The Board's proposal would remove an estimated $15 billion dollars from the financial services marketplace. This significant reduction will require higher fees to be paid by consumers, negatively impact lending, and may ultimately lead to a reduction of jobs in the financial services industry and the broader economy. The Durbin Amendment's unprecedented shift of resources from one industry to another, without a clear and direct benefit to consumers,

will hurt small businesses and consumers in the long-run. Additionally, a slowdown in innovation and lack of competition among debit card issues could lead to increased use of less efficient payment systems such as cash or checks, which could ultimately negatively impact consumer spending and the economy as a whole.

The Roundtable is, also, closely tracking implementation of Section 619 of the Dodd-Frank Act that sets forth the new Section 13 of the Banking Holding Company Act of 1956 (commonly referred to as the "Volcker Rule"). As its preamble provides, the Dodd-Frank Act was intended to "promote the financial stability of the United States" and to respond to particular risks to that stability, such as the "too big to fail" problem and "abusive" financial services practices. The Dodd-Frank Act was not intended to punish the financial services industry nor to stifle the ability of the industry to provide products and services to meet market demands. As a result, we have asked the regulators to not interpret the Volcker Rule to extend beyond what Congress intended. In this manner, the regulations would meet the mandate of the Dodd-Frank Act and minimize the risk of impairing financial institutions' ability to fulfill their crucial role of supporting financial stability and the U.S. economy.

The Volcker Rule was not intended to supplant or overlay well-established regulatory regimes that have proved to be effective and have not been implicated by the recent financial crisis, such as ERISA and insurance regulation. Unintended consequences and harm to safety and soundness would result by applying the Volcker Rule beyond its statutory intent. Traditional banking, fiduciary, investment and insurance activities, as well as the manner and structures through which such activities are conducted, should remain subject to traditional safety and soundness principles and other similar regulations that already appropriately and effectively regulate them.

Additionally, we have encouraged regulators to closely examine the equality of competitive opportunity afforded to banking organizations formed under the laws of the United States compared to non-U.S. banking organizations The Volcker Rule expressly permits non-U.S. banking entities to conduct activities outside of the United States that would otherwise be prohibited by the Volcker Rule. U.S.-based banking organizations and their subsidiaries have no such authority with respect to their non-U.S. operations. Because this divergent treatment necessarily subjects similarly situated globally-active banking organizations to different standards and limitations, regulators should implement the Volcker Rule with a careful eye to avoid disadvantaging U.S.-based banking organizations that are active globally, as compared to their non-U.S. competitors. Unless similar flexibility can be applied to the non-U.S. activities of globally-active U.S. banking organizations, applying significant limitations to the business of U.S. banking organizations will hinder their ability to compete globally, while contributing little to the goal of system-wide financial stability towards which the Dodd-Frank Act and the Volcker Rule are directed.

As it relates to the new Consumer Financial Protection Bureau (the "Bureau"), the Roundtable has advocated for strong, rational consumer protection standards and enforcement that emphasize safe harbor, uniform national standards, uniform disclosures for all agencies, enforcement for non-regulated companies, and quantifiable standards. While the Bureau has not yet proposed any new regulations, we remain concerned that the manner in which the

Bureau chooses to use its sweeping powers to write and enforce consumer financial regulations could have a significant adverse effect on jobs and the economy.

Experience with regulations recently issued under the Credit Card Accountability Responsibility and Disclosure Act of 2009 has shown that increasing the cost and risk of extending consumer credit results in a reduction of the amount of credit extended, a narrowing of available options, and increases the price of credit with resulting adverse ripple effects on economic activity and job growth. Regulations issued by the Bureau that limit innovation, reduce consumer choice and fail to take account of market forces are likely to adversely impact the economy and jobs. One study on *The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit* (attached) found that, under conservative assumptions, actions by the Bureau could increase the interest rates consumers pay by at least 160 basis points; reduce consumer borrowing by at least 2.1 percent; and reduce the net new job creation by 4.3 percent. We are hopeful that through responsible implementation and vigorous oversight of this new agency these numbers will not become a reality.

Finally, Section 115 of the Dodd-Frank Act, which outlines "enhanced prudential standards," has the potential to negatively affect job creation and economic recovery by making credit less available and more costly. These new standards are intended to mitigate risk to financial stability and would apply to systemically important nonbank financial firms to be designated by the Financial Stability Oversight Council (the "FSOC") and to bank holding companies with assets over $50 billion. The "standards," which are to be implemented by the Federal Reserve Board, include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits, and overall risk management requirements. The Roundtable believes increased capital standards, beyond what is required for safety and soundness, will directly retard the growth of credit availability and increase its cost, which will make it harder and more costly for businesses to borrow, thus making job creation more difficult. Similarly, overly strident liquidity requirements will reduce the amount of loans available, as they are comparatively illiquid assets, and negatively impacting economic growth.

We thank you for the opportunity to comment on proposed regulations, specifically the Dodd-Frank Act, and their potential negative impact on the financial services sector, job creation, and the larger economy. We stand ready to work with you and your staff as you conduct oversight of these important issues.

Best regards,

Steve Bartlett
President and CEO

THE EFFECT OF THE CONSUMER FINANCIAL PROTECTION AGENCY ACT OF 2009 ON CONSUMER CREDIT

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The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit

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7 January 2010

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Electronic copy available at: http://ssrn.com/abstract=1483906

I. Introduction

In 2009, the United States Department of the Treasury submitted the Consumer Financial Protection Agency Act of 2009 to Congress, proposing a sweeping overhaul of consumer financial regulation.[1] Congress has wrestled with the Administration's proposal in the ensuing months. In December, the House of Representatives passed a bill that adopted some key elements of the Administration's bill but discarded others.[2] As of the printing of this Article, the Senate is still working on this contentious subject, and, as of the end of 2009, no bill has advanced to a Committee vote. This Article analyzes the Administration's bill since it provides the template for the other legislation considered and because some of the ideas advanced by the Treasury Department are worthy of debate regardless of whether they are adopted during the current session of Congress or at all.

The Administration's proposed legislation would create a new agency that would take over many of the consumer protection functions of several federal regulatory agencies and have jurisdiction over virtually all consumer financial products and services.[3] The new agency is intended to achieve stronger regulation of consumer financial products and services through more extensive powers than existing agencies have under current laws.[4] Under the Administration's bill, the CFPA would have the power to, among other things:

- prohibit certain consumer financial products or services or features of those products or services;[5]
- impose more stringent and intrusive disclosure requirements on providers of consumer financial products and services;[6]
- require that providers offer "plain vanilla" products that the agency would design, before or at the same time those providers offered their own variants on these standard products;[7] and,

[1] UNITED STATES DEPARTMENT OF THE TREASURY, CONSUMER FINANCIAL PROTECTION AGENCY ACT OF 2009 (2009), *available at* http://www.financialstability.gov/docs/CFPA-Act.pdf [hereinafter CFPA Act] (proposing 2009 Consumer Financial Protection Agency legislation for passage by Congress). The reforms of consumer financial protection and the proposal to create a single agency were presented on July 17, 2009 in UNITED STATES DEPARTMENT OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 55-75 (2009) [hereinafter New Foundation], *available at* http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (outlining proposals for various governmental regulations of financial services and credit products).

[2] We discuss the differences between the Administration and the House bill below. *See generally infra* n. 13 and accompanying text.

[3] These include the Federal Reserve Board of Governors, Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, and the Federal Trade Commission. *See* CFPA Act, *supra* note 1, at § 1061(a). While the CFPA would regulate many consumer financial products and services, there are two principal exceptions: (1) insurance would be excluded, except for credit insurance, mortgage insurance, and title insurance; (2) investment products that are already regulated by the SEC or CFTC would be excluded. CFPA Act, *supra* note 1, at § 1082(d).

[4] New Foundation, *supra* note 1, at 3 ("We propose . . . stronger regulations to improve the transparency, fairness, and appropriateness of consumer and investor products and services.").

[5] CFPA Act, *supra* note 1, at § 1031(c).

[6] *Id.* at § 1032.

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- ensure that underserved consumers and communities would have access to consumer services, lending, and investment.[8]

The proposed legislation expressly allows states and localities to impose stricter regulations than those adopted by the CFPA and engage in enforcement efforts complementing those conducted by the CFPA.[9] The Act would therefore end federal preemption of state consumer protection for nationally chartered financial institutions. The Act would also change the law on consumer financial protection by extending the current condemnation of "unfair and deceptive practices" to include "abusive" practices[10] and require that lenders make "reasonable" disclosures.[11]

The Treasury Department initially proposed this new system of consumer financial protection in its June 2009 white paper *Financial Regulatory Reform: A New Foundation.* However, the proposal for the new agency and many of the key principles for how this agency would regulate consumer financial products were presented in articles and reports that were authored by several law professors, including the Assistant Secretary of the Treasury who was involved in the drafting of the legislation.[12] These articles and reports provide the intellectual foundation for modifications in consumer protection regulation on the premise that consumers are irrational and make mistakes systemically in how they borrow money. Accordingly, these writings provide a guide for how its proponents intend the new agency and laws to work.

This Article concludes that CFPA Act as proposed by the U.S. Department of the Treasury would:

- Make it harder and more expensive for consumers to borrow and would risk reversing the decades-long trend towards the democratization of credit.
- Create a "supernanny" agency that is designed to substitute the choice of bureaucrats for those of consumers. And,

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[7] *Id.* at § 1036(b).
[8] *Id.* at § 1014(c)(2).
[9] *Id.* at § 1035(a). Currently, OCC rules preempt states and localities from supervising, examining and regulating the business activities of national banks and their operating subsidiaries. 12 C.F.R. pt. 7, 34; UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, OCC PREEMPTION RULES: OCC SHOULD FURTHER CLARIFY THE APPLICABILITY OF STATE CONSUMER PROTECTION LAWS TO NATIONAL BANKS (2006), *available at* http://www.gao.gov/new.items/d06387.pdf. *See also* Home Owners' Loan Act of 1933, 12 U.S.C. §§ 1461-1470 (2006).
[10] The terms "abusive" and "abuse" are not defined in the Act. *See generally* CFPA Act, *supra* note 1, at § 1002 (listing definitions of various terms under the proposed Act).
[11] CFPA Act, *supra* note 1, at § 1032(b).
[12] *See, e.g.*, Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir, *Behaviorally Informed Financial Services Regulation* 1 (New American Foundation Working Paper, October 2008); Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 39 (2008).

- Jeopardize the financial recovery by reducing credit when the economy is fragile and there is already too little credit.

We briefly explain each of our findings in this introduction.

The Treasury's CFPA Act would also make it harder and more expensive for consumers to borrower. It would likely:

- Prohibit lenders from offering some credit products and services that consumers want and benefit from. The CFPA would have the power to do this and the proponents of the agency have argued that many common products, including subprime mortgages and credit cards, are of dubious benefit to consumers.
- Impose significant additional costs on lenders that would be passed on to borrowers. These costs would include exponentially higher litigation and regulatory costs that would result from allowing states and municipalities to adopt more stringent regulations and imposing new and untested liability standards on lenders. They also include the costs of complying with the stronger regulations that the CFPA is supposed to apply.
- Require lenders to push consumers towards lending products designed by the CFPA. The CFPA would have the power to impose significant costs on lenders offering innovative lending products and the consumers who want them. The CFPA's proponents strongly advocated this paternalistic approach in which the government provides soft or hard "nudges" to get consumers to take an option these proponents prefer. There is no reason to believe that products designed by a regulatory agency would be better than those designed by lenders and freely chosen by consumers. (The CFPA may have sufficient powers to "induce" lenders to provide products of its design even without the ability to require lenders to offer "plain vanilla" products.)

These aspects of the CFPA Act would result in consumers losing access to methods of lending that the agency prohibits or that lenders withdraw as a result of the higher costs they incur. Lenders will also pass on the higher costs resulting from federal and state regulation of lending products to consumers in the form of higher interest rates and fees. These aspects of the CFPA Act would likely reverse the decade long trend towards the democratization of credit. The increased cost of lending combined with requirements to offer agency-designed products is likely to result in a significant reduction in credit

availability, particularly to people who have historically had more difficulty obtaining access to credit. Finally, the increased cost of credit and reduced availability would impose collateral damage on small businesses that often rely on consumer financial products.

The CFPA Act would create a "supernanny" that is designed to substitute bureaucratic choice for consumer choice. The CFPA Act, as explained by its proponents, is based on the findings of "behavioral law and economics" that consumers make bad decisions when it comes to financial services products and would be made better off with the government steering them to better decisions. A Consumer Financial Protection Agency premised on this paternalistic view would be prone to replace what consumers believe is in their interest with its own views. It is doubtful that even the most well educated bureaucrats could design sustainable and profitable products better suited to satisfy consumer needs than those designed by lenders. Similarly, it is unlikely that any group of regulators could make better decisions on how and on what terms to borrow than the consumers with the greatest stake in the loan.

The CFPA Act poses especially severe risks to American households and to the economy over the next few years. The American economy remains fragile. Credit availability to households remains restricted, which has hurt those households directly. The credit crunch has also indirectly harmed consumers through decreased economic activity, resulting in fewer jobs and reduced incomes. In addition to the long-run effects the CFPA Act would have on credit availability, the proposed legislation would also especially dampen credit availability in the nearer term because financial institutions would face a great deal of uncertainty over the scope and risks of the new regulations. The resulting reduction in credit availability would likely slow the nascent economic recovery and especially impact job creation as a result of the multiplier effect of consumer spending on economic activity. It would also dampen the formation of new businesses that generate most of the economy's net new jobs. Adopting a new regulatory system for consumer financial products that could make it harder for consumers to borrow in 2010 and 2011 is an especially bad idea.

Our conclusion is that the Treasury Department's CFPA Act of 2009 is a misguided attempt to erect an agency that could substitute its own view for those of consumers on how and under what circumstances consumers should be able to borrow money. Short-term the CFPA Act would tighten the credit crunch that still threatens the economy. Long-

term it would reduce the availability of credit generally to consumers as well as small businesses. Most unfortunately, the CFPA Act-induced reduction in credit availability would reverse successful efforts to democratize credit by which all segments of American consumers have increasingly been able to borrow to meet their short-term and long-term needs.[13]

The remainder of the Article explains the basis for our conclusions. One must begin with an understanding as to how consumers benefit from the variety of lending products available to them in order to understand why the CFPA Act will likely prove harmful. Furthermore, it is important to recognize how financial innovation through the proliferation of consumer credit products has democratized credit by making it available to an ever-broadening segment of society. Accordingly, we explain each of these in Sections II and III respectively. We then turn in Section IV to explaining the rationale for the CFPA Act as proposed. In Section V, we analyze how the provisions of the CFPA Act and the powers granted to the new agency would likely affect the cost and availability of consumer credit to households and small businesses. Section VI presents our conclusion – that the CFPA Act would likely harm consumers and small businesses by restricting the availability of credit at a time when the economy needs more, rather than less, credit.

II. Consumer Borrowing

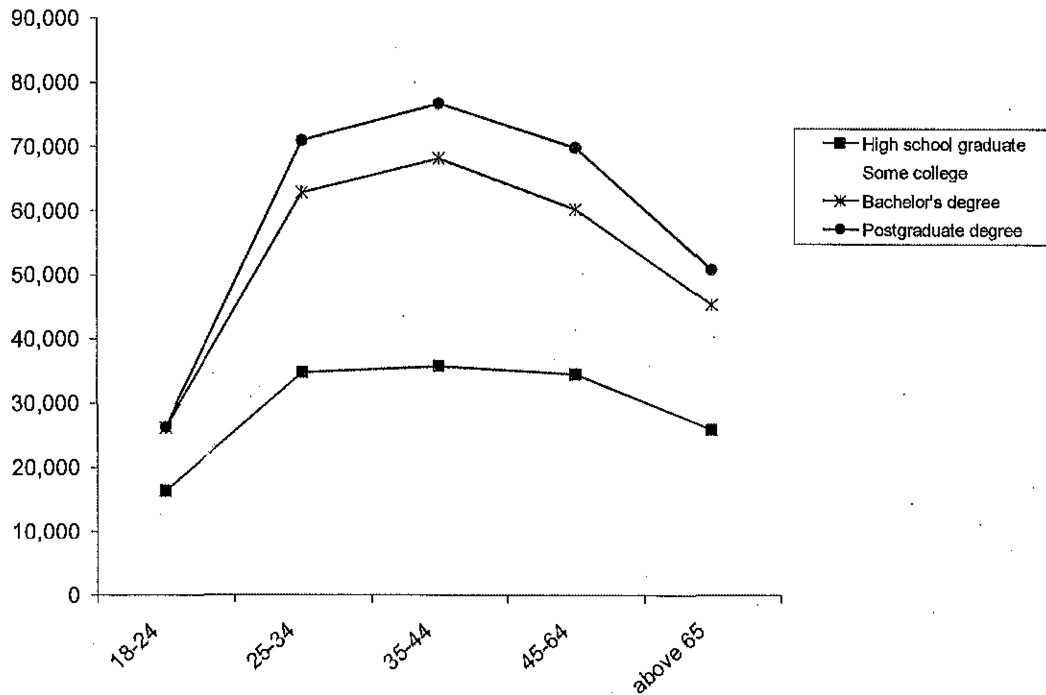
A. Consumer Benefits from Borrowing

Households mainly borrow to even out how much they consume over their lifecycles. People tend to have increasing wages over the first couple of decades of their time in the workforce. Wages reach a plateau and then decline until retirement. Figure 1 shows the typical time patterns which vary according to educational level. If people neither borrowed nor saved they would live much better in middle age than earlier or later. In fact, to the extent they are able to, households usually borrow when they are young. They may take out loans to finance an education, the purchase of durable consumer goods,

[13] On December 11, 2009, the U.S. House of Representatives passed the *Wall Street Reform and Consumer Financial Protection Act of 2009*. H.R. 4173, 111st Cong. (2009). Title IV of that bill addresses consumer financial protection. *See generally id.* at § 4001. There are many key differences between the House Bill and the Administration's proposed bill. Most importantly the House bill eliminates the proposed "plain vanilla" provisions discussed at some length in this paper as well as the proposed "reasonableness" requirements. The House bill also retains elements of the "state preemption" problems we discuss, though it limits these with regards to banks at the discretion of the Office of the Comptroller of the Currency. The House bill nevertheless still imposes liability for "abusive" lending practices, consolidates vast swaths of financial regulation in the Director of the Agency, and provides states various incentives to litigate, such as the opportunity to recover litigation costs. *Id.* at §§ 4301(a), 4102(a)(2), 4505(b).

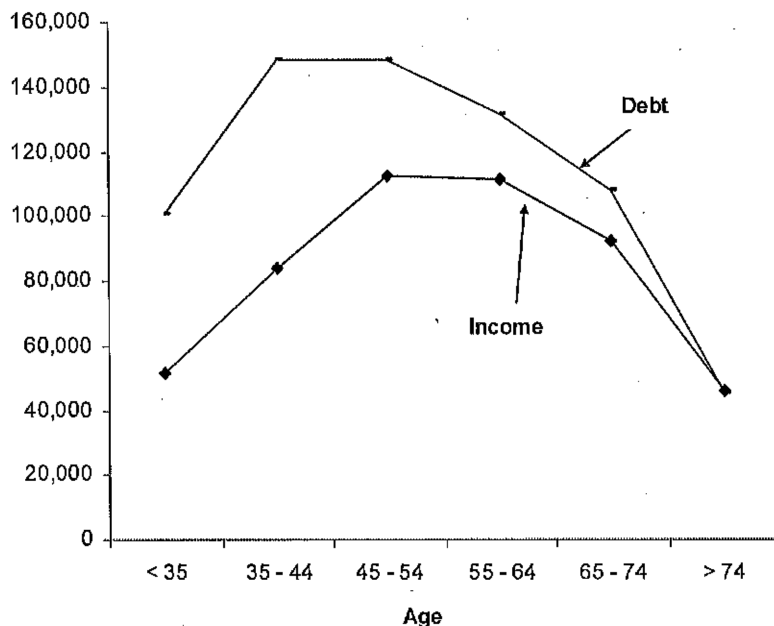
or even the purchase of a home. As they get older they can reduce borrowing and become net savers through home ownership or other investments. They draw down their investments, plus forced savings such as social security, after they leave the work force. Figure 1 shows the typical profile of borrowing and asset accumulation over a lifecycle.

Figure 1. Lifetime earnings for different levels of education in 2007 dollars.



Note: Earnings values correspond to averages for male and female workers.
Source: U.S. Bureau of the Census, Historical Income Tables, available at http://www.census.gov/hhes/www/income/histinc/p28.html.

Figure 2. Borrowing and income over the lifecycle in 2007 dollars.



Note: Debt includes consumer and mortgage debt. Income corresponds to average annual before-tax income.
Source: Federal Reserve Board of Governors, Survey of Consumer Finance, 2007. The debt line shows the level of accumulated debt at a point in time while the income line shows the annual income at a point in time.

Consumers borrow for other reasons as well. Some consumers borrow because they have experienced unanticipated drops in income, perhaps due to a job loss or a divorce, or because they have an unusual expense, such as a wedding or a vacation. Many consumers also borrow to pay for other expenses such as buying clothes.[14] As has always been the case some consumers take on more debt than they should and run into trouble.[15] But, by and large, most people borrow responsibly.[16]

[14] Consumer surveys have found that consumers typically prefer to use their debit cards instead of credit cards for small everyday purchases. *See, e.g.*, Susan Reda, *2003 Consumer Credit Survey*, STORES MAGAZINE, November 2003. Economists explain the consumer preference to use debit cards instead of credit cards with "mental accounting." Mental accounting refers to the thought process that consumers engage in before they enter into a transaction which discourages them from overspending and serve as a mechanism of self regulation. *See* Drazen Prelec & George Loewenstein, *The Red and The Black: Mental Accounting of Savings and Debt*, 17 MARKETING SCIENCE 4 (1998).

[15] *See generally* Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U. L. REV. 1463, 1492-99 (2005).

[16] The American Bankruptcy Institute reported that there were 1,064,927 personal bankruptcy filings in 2008, which corresponds to less than 1% of US households. *See* Press Release, American Bankruptcy Institute, *Consumer Bankruptcy Filings up Nearly 33 percent in 2008* (January 9, 2009), *available at* http://www.abiworld.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=56120. According to the Mortgage Bankers Association, 3.3 percent of mortgages were in the foreclosure process at the end of 2008. *See* Press Release, Mortgage Bankers Association, Delinquencies and Foreclosures Continue to Climb in Latest MBA National Delinquency Survey per American (May 28, 2009), *available at* http://www.mortgagebankers.org/NewsandMedia/PressCenter/69031.htm. The average credit card default was 5.73 percent in August according to Moody's. *See Moody's Credit Card Index Improves in July*, FORBES, August 21, 2009, *available at* http://www.forbes.com/feeds/ap/2009/08/21/business-us-moody-apos-s-credit-cards_6803326.html. These rates are lower during normal economic times.

Consumers benefit directly from borrowing. Economists have shown that as a result of aligning consumption and income more closely, consumers can increase their overall level of well being over their lifetimes. In any event, most people who can borrow against their future incomes tend to enjoy a nicer lifestyle when they are younger than they could achieve from current income.[17] Consumers also benefit indirectly from borrowing. By buying more they enable businesses to expand production and create more jobs.[18] That then raises consumer income and spending. International experience also suggests that the availability of credit spurs economic growth.[19]

B. The Risks of Lending to Consumers

Financial institutions face some serious problems in lending to consumers though. There is great uncertainty over the ability of any individual to pay back a loan. The earnings with which an individual borrower can pay back the loan are unknown and in the future. Moreover, it can be difficult to collect when people default because sometimes their only collateral is whatever money they might earn from future work. Lending faces the well-known problems of adverse selection (loans are most attractive to those who are least likely to pay them back); asymmetric information (borrowers know more about their ability to repay than lenders ever could); and moral hazard (borrowers will take less care to repay loans if they know they can avoid repayment as a result of debt relief laws, rules and programs, and possible lender forbearance).

The risks to lenders from adverse selection, asymmetric information and moral hazard tend to result in precautionary limits on the amount of lending—or liquidity—available to consumers. In the extreme, consumers who want to borrow cannot find anyone to lend to them. Centuries ago there was little consumer lending because of the risks of collecting; and there was little borrowing because laws to ensure repayment—and reduce moral hazard—had draconian consequences such as time in debtor prison.[20]

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[17] Economists explain this pattern of consumer behavior with the permanent income hypothesis according to which people base their consumption expenditures on long-term income trends. *See* PAUL SAMUELSON & WILLIAM NORDHAUS, ECONOMICS 421 (Irwin McGraw-Hill 1998).

[18] The essence of this is the multiplier mechanism where an increase in investment raises the income of consumers and thereby leads to a cascading chain of further spending increases. *See id.* at 446-54.

[19] *See* Aghion Philippe, Abhijit V. Banerjee, George-Marios Angeletos & Kalina B, Manova, *Volatility and Growth: Credit Constraints and Productivity-Enhancing Investment* (MIT Department of Economics Working Paper No. 05-15, April 30, 2005), *available at* http://ssrn.com/abstract=719772 (finding that "tighter financial constraints make R&D investment and growth more sensitive to shocks, while also generating a more negative correlation between volatility and growth to both higher aggregate volatility" for a panel of countries over the period 1960-2000).

[20] Even English landowners did not mortgage their property before the 1600s because if they missed a payment, they forfeited their entire holdings. *See generally* GIUSEPPE BERTOLA ET AL., THE ECONOMICS OF CONSUMER CREDIT 1-27 (MIT Press 2006).

Economists use the term "liquidity constraint" to refer to the situation in which an individual cannot receive additional credit at any price. Some households cannot receive any credit at all while other households cannot receive additional credit even though they are willing to pay for it. Over the years consumers have seen the relaxation of these liquidity constraints as a result of the development of financial markets and innovations in the provision of financial products and services that have enabled lenders to better deal with adverse selection, asymmetric information, and moral hazard problems. These developments have benefited members of social and economically disadvantaged groups especially. Over the last several decades the supply of credit has become democratized with, as we will see below, all but the very poorest members of society able to borrow to some degree.

C. Moral Objections to Borrowing and Lending

Not everyone has applauded the democratization of consumer borrowing over the years. There has been an almost constant thread of moral opprobrium to borrowing from various quarters since the early days of our country. During the 19th century as retailers increasingly provided consumer credit various social commentators warned against the practice. One social critic chastised women for the "curious process of reasoning" that led them to buy on installment rather than paying up front.[21] By the turn of the 20th century, social commentators warned against the evils of spending and going into debt through morality tales such as *Keeping Up with Lizzie* (which inspired the subsequent comic strip *Keeping up with the Joneses*). As Irving Bacheller's *"Charge It"* observed in 1912, "Credit is the latest ally of the devil. It is the great tempter. It is responsible for half the extravagance of modern life."[22] These commentators have argued for public policies to prevent consumers from borrowing.[23]

American consumers have largely chosen to ignore this well-meaning advice throughout the nation's history. They have embraced new forms of credit that enable them to enhance their current standards of living through borrowing. By and large that is an economically sensible response to the shape of lifecycle earnings, and most consumers do so responsibly. As we will see below, the academic scholars who designed the CFPA

[21] LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 181 (Princeton University Press 2001).
[22] IRVING BACHELLER,"CHARGE IT," OR KEEPING UP WITH HARRY 116 (Harper & Brothers 1912).
[23] CALDER, *supra* note 21, at ch.3.

and are its leading proponents are the intellectual heirs of the social critics who thought that credit is the "great tempter" from which consumers should be restrained and protected.

III. The Democratization of Consumer Lending

Beginning in the early 1980s a number of innovations significantly reduced liquidity constraints thereby enabling more Americans to borrow more.[24] These innovations helped increase credit availability dramatically for members of socially and economically disadvantaged groups thereby democratizing credit. The gaps between credit availability for households headed by upper income white men and credit availability for households headed by single parents, the less well-off, and minorities closed considerably. The expansion in consumer spending also helped fuel economic growth and job creation and helped sustain a long period of economic expansion that started in 1982 with just some minor recessions along the way until the recent financial crisis.

A. Computerized Risk Analysis and Securitization

Innovations in computerized risk analysis and securitization were major developments behind these improvements. Both innovations have become controversial as each played a role in the financial crisis. After we describe these innovations we explain that it was the failure of financial institutions to use these important tools properly rather than a problem with the tools themselves. It is therefore important to preserve the benefits of these innovations while dealing directly with the problems that were exposed by the financial crisis.

1. Risk Analysis

We mentioned earlier that lenders are reluctant to provide credit to individuals because of problems of adverse selection, asymmetric information, and moral hazard. Advances in risk analysis over the last three decades have steadily reduced the severity of these problems. Those advances have resulted from a combination of the information technology revolution (which has provided more and cheaper computer power), the

[24] Angela Lyons, *How Credit Access Has Changed Over Time for U.S. Households*, 37 THE JOURNAL OF CONSUMER AFFAIRS 231, 248 (2003).

increased availability of credit-related data on individuals, and the development of sophisticated algorithms for predicting risk.[25]

Sophisticated "automatic underwriting" of loans began with credit cards. These loans are unsecured and are therefore very risky. There were significant defaults when credit cards were first issued en masse in the 1970s. Fair-Isaac was one of several companies to develop credit scores based on mathematical models that credit card lenders and others could use as inputs into their risk assessment models. Its "FICO" score, developed in the 1980s, became the standard measure for credit risk.[26] Some large lenders developed their own scoring systems based on public information as well as relevant proprietary information they have available for clients.[27] As we document below, steady refinements of these risk assessment models have proved critical in enabling credit card issuers to expand credit to an ever wider group of Americans.

Automatic underwriting was adopted by the mortgage industry in the mid 1990s. Prior to automatic underwriting, all mortgages were evaluated by hand based on various guidelines. Automatic underwriting based on statistical models of credit default caught on quickly. By 2000, 60-70 percent of loans were evaluated based on these techniques.[28] Several factors were important to the growth of these automated risk analysis for mortgages. Studies found that the automatic techniques were able to identify reliably a larger pool of credit-worthy candidates and do so at lower cost than human underwriters. These automated techniques also enabled the lenders to better verify origination decisions and to reduce adverse selection problems. These techniques further reduced opportunities for discrimination against minorities because the algorithms were "color blind" and did not factor race or ethnicity information into the calculus. The significant expansion in mortgage lending to African Americans that we document below was due at least in part to the development of these techniques.[29]

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[25] Robert M. Hunt, *A Century Of Consumer Credit Reporting In America* (Federal Reserve Bank of Philadelphia, Working Paper, June 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=757929. *See also* Ben S. Bernanke, Chairman, Fed. Reserve, Financial Innovation and Consumer Protection, Keynote Address at the Federal Reserve System's Sixth Biennial Community Affairs Research Conference (April 17, 2009), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20090417a.htm.

[26] The FICO scoring system compiles information from a variety of sources such as public record, credit application reports and awards points, using mathematical models, for a number of factors that can help predict the likelihood of a person repaying debts on time, e.g. length of credit history, types of credit used, amounts owed. The total number of these points -- the credit score -- predicts how creditworthy a person is. *See* History of Fair Isaac Corporation, http://www.fico.com/en/Company/Pages/history.aspx (last visited Sept. 6, 2009).

[27] Consumer Federation of America, Fair Isaac Corporation, Your Credit Score, http://www.pueblo.gsa.gov/cic_text/money/creditscores/your.htm (last visited Sept. 6, 2009).

[28] John W. Straka, *A Shift in the Mortgage Landscape: The 1990s Move to Automated Credit Evaluations*, 11 JOURNAL OF HOUSING RESEARCH 207, 216 (2000), *available at* http://www.knowledgeplex.org/kp/text_document_summary/scholarly_article/relfiles/jhr_1102_straka.pdf.

[29] *Id.*

Other types of credit also benefited from the development of sophisticated risk analysis. Overdraft protection, which allows consumers to receive an advance from the bank when a check they wrote is for more than the available funds in their account, has also benefited from technological innovation. Historically, financial institutions relied primarily on individual judgment to guide whether to pay checks that would overdraw a consumer's account. Recently, however, this process has been automated by financial institutions. Customers who meet the bank's predetermined thresholds, which are based on the bank's risk analysis, are approved instantly. The speed and the relatively low cost of automated approval also allowed banks to extend this service to non-check transactions including ATM withdrawals and debit card transactions. As Federal Reserve Board Chairman Bernanke remarked: "Although institutions usually charged the same amount when they paid an overdraft as when they returned the check unpaid, many consumers appreciated this service because it saved them from additional merchant fees and the embarrassment of a bounced check."[30] Of course, there are legitimate controversies over whether consumers receive adequate notification of the fees they pay for overdraft protection. But consumers largely benefit from not being embarrassed or being unable to complete a purchase when their checking account balances are temporarily low.

Automobile loans have also become more accessible to consumers because of developments in credit scoring and risk analysis. For example, the process for approving an auto loan has been reduced to hours or minutes instead of days and weeks. By 2001, 84 percent of automobile loan applicants in the United States received a decision within an hour while 23 percent of applicants received a decision in less than 10 minutes.[31]

2. Securitization

Before the development of securitization lenders generally held onto loans they made. That limited total bank lending to a multiple of their capital and also exposed these lenders to considerable variety of risks—such as events like a plant closing in the community served by a small bank—that affected many of the loans in the lenders' portfolios. With securitization the originators of loans were able to sell off some or all of their loans to other market participants and thereby diversify their risks. Moreover, by

[30] *See* Bernanke, *supra* note 25, at 1.

[31] Michael E. Staten & Fred H. Cate, *The Impact of National Credit Reporting Under the Fair Credit Reporting Act: The Risk of New Restrictions and State Regulation* (Financial Service Coordinating Council, Working Paper, 2003), *available at* http://www.sifma.org/regulatory/privacy/pdf/FSCCBenefitsCreditReporting.pdf.

creating a security instrument that consisted of a portfolio of loans it became possible to sell these instruments to the global capital markets. That increased the supply of funds that was available for lending. With the loan removed from the bank's books, the bank had funds freed up to lend to another customer.

Securitization has experienced tremendous growth since it was introduced in the 1970s, expanding from mortgage loans to encompass a wide range of financial assets, including, automobile loans and leases, student loans, credit card loans and small business loans. The value of outstanding mortgage based securities increased from $6.6 trillion in 2004 to $8.9 trillion in 2008 in constant 2008 dollars.[32] Similarly, securitization of other types of loans such as auto, credit card, home equity, manufacturing, and student loans grew from $528 billion in 1996 to $2.7 trillion in 2008 in constant 2008 dollars.[33]

3. Breakdowns in the Subprime Mortgage Market

The subprime mortgage crisis revealed significant breakdowns in the application by financial institutions of both risk analysis and securitization. Loan-to-value ratios increased, a greater fraction of households received mortgages that were interest only, and more households received mortgages without having full documentation. Mortgage brokers who were paid on commission increasingly looked the other way in putting applications through.[34] Most importantly, the financial institutions that purchased these subprime mortgages and packaged them into securities, the credit agencies that rated these securities, and the investors who bought these securities did not account for the possibility of a significant slowdown or decline in the change in housing prices. A broad-based decline in housing prices cannot be diversified away by pooling mortgages because all of these loans would be affected by this "correlated risk". The decline in housing prices combined with the fact that many of the sub-prime mortgages needed to be refinanced

[32] Securities Industry and Financial Markets Association, Mortage-Backed Securities Outstanding, http://www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_USMortgageRelatedOutstanding.pdf (last visited Sept. 6, 2009). Numbers are converted into constant 2008 dollars using GDP deflator series from the Gross Domestic Product: Implicit Price Deflator. *See* Bureau of Economic Analysis, Gross Domestic Product: Implicit Price Deflator, http://research.stlouisfed.org/fred2/data/GDPDEF.txt (last visited Sep. 10, 2009), *available at* http://research.stlouisfed.org/fred2/data/GDPDEF.txt (outlining data last updated August 27, 2009).

[33] Securities Industry and Financial Markets Association, Asset-Backed Securities Outstanding, http://www.sifma.org/research/pdf/ABS_Outstanding.pdf (last visited Sept. 6, 2009). Numbers are converted into constant 2008 dollars using GDP deflator series from the Gross Domestic Product: Implicit Price Deflator. *See* Bureau of Economic Analysis, Gross Domestic Product: Implicit Price Deflator (last visited Sep. 10, 2009) (outlining data last updated August 27, 2009).

[34] It appears, however, that the financial markets took these individual risks into account by demanding significant interest rate premiums on these loans that could cover significant defaults. What they did not take into account was the possibility of declines in housing prices that would result in correlated risks across individuals. For a lengthier discussion of this topic, *see* Dwight M. Jaffee, *The U.S. Subprime Mortgage Crisis: Issues Raised and Lessons Learned* (Commission on Growth and Development, Working Paper, 2008), *available at* http://www.growthcommission.org/storage/cgdev/documents/gcwp028web.pdf.

after two to three years resulted in a massive increase in defaults. The foreclosure rate for adjustable rate subprime mortgages increased from a low 3 percent in 2005 to over 8 percent in 2007.[35]

The problems from the increase in default rates were exacerbated by the fact that many of the large financial institutions that packaged the loans kept a significant portion of the loans on their own books rather than selling them into the global markets as the basic thesis of securitization suggested they should have done.[36] These institutions therefore had a concentration of what had become toxic assets.[37]

In conclusion, this review of enhanced risk analysis and securitization has shown that these innovations helped expand the supply of credit overall and made it available to an ever wider portion of the American public. As the Chairman of the Federal Trade Commission noted, "Many fail to appreciate that the average American today enjoys access to credit and financial services, shopping choices, and educational resources that earlier Americans could never have imagined."[38] Before we document these effects we describe additional innovations for several important types of consumer financial products.

B. Financial Innovations for Individual Consumer Financial Products and Services

1. Mortgages

Although consumers could easily finance the purchase of sewing machines by the early 20th century they still had great difficulty financing the purchase of homes. Residential mortgages were only available for 5-10 years after which the principal became due and the borrower had to refinance.[39] Rates were variable and loan-to-value ratios were below 50 percent. Relatively few Americans could finance the purchase of homes. This situation changed largely as a result of the creation of federally sponsored mortgage

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[35] STAFF OF J. ECON. COMM., 110TH CONG., THE SUBPRIME LENDING CRISIS, REPORT AND RECOMMENDATIONS BY THE MAJORITY STAFF OF THE JOINT ECONOMIC COMMITTEE 27 (Comm. Print 2007), *available at* http://www.gfoa.org/downloads/CongressSubprimeReport.pdf. For more information on default details rates of subprime loans by origination year, *see* James R. Barth, Tong Li, Triphon Phumiwasana & Glenn Yago, *Perspectives on the Subprime Market* (Milken Institute Working Paper, January 2008), *available at* http://ssrn.com/abstract=1070404.

[36] *See* Dwight Jaffee, *supra* note 34, at 28. *See also* Dwight M. Jaffee et al., *Mortgage Origination and Securitization in Financial Crisis*, *in* RESTORING FINANCIAL STABILITY: HOW TO REPAIR A FAILED SYSTEM 72 (Wiley Finance 2009).

[37] *Id.*

[38] Timothy J. Muris, Chairman, Fed. Trade Comm'n, Protecting Consumers' Privacy: Goals and Accomplishments, Remarks at the Networked Economy Summit (June 11, 2002), *available at* http://www.ftc.gov/speeches/muris/gmason.shtm.

[39] Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 JOURNAL OF ECONOMIC PERSPECTIVES 93 (2005).

insurance in response to the housing collapse following the 1929 stock market crash.[40] This insurance enabled banks to issue long-term fixed rates mortgages. After World War II these new mortgages enabled millions of Americans to finance homes during the economic expansion that started in the early 1950s. The number of American households who owned homes increased from 23.9 million in 1950 to 36.3 million in 1965 to 78.7 million in 2008. Increases in the supply of mortgage lending successively enabled the post-World War II generation, the large baby boom generation, and the Generation X to buy and finance homes.

The stagflation years of the 1970s had brought considerable problems to the housing market. High interest rates led depositors to move funds from banks that had regulatory ceilings on the rates they could pay depositors to treasury securities and other instruments. Depositors had been a major source of mortgage funding. At the same time high interest rates on fixed rate mortgages put home ownership out of reach of many Americans. Efforts to introduce adjustable rate mortgages during the 1970s met with considerable opposition from consumer groups and regulators imposed tight restrictions on allowable changes in the interest rates.[41] As a result many Americans who wanted to buy homes were not able to do so at fixed rate mortgage terms. They were liquidity constrained.[42]

Although inflation was tamed by the early 1980s, and interest rates began coming down significantly thereafter, there was concern that the future would bring significant volatility in interest rates that would put lenders at risk and thereby curtail mortgage lending to households. The main innovation that was introduced was the 30 year adjustable rate mortgage (ARMs) that would allow mortgage earnings to keep pace with the cost to lenders of funding those mortgages.[43] Home purchasers found these mortgages appealing because they were usually set at short-term interest rates which were substantially lower than long-term interest rates which reflected risk premiums for future inflation. Over the course of the 1980s a significant part of new mortgage loans were

[40] As with the current crisis, housing prices fell, leading homeowners to walk away from their loans which resulted in banks selling foreclosed homes and further driving down home prices.

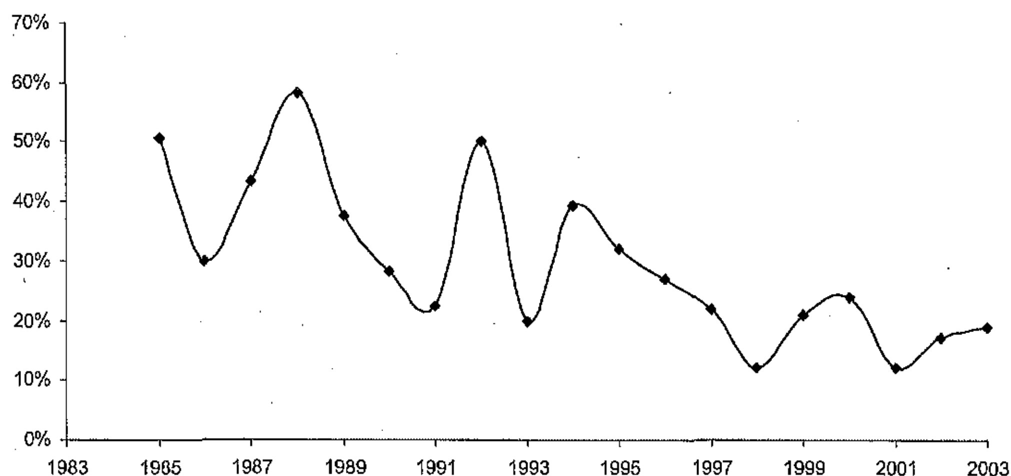
[41] Kristopher Gerardi, Harvey S. Rosen & Paul Willen, *Do Households Benefit from Financial Deregulation and Innovation? The Case of the Mortgage Market* (Federal Reserve Bank of Boston, Public Policy Discussion Papers, June 2006), *available at* http://www.bos.frb.org/economic/ppdp/2006/ppdp066.pdf.

[42] Many lenders holding portfolios of fixed rate mortgages sustained major loses when interest rates climbed and the rates they paid for funds were well above what they earned. The interest rate inversion of the last years of the 1970s and the first years of the 1980s was at the core of the savings and loan crisis of the 1980s.

[43] Congressional legislation was passed in 1981 to allow S&Ls to invest in ARMs which stimulated their supply.

ARMs, reaching a peak of 58 percent in 1988 as shown in Figure 3. Many households benefited from the ARMs because interest rates ended up declining in subsequent years.

Figure 3. Loans with adjustable mortgage rates as proportion of all loans, 1984-2003.



Source: Monthly Interest Rate Survey, Table 34, Federal Housing Finance Board; http://www.fhfa.gov/Default.aspx?Page=252.

As long-term interest rates declined more home buyers and households who were refinancing mortgages shifted back to fixed rate mortgages.

Other innovations were also introduced. These included ARMs with fixed interest rates for several years, graduated payment mortgages, mortgages that allowed initial payments to fall below interest charges, and low down payment mortgages. As Professor Jaffee observes, "These mortgages were all designed to meet specific needs: option mortgages for borrowers with widely fluctuating incomes, converting ARMs for borrowers who expect a rising income profile, and so on."[44]

Securitization was another major innovation in the mortgage industry. It was responsible for expanding the source of capital to make it possible for millions of young Americans coming into the labor market and forming households to buy homes. Freddie Mac was created in 1970 and was charged with creating a more liquid market for mortgages.[45] Mortgage-backed securities emerged and started becoming popular in the 1980s. These securities allowed financial institutions to better diversify their risks by selling some portion of mortgage loans they had originated. As importantly, they broke the dependence of the supply of mortgages on the supply of deposits. Banks could receive

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[44] *See* Jaffee, *supra* note 34, at 14.

[45] *See* Freddie Mac Corporate History, http://www.freddiemac.com/news/corp_facts.html (last visited Sept. 6, 2009).

compensation for originating and then servicing loans by selling mortgage backed securities. The mortgage originators increasingly became intermediaries between mortgage borrowers and the global capital markets which vastly expanded the amount of liquidity available to borrowers.[46]

A significant portion of the American population was, nevertheless, still unable to get mortgages in the 1980s. Lower income individuals, people who had not established a credit history possibly because of having faced adverse economic circumstances, and people with poor credit histories were shut out of the mortgage lending market. They comprised a substantial portion of the 20 percent of households that were liquidity constrained. The U.S. government encouraged financial institutions to expand lending to these groups for a variety of policy reasons.[47] Computerized risk analysis and securitization made the expansion of lending to this underserved part of the population possible.

Subprime mortgages expanded in the last half of the 1990s and especially rapidly in the first half of the 2000s. In 1994, only 5 percent of the mortgages that were originated were subprime. Subprime originations grew to 13 percent in 2000 and reached 20 percent in 2005 and 2006.[48] Then the housing bubble burst. Subprime originations declined sharply falling to less than 1 percent of all originations in the last quarter of 2008. Although there were serious problems in the subprime mortgage market, as we discuss below, these mortgages helped a significant number of socially and economically disadvantage households, who had not had access to credit, to buy their homes. More importantly, going forward, it is essential to distinguish between subprime mortgage lending and the housing bust. Housing prices will eventually reach a new equilibrium that reflects their fundamental value and may have normal appreciation after that.[49] So long as subprime mortgages reflect the realities of the housing market, they can enable many socially and economically disadvantaged individuals to obtain home loans that they would not otherwise be able to get.

2. Non-Mortgage Lending

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[46] Between 1980 and 2008 the share of home mortgages that were held by the originating institution declined from 89 percent to 41 percent. Meanwhile, the share of mortgages that were securitized increased from 11 percent to 59 percent. *See* James R. Barth et al., *Mortgage Market Turmoil: The Role of Interest-Rate Resets*, 2 GH BANK HOUSING JOURNAL 17 (2007), at 24.

[47] Lyons, *supra* note 24, at 231-32.

[48] Barth et al., *supra* note 35, at 3.

[49] Between June 2001 and July 2009 home prices appreciated at the rate of inflation with the gains from the boom being largely offset by the bust. *See* Floyd Norris, *After a Bumpy Ride, Back at Square One*, N.Y. TIMES, August 28, 2009.

As discussed, consumers borrow money to help smooth out consumption and income over their lifecycles. Importantly they borrow to purchase consumer durables ranging from televisions to automobiles. American consumers have seen over the nation's history a steady increase in their ability to borrow to finance current consumption as a result of innovations in consumer financial products and services. These innovations have provided more and cheaper credit to consumers over time. With each new innovation more credit worthy borrowers have been able to move from more to less expensive forms of credit as we show below.

During the great economic expansion of the 19th century, American consumers saw rising incomes over their lifetimes and enjoyed an increasing array of consumer products available to them.[50] As the century progressed, retailers became significant providers of credit to consumers. Retailers allowed customers to put purchases on a "house charge" to be paid at the end of the month and they sold products on installment plans that allowed consumers to pay over time.[51] As of 1929, retailers were the primary suppliers of consumer credit accounting for more than 60 percent of consumer credit with financial institutions providing the remainder.[52] A fifth of retail sales were carried on open accounts—a type of revolving credit—by 1929 and that share remained roughly steady until after World War II.[53] Retail credit was expensive by modern standards.[54]

Retail credit was also limited and highly restricted. Retailers gave customers identification cards that they could use when they charged merchandise. But generally these cards could only be used to pay at the retailer that issued the card or in some cases groups of retailers that agreed to use a common card. A key innovation occurred in 1950 when Diners Club introduced the general-purpose charge card which consumers could use at many unrelated merchants. Diners Club provided the financing for the merchant and collected from the cardholder. Like the house charge programs the cardholder paid at the end of the month. American Express introduced a similar product in 1958. Charge cards were widely accepted by merchants and carried by millions of Americans—principally well-off businessmen—by the end of the 1950s.

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[50] *See* BERTOLA ET AL., *supra* note 20, at ch. 9.

[51] Until 1916 most states had usury laws that limited the ability of financial institutions to lend profitably to consumers. Retailers could effectively lend, and bypass these usury laws, by including the cost of the loan (including the risks of nonpayment) in the purchase price. *See, e.g., id.*

[52] BERTOLA ET AL., *supra* note 20, at 309.

[53] *Id.*

[54] *See* BERTOLA ET AL., *supra* note 20, at 308.

In 1958, Bank of America introduced the modern general-purpose credit card. It allowed consumers to finance their purchases over time on a revolving line of credit. This feature substituted for the various credit programs offered by retailers. At the time Bank of America could only operate in California because of interstate banking regulations. Similar cards were introduced by other banks around the country. The modern credit card industry did not really take off until the early 1980s. State usury laws had significantly constrained the expansion of credit cards during the 1970s because the cost of capital was too high to enable banks to profitably extend credit at the interest rates allowed in many states.[55] A Supreme Court decision allowed banks to issue nationally without being subject to these state restrictions.[56] That decision, together with the economic expansion that began in the early 1980s, allowed the development of a robust national market for credit cards.

Over time computerized risk analysis and securitization both became important factors in helping to increase the supply of revolving credit. Crude risk analysis methods tended to deny many people credit who failed to meet certain thresholds. More refined risk analysis made it possible to issue credit to a wider group of individuals. These individuals usually paid higher fees including interest rates because they had greater expected default rates and other payment-related problems on average. Lenders developed various pricing plans to accommodate these expanding categories of borrowers.

The increased availability of credit cards has also provided significant benefits to small businesses. Almost half of firms with fewer than 20 employees use personal credit cards to help finance their businesses.[57] That has enabled small businesses, especially new ones that do not have a significant credit history, to obtain sources of working capital as well as longer term loans.[58] Smaller retailers have also benefited from the expansion of credit cards. Larger retailers can afford to offer store cards along with other lending programs such as installment sales. Smaller firms typically lack the financial resources or the scale to offer their consumers credit. The widespread availability of consumer credit

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[55] Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG 201 (1986).

[56] *Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 318 (1978).

[57] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 110TH CONG., REPORT TO THE CONGRESS ON THE AVAILABILITY OF CREDIT TO SMALL BUSINESSES 30 (2007). 46.7 percent of businesses with fewer than 500 employees rely upon personal credit cards. Id.

[58] *See* DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING, 107-114 (MIT Press 2005); David Blanchflower & David S. Evans, *The Role of Credit Cards in Providing Financing for Small Businesses*, 77 THE PAYMENT CARD ECONOMICS REVIEW 77 (Winter 2004), *available at* http://ssrn.com/abstract=1474450.

from third parties has therefore benefited smaller retailers and helped level the playing field with larger retailers.[59]

There are controversies on whether Americans took on too much debt as a result of the availability of credit cards and over some of the pricing practices of the card issuers. These are valid concerns that lie outside the scope of this paper and which have been addressed by recent legislation and regulation. However, we think it is important to recognize that despite these issues a vast number of Americans have benefited from expanded access to loans which has enabled them to deal with emergencies and smooth out consumption over their lifecycles. As we note below, it also enabled them to shift borrowing from more expensive retail loans. For example, if credit cards were banned, or sharply curtailed, today many consumers would be buying furniture on installment plans from retailers and paying much more in the end than they pay with credit cards. Other consumers would turn to payday lenders, pawn shops, and loan sharks.

Another major innovation was home equity loans. These were introduced in the late 1970s.[60] Many households had realized large increases in the value of their homes. But their investments in their homes were illiquid. To borrow, these households used primarily credit vehicles, such as credit cards, that did not require collateral and therefore had relatively high interest rates. The home equity loan allowed them to borrow against the equity they had built up in their houses and at lower rates than many other forms of credit since the house served as collateral. The value of home equity lines increased from around $322 billion in 1990 to over $1.1 trillion in 2008 in constant 2008 dollars.[61]

Computerized risk analysis and securitization facilitated the expansion of other forms of credit from the early 1980s to the present. For example, automobile loans, for which the loan-to value ratio is typically around 90 percent, increased from about $254 billion in 1980 to $584 billion in 1999 in constant 2008 dollars.[62]

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[59] Evans & Schmalensee, *supra* note 58, at ch.3.

[60] Louise Story, *Home Equity Frenzy Was a Bank Ad Come True*, N.Y. TIMES, August 15, 2008, *available at* http://www.nytimes.com/2008/08/15/business/15sell.html.

[61] Press Release, Federal Reserve Board of Governors, Flow of Funds Accounts of the United States (Sept. 18, 2008), *available at* http://www.federalreserve.gov/releases/z1. Numbers are converted into constant 2008 dollars using GDP deflator series from Gross Domestic Product: Implicit Price Deflator, Bureau of Economic Analysis, last updated August 27, 2009 *available at* http://research.stlouisfed.org/fred2/data/GDPDEF.txt

[62] For 1980 numbers, *see* Economic Research, Federal Reserve Bank of St. Louis, Series: AUTONS, Total Automobile Credit Outstanding, *available at* http://research.stlouisfed.org/fred2/series/AUTONS. For 1999 numbers *see* Federal Reserve Statistical Release G19 (June 7, 1999), *available at* http://www.federalreserve.gov/releases/g19/19990607/. Numbers are converted into constant 2008 dollars using GDP deflator series from Gross Domestic Product: Implicit Price Deflator, Bureau of Economic Analysis, last updated August 27, 2009 *available at* http://research.stlouisfed.org/fred2/data/GDPDEF.txt. More recent data on the total amount of automobile loans outstanding are not publicly available.

The expansion of non-mortgage credit as a result of the introduction of innovative methods of lending has enabled consumers to substitute less expensive for more expensive forms of credit. Although there is no hard evidence we are aware of, it is likely that the introduction by retailers of house charges and revolving loans reduced the reliance of 19th century consumers on the main alternative forms of credit which were pawn brokers and loan sharks. Charge and credit cards displaced retail credit. Between 1968 and 2008 the fraction of non-mortgage debt from retailers declined from 17 percent to about 2 percent while the fraction based on credit cards increased from 1.3 percent to 38.1 percent of consumer credit.[63] Credit cards generally offered better financing terms than store programs as well as greater variety and portability. When home equity loans became available consumers substituted this cheaper form of lending for borrowing on credit cards.[64] Rates on home equity lines are typically lower than those on credit cards, and also offer tax benefits.[65] This made borrowing against a person's existing home for non-housing consumption more common.[66] Of course, as housing values have declined we would expect home equity loans will as well and consumers will trend back to cards.

C. The Effects of Financial Innovation on the Expansion and Democratization of Credit

These financial innovations have helped relax liquidity constraints on millions of Americans who would not have been able to get credit or would not have been able to get as much credit as they wanted. Professor Lyons found that in 1998 American households were able to obtain 68.3 percent of the credit they wanted up from 55.5 percent in 1983.[67] That trend has likely continued to the present given the effects of the innovations discussed above. As we demonstrate, access to credit has expanded to the socially and economically groups that are most likely to be liquidity constrained.

1. Home Ownership

The growth rate in home ownership for several socially and economically disadvantaged groups increased more rapidly than the growth rate for better situated

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[63] Reserve Statistical Release G19, Consumer Credit Historical Data, *available at* http://www.federalreserve.gov/releases/g19/hist/.
[64] Michael E. Staten, *Consumer Debt: Myths about the Impact of the Recession*, Credit Research Center Reprint #21 (Autumn 1993).
[65] According to Bloomberg, the average lowest credit card rate was 11.25 percent as of Aug 19, 2009 while the rate for home equity loans was 8.55 percent according to bankrate.com. Jeff Plungis, *Consumer Gains on Credit-Card Law Pared by Rate Hikes*, BLOOMBERG.COM, August 19, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20670001&sid=aBKkB081ypy4.
[66] Barry Z. Cynamon & Steve M. Fazzari, *Household Debt in the Consumer Age: Source of Growth- Risk of Collapse*, 3 CAPITALISM AND SOCIETY (2008).
[67] Lyons, *supra* note 24, at 248.

groups between the late 1980s and the late 2000s. Between 1995 and 2008 the rate of growth of home ownership for African Americans was 11.0 percent and that of Hispanics was 16.6 percent compared to 5.8 percent for whites.[68]

Individuals in the bottom fifth of the income distribution have experienced an increase in home ownership as a result of greater access to capital. Between 1989 and 2007, as shown in Table 1, the percent of families who owned a primary residence in the bottom quintile of the income distribution increased from 32.9 to 41.4 percent (a change of 8.5 percentage points); that compares with an increase from 65.4 to 69.3 percent (a change of 3.9 percentage points) for households in the middle quintile of the income distribution. Thus the increase in home ownership was almost twice as high for the low as for the middle income group. The gap between the poorest and middle income category decreased from 32.5 percent points (65.4-32.9) to 27.9 percentage points.

The percent of home ownership for single parents increased from 42.7 percent to 49.1 percent (falling from a peak of 54.5 percent in 2004 before the housing collapse started) while percent of home ownership among couples with children remained roughly constant between 1989 and 2007 (changing from 77.5 percent to 78.0 percent). The increase of 6.4 percentage points in home ownership for single parents was more than 12 times higher than the 0.5 percentage point increase for parents with children.

Table 1. Percent of families with primary residence, by racial, family structure, and income characteristics

Year	Race or ethnicity		Family structure		Percentile of income		Age of head	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle	< 35	45 - 54
1989	70.5	44.4	42.7	77.5	32.9	65.4	39.4	76.5
1992	70.3	44.4	43.0	74.6	38.9	61.8	36.8	75.4
1995	70.6	44.3	46.8	74.6	39.7	62.6	37.9	75.3
1998	72.0	47.2	46.9	79.1	38.8	67.3	38.9	74.4
2001	74.3	47.3	48.5	78.7	40.6	66.0	39.9	76.2
2004	76.1	50.8	54.5	77.8	40.3	71.6	41.6	77.3
2007	75.6	51.9	49.1	78.0	41.4	69.3	40.7	77.3

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

[68] The percentage of African American homeowners grew from 42.7 percent in 1995 to 47.4 percent in 2008, the percentage of Hispanic homeowners grew from 42.1 percent to 49.1 percent while the percentage of white homeowners increased from 70.9 percent to 75 percent. *See* U.S. Census, Homeownership Rates by Race and Ethnicity of Householder: 1994 to 2008, *available at* www.census.gov/hhes/www/housing/hvs/annual08/ann08t22.xls.

Between 1989 and 2007 all groups experienced an increase in the value of their homes. As reported by the Survey of Consumer Finances, the gap between the value of the homes afforded by lower and middle class people shrunk between 1989 and 2007.[69] In 1989 the average value of the home for the lowest income quintile was half of the price of the middle quintiles.[70] In 2007, the median home value for the lowest quintile is only 50 percent lower than that for the middle.[71] The median value of the home owned by African Americans and Hispanics increased by 125 percent compared to an increase of only 66 percent for the value of homes owned by white people.[72]

These increases in home ownership were made possible because of the increased availability of mortgage finance. Table 2 shows the percent of households with mortgages or home equity loans for each of the groups discussed above. Between 1989 and 2007 the share of Hispanics and African Americans with mortgages increased 10.6 percentage points (39.2-28.6) compared to an increase of 7.2 percent points for white. Similarly, the percent of lower income people with mortgages almost doubled from 7.5 percent to 13.7 percent.

Table 2. Percent of families with mortgages or home-equity

Year	Race or ethnicity		Family structure		Percentile of income		Age of head	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle	< 35	45 - 54
1989	42.0	28.6	30.8	62.2	7.5	37.3	34.9	56.9
1992	42.1	27.3	28.3	63.2	10.4	35.4	30.9	59.4
1995	43.3	30.2	32.0	63.0	10.4	37.7	32.9	61.1
1998	45.5	30.3	28.9	65.5	10.8	42.5	32.9	57.6
2001	46.1	35.1	34.1	67.0	12.8	43.1	35.6	58.7
2004	49.7	36.3	41.3	66.5	14.6	50	37.7	62.5
2007	49.2	39.2	37.0	67.8	13.7	48.8	37.1	63.8

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

2. Access to Non-Housing Credit

Socially and economically disadvantaged groups also secured greater access to non-mortgage credit between 1989 and 2007. Tables 3-6 summarize the changes and

[69] Federal Reserve Board of Governors, Survey of Consumer Finance, 1992-2007, http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html (last visited Sep. 29, 2009).
[70] *Id.*
[71] *Id.*
[72] *Id.*

overall growth rates for the groups discussed above for automobile ownership, education loans, credit card loans and home equity loans.

Between 1989 and 2007 the percentage of non-white households with automobile loans increased from 29.3 percent to 33.3 percent while the share of white households with auto loans decreased slightly following a peak of 37.4 percent in 2004 (see Table 3). The share of single parents with vehicles loans increased from 26.9 percent to 28.3 percent while the share of married couples with car loans dropped to 50.4 percent following an increase to 51.1 percent in 2004. Similar observations can be made for lower income and younger people.

Table 3. Percent of families with vehicle installment loans

Year	Race or ethnicity		Family structure		Percentile of income		Age of head	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle	< 35	45 - 54
1989	36.6	29.3	26.9	50.7	11.5	41.5	37.8	47.6
1992	31.4	24.9	25.1	44.1	10.0	33.5	36.6	34.6
1995	32.9	27.6	24.0	47.6	11.2	34.3	40.1	37.9
1998	32.0	29.4	27.1	44.2	12.4	37.1	36.9	40.1
2001	35.9	32.1	34.5	50.9	12.3	42.0	45.0	37.8
2004	37.4	30.9	30.9	51.1	12.8	43.6	41.3	39.0
2007	35.5	33.3	28.3	50.4	13.0	41.1	44.3	39.1

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

The increased access to credit also provided minority groups with improved access to education loans as evidenced by Table 4. Between 1989 and 2007 the proportion of non-white households holding education loans increased 7.7 percent points (from 10.8 percent to 18.5 percent) compared with an increase of only 5.6 percent points for white (from 8.3 percent to 13.9 percent).

Table 4. Percent of families with education installment loans

Year	Race or ethnicity		Family structure		Percentile of income	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle
1989	8.3	10.8	17.0	8.9	8.4	7.7
1992	10.8	10.3	15.0	13.5	10.6	14.1
1995	11.6	12.7	13.7	17.3	9.5	11.4
1998	11.4	11.4	13.6	14.4	9.9	11.7
2001	11.2	13.5	14.3	14.9	7.7	13.6
2004	13.7	12.9	14.4	18.0	10.9	15.8
2007	13.9	18.5	20.2	20.7	10.7	16.6

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

The gap between minority groups holding credit cards and the rest of the population also declined. The gap in having revolving credit between white and nonwhite households disappeared between 1989 and 2007. Meanwhile, the gaps between single parents and couples with children and between the lowest and middle income quintiles also declined dramatically over this period as shown on Table 5.

Table 5. Percent of families with credit card balances

Year	Race or ethnicity		Family structure		Percentile of income		Age of head	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle	< 35	45 - 54
1989	41.5	34.4	35.6	53.8	15.3	48.9	44.5	49.3
1992	44.2	42.1	43.3	56.0	23.4	51.9	51.8	48.9
1995	47.1	48.0	43.9	60.9	26.0	52.9	54.7	56.4
1998	44.3	43.5	38.0	55.8	24.5	50.1	50.7	52.5
2001	43.3	47.6	48.1	52.4	30.3	52.8	49.6	50.4
2004	46.0	46.7	48.6	56.7	28.8	55.1	47.5	54.0
2007	45.1	48.4	45.1	54.7	25.7	54.9	48.5	53.6

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

Similar trends are also observed for home equity lines of credit. As homeownership increased and home equity lines of credit became available in the 1980s, more households were taking advantage of their house equity (see Table 6). In 2007, 5.5 percent of non-white households had access to a home equity line versus only 1.2 percent in 1989. From 1989 to 2007 the proportion of single parents with home equity lines increased from 0.8 percent to 6.4 percent. A greater number of younger people were using home equity loans to finance purchases. In 2008 there were 4 percent of people under 35 with home equity lines of credit vs. only 0.8 percent in 1989.

Table 6. Percent of families with home equity lines of credit

Year	Race or ethnicity		Family structure		Percentile of income		Age of head	
	White, non Hispanic	Nonwhite or Hispanic	Single with children	Couple with children	Bottom	Middle	< 35	45 - 54
1989	3.8	1.2	0.8	5.5	0.1	2.4	0.8	6.2
1992	5.2	1.4	1.3	7.0	0.0	3.7	1.1	8.3
1995	3.3	1.4	0.9	4.7	0.0	1.4	1.4	5.1
1998	5.0	2.6	2.7	7.4	0.5	3.3	1.4	7.9
2001	5.7	1.9	2.0	7.3	1.0	3.0	2.9	7.2
2004	10.5	3.6	5.6	13.6	1.3	7.1	3.5	13.1
2007	9.8	5.5	6.4	11.0	1.9	6.9	4.0	11.7

Note: Bottom percentile is for people in the lowest 20 percent and middle quintile is for people in 40-59 percent range.
Source: 2007 Survey of Consumer Finance, The Federal Reserve Board (June 15, 2009), available at http://www.federalreserve.gov/pubs/oss/oss2/2007/2007%20SCF%20Chartbook.pdf.

D. The Effects of Financial Innovation on Economic Expansion and Job Growth

The increased supply of credit to households that began in the early 1980s helped fuel economic expansion and job growth for several decades. More credit means more funds available for consumption and investment which then increases demand for goods. To meet the growing demand, firms start producing more goods and hiring more workers which in turn results in higher employment and income for consumers. The increased income further stimulates consumption and supply of goods. Thus, the initial consumption stimulation starts a cascading chain of further spending and increases which leads to an overall economic growth. Economists call this mechanism "the multiplier effect."[73]

IV. The Rationale for the Consumer Financial Protection Agency Act of 2009

Although consumer lending has benefited millions of Americans, it has not been without its problems. As with almost any industry, some firms engage in unscrupulous or even fraudulent practices. Some consumers borrow on incomplete or imperfect information for a variety of reasons. The U.S. Congress has passed numerous laws such as the Truth in Lending Act and the FTC Act that regulate various aspects of consumer lending, especially disclosure requirements. Various states have also passed laws to protect borrowers, including state consumer protection legislation, usury laws, and

[73] For more discussion about the multiplier effect, *see generally* PAUL SAMUELSON & WILLIAM NORDHAUS, *supra* note 17, at 446.

restrictions on payday lending and other forms of lending. As a result, consumer lending is already extensively regulated in the United States.

The U.S. Department of Treasury has proposed sweeping changes to this system of regulation. In announcing the plan, President Obama said that consumer financial protection was needed because "crisis was not just the result of decisions made by the mightiest of financial firms; it was also the result of decisions made by ordinary Americans to open credit cards and take out home loans and take on other financial obligations."[74] The Treasury Department argued that mortgage companies as well as other financial firms sold products that "were overly complicated and unsuited to borrowers' financial situation[s] . . . with disastrous results for consumers and the financial system." The Treasury Department's report does not, however, provide evidence to support the naked assertion that failed consumer protection regulation played a significant factor in the financial crisis. Indeed, there is no evidence that we are aware of that predatory lending or other practices that would violate the consumer protection laws resulted in a significant portion of the loss in value of the mortgage backed securities that were at the heart of the financial meltdown.[75] There is therefore little basis for concluding that increased consumer protection in the mortgage market would have prevented the financial crisis, that failed consumer protection was a significant cause of the financial crisis, or that the changes sought by the CFPA Act would have averted or even meaningfully reduced the harm from the financial crisis.

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[74] Barack Obama, President of the United States, Speech on 21st Century Financial Regulatory Reform (June 17, 2009), *available at* http://www.cfr.org/publication/19658/obamas_speech_on_21st_century_financial_regulatory_reform.html.

[75] That is not to deny that some consumers were victims of unfair and deceptive practices in securing mortgages and that the regulatory agencies could and should have done a better job regulating that burgeoning subprime mortgage market. There is no evidence that we are aware of, however, that a significant portion of the individuals who defaulted were victims of unscrupulous mortgage practices or that they would have failed to take out mortgages in the absence of these practices. Oren Bar-Gill and Elizabeth Warren have argued that "the high proportion of people with good credit scores who ended up with high-cost mortgages raises the specter that some portion of these consumers were not fully cognizant of the fact that they could have borrowed for much less." *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 39 (2008). They claim that many people who got sub-prime mortgages could have received less expensive prime mortgages. These authors do not provide any evidence that a significant number of homeowners that defaulted would not have done so had they paid lower interest rates. It is doubtful that there would have been fewer defaults since even with lower interest rates these home owners would have had negative equity in their homes and therefore would gain from defaulting. In addition, a Federal Reserve Bank of Boston study finds that most subprime mortgage borrowers would not have received prime mortgages. Christopher L. Foote, Kristopher S. Gerardi, Lorenz Goette & Paul Willen, *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What We Don't* (Federal Reserve Board of Boston, Public Policy Discussion Paper No. 08-2, May 30, 2008), *available at* http://ssrn.com/abstract=1153411. Deterioration of the underwriting standards has also been put to blame for the current crisis. Another study at the Federal Reserve Bank of Boston found that loans issued in 2005–2006 were not very different from loans made earlier, which, in turn had performed well, despite carrying a variety of serious risk factors. While the 2005-2006 loans may have carried risk factors, such as increased leverage, underwriting standards alone cannot explain the dramatic rise in foreclosures. *See* Kristopher S. Gerardi, Andreas Lehnert, Shane Sherland & Paul Willen, *Making Sense of the Subprime Crisis* (Federal Reserve Board of Boston, Public Policy Discussion Paper No. 09-1, December 22, 2008), *available at* http://ssrn.com/abstract=1341853; Geetesh Bhardwaj & Rajdeep Sengupta, *Where's the Smoking Gun? A Study of Underwriting Standards for US Subprime Mortgages* (Federal Reserve Bank of St. Louis, Working Paper No. 2008-036B, Apr. 1, 2009), *available at* http://ssrn.com/abstract=1286106.

To the extent an intellectual case has been made for the new agency, it has been made by several law professors in a series of articles that appeared in 2008. Their arguments are largely based on a belief that consumers make poor choices when it comes to financial products and services and that stronger consumer protection regulation could make these consumers better off by regulating the design of these products, mandating various disclosures, restricting consumer choice, and 'nudging' consumers toward certain standardized financial products.

The CFPA Act appears to have evolved from a May 2008 paper written by two law professors: Elizabeth Warren of Harvard, who is currently the head of the Congressional Oversight Panel on TARP funding, and Oren Bar-Gill of New York University.[76] They identified a series of problems with consumer financial products, argued that existing federal regulatory agencies lack the ability or motivation to deal with these problems, and proposed the creation of a new federal consumer financial protection agency.[77] Along with several co-authors, Michael Barr, a University of Michigan Law School professor who is now the Assistant Secretary of the Treasury involved in the draft legislation expanded upon the proposed Bar-Gill/Warren agency by detailing key aspects of the regulatory approach the agency should take in an October 2008 paper.[78] Barr et al. proposed requiring that lenders offer standardized products designed by the agency regulators.[79] Further, Barr et al. would permit individuals to sue lenders if certain substantive terms of financial products, including disclosure terms, were deemed "unreasonable."[80] These papers provide the articulated basis for understanding the rationale behind the CFPA Act as envisioned by its architects, insight into how the new agency would analyze consumer lending products, and a means to predict how the new agency would affect people's access to consumer credit and their choice of products. In the absence of concrete guidelines specifying how the broad discretionary authority granted to the new agency will be exercised, these papers provide the most reliable basis to predict how the CFPA will operate in practice.

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[76] *See* Bar-Gill & Warren, *supra* note 75, at 26-27. Bar-Gill and Warren's case for the CFPA Act relies heavily on their previous work. *See, e.g.*, Oren Bar-Gill, *Seduction By Plastic*, 98 NW. U. L. REV. 1373 (2004); Elizabeth Warren, *Unsafe at Any Rate*, 5 DEMOCRACY: A JOURNAL OF IDEAS, (Summer 2007), *available at* http://www.democracyjournal.org/article.php?ID=6528.
[77] Bar-Gill & Warren, *supra* note 75, at 26.
[78] Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir, *Behaviorally Informed Financial Services Regulation* 1 (New American Foundation Working Paper, October 2008).
[79] *Id.* at 7-9.
[80] *Id.* at 9, 15.

The proposed new consumer financial protection agency, as described by these authors, is based on the following set of presumptions concerning consumer behavior, markets, and regulation:

- "[m]any consumers are uninformed and irrational,"[81]
- "consumers make systematic mistakes in their choice of credit products and in the use of these products,"[82] and,
- regulations should adopt a number of "behaviorally informed" policies designed to address the consequences of consumer ignorance and irrationality.[83]

This view of consumers, and the policy recommendations that follow, are in turn based on the "behavioral law and economics" literature.[84] This literature consists of a number of studies in economics and psychology that find that consumers appear to make various systematic mistakes evaluating probabilities and discounting future values, and, further, that consumers make various choices that appear inconsistent with each other.

Members of the behavioral law and economics school typically believe that these studies provide a basis for government interventions in the market to prevent consumers from harming themselves. Some members advocate "soft paternalism" that 'nudges' consumers towards what certain scholars deem to be better choices.[85] Such 'nudges' often take the form of default rules which map onto the policy preferences of the academic advocate. Professors Cass Sunstein and Richard Thaler, for example, have advocated that businesses make 401-(k) plans "opt out" to nudge consumers to invest in these plans and thereby overcome what Sunstein and Thaler perceive as a tendency to irrationally overemphasize current consumption over long-term saving. Other behavioral law and economics scholars advocate "hard paternalism" that renders disfavored choices impractical or illegal, even between willing and informed consumers and providers.[86] "Hard paternalism" includes recently proposed "sin" or "vice" taxes aimed at reducing the consumption of junk food, soda, and cigarettes.[87]

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[81] *See* Bar-Gill & Warren, *supra* note 75, at 21; Barr et al., *supra* note 78, at 1.

[82] Bar-Gill & Warren, *supra* note 75, at 26.

[83] *See generally* Barr et al., *supra* note 78, at 1.

[84] For a summary of this literature, *see* Christine Jolls, *Behavioral Law and Economics*, *in* ECONOMIC INSTITUTIONS AND BEHAVIORAL ECONOMICS (Peter Diamond ed., Princeton University Press 2006); Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

[85] RICHARD THALER & CASS SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (Yale University Press 2008).

[86] *See, e.g.*, Bar-Gill & Warren, *supra* note 75, at 21; Eyal Zamir, *The Efficiency of Paternalism*, 84 VA. L. REV. 229, 230-32 (1998); Orly Lobel & On Amir, *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy* (reviewing Thaler & Sunstein, *supra* note 85); Jonathan Gruber, *Smoking's 'Internalities,'* 25 REGULATION 52 (Winter 2002-2003).

[87] *See* Gruber, *supra* note 86.

Behavioral law and economics scholars favoring both "soft" and "hard" forms of paternalism usually take a dim view of consumer borrowing. They believe that consumers systematically over-value current consumption and do not adequately account for the costs of repayment in the future.[88] Some members of this school therefore advocate a variety of prohibitions on consumer lending, including banning subprime mortgages;[89] prohibiting credit cards;[90] requiring the unbundling of transacting and financing services offered by credit card companies so that consumers could not use the same card to make a purchase and then finance it;[91] and applying state usury laws to credit cards.[92]

Economists generally agree that consumers do not carry out the perfectly rational computations that theoretical models usually assume. However, there is considerable controversy over whether many of the findings relied on by behavioral law and economics scholars are sufficiently reliable for the purpose of fashioning policy recommendations. Many of the findings are based on laboratory experiments in which students or other test subjects are asked to complete some hypothetical exercise. Economists have found that some of these findings are simply the artifact of how questions are posed to the test subjects[93] while others have argued that the authors of these studies have not adequately explored whether there is a rational explanation for their findings.[94] As Professor David Levine of the California Institute of Technology has observed, "While behavioral economics points to many paradoxes and problems with mainstream economics, their own models and claims are often not subject to a great deal of scrutiny."[95]

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[88] *See* Bar-Gill, *supra* note 76, at 1395-1404.

[89] *See generally* Alan M. White, *The Case for Banning Subprime Mortgages*, 77 U. CIN. L. REV. 617 (2008) (expounding upon banning several "subprime" lending practices because, amongst other grounds, consumers systematically over-value present-day consumption to future detriment).

[90] *See, e.g.*, George Loewenstein & Ted O'Donoghue, *We Can Do This the Easy Way or the Hard Way: Negative Emotions, Self-Regulation, and the Law*, 73 U. CHI. L. REV. 183, 204 (2006) (advocating a ban on credit cards).

[91] *See* Bar-Gill, *supra* note 76, at 1425-26.

[92] *Id.* at 1426-28.

[93] Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay-Willingness to Accept Gap, the "Endowment Effect," Subject Misconceptions and Experimental Procedures for Eliciting Valuations*, 95 AMERICAN ECONOMIC REVIEW 530 (2005) ("The primary conclusion derived from the data reported here is that observed WTP-WTA gaps do not reflect a fundamental feature of human preferences. That is, endowment effect theory does not seem to explain observed gaps. In addition, our results suggest that observed gaps should not be interpreted as support for prospect theory").

[94] David Levine, Is Behavioral Economics Doomed: The Ordinary Versus the Extraordinary, Max Weber Lecture (June 8, 2009), *available at* http://www.dklevine.com/papers/behavioral-doomed.pdf. *See also* John List, *Neoclassical Theory Versus Prospect Theory: Evidence from the Marketplace*, 72 ECONOMETRICA 615 (2004) (arguing that laboratory results are not robust to market interactions where competition, expertise, and learning might be expected to ameliorate these biases); John A. List, *Does Market Experience Eliminate Market Anomalies?*, 118 Q. J. ECON. 41 (2003) (arguing the same); Michael S. Haigh & John A. List, *Do Professional Traders Exhibit Myopic Loss Aversion? An Experimental Analysis*, 60 J. FIN. 523 (2005) (arguing the same); John A. List & Uri Gneezy, *Putting Behavioral Economics to Work: Testing for Gift Exchange in Labor Markets Using Field Experiments* (Nat'l Bureau of Econ. Research, Working Paper, 2006) (arguing the same); Plott & Zeiler, *supra* note 93, at 1 (finding that the existence and magnitude of the "endowment effect" to be a function of experimental procedures and subject misconception rather than individual preferences); Elizabeth Hoffman, Kevin McCabe, Keith Shachat & Vernon Smith, *Preferences, Property Rights, and Anonymity in Bargaining Games*, 7 GAMES AND ECONOMIC BEHAVIOR, 346 (1994) (arguing that experimental results themselves are the product of experimental procedures and subject misconception rather than individual preferences).

[95] *See* Levine, *supra* note 94, at 10.

Although we believe that regulators and policymakers should be aware of some of these new behavioral studies, and may even find useful insights from them, there is hardly a consensus among economists that these studies or their findings are sufficiently robust or accepted to provide the basis for regulators to substitute their judgments for consumers.[96] Unfortunately, many of the behavioral law and economics scholars, including the developers of the CFPA, have leapt from a limited and controversial set of academic studies to radical proposals in which the government substitutes consumer decisions with its own preferences. As Professor Jeffrey Rachlinski of Cornell University School of Law notes, "virtually every scholar who has written on the application of psychological research on judgment and choice to law has concluded that cognitive psychology supports institutional constraint on individual choice."[97]

In concluding that regulators can (and would) make better choices than consumers, behavioral law and economics proponents tend to forget that regulators are human too and subject to some of the same "cognitive biases" as regular people.[98] Judge Richard Posner, among other critics, has argued that regulators are just as likely to suffer from cognitive biases as consumers and regulatory 'nudges' therefore have significant potential to do more harm than good.[99] Regulators are, moreover, typically insulated from the incentives to mitigate these errors through education or other means that private actors face in competitive markets.

The CFPA Act is therefore predicated on the view that consumers frequently make irrational decisions especially when it comes to financial products and that the government would make better decisions for consumers and should establish a "supernanny" to protect consumers from themselves. These advocates have not made an adequate case for this radical approach to government intervention in the market.

There is a further concern. The legal scholars who have proposed and designed the CFPA follow in the tradition of the 19th century moralists who believed that credit was the "great tempter."[100] These scholars appear to believe that borrowing money imposes great costs on consumers without providing concomitant benefits. They would therefore favor regulations that sharply constrain the ability of consumers to borrow money. They also

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[96] *Id.*

[97] Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165 (2003).

[98] Most of the experimental evidence that shows "irrational" behavior has been conducted with college and graduate students and is perhaps more representative of the college-educated people who work at regulatory agencies than the average American who borrows money.

[99] Richard Posner, *Treating Financial Consumers as Consenting Adults*, WALL ST. J., July 22, 2009, *available at* http://online.wsj.com/article/SB10001424052970203946904574302213213148166.html.

[100] BACHELLER, *supra* note 22, at 116 (Harper & Brothers 1912).

share the hubris of the 19th century moralists in thinking that they know better than consumers what is good for them. Irving Bacheller's 1912 screed, *Charge It!*, expounded this philosophy in no uncertain terms. Railing against the "evils of credit" Bacheller argued against one of the financial innovations of the early 20th century—the personal checkbook—which he insisted would tempt consumers to spend too much money.[101]

V. Effects of the CFPA Act on Access to Consumer Credit and Economic Performance

The Treasury's CFPA Act of 2009 would likely inflict significant collateral damage on consumers, small businesses and the economy. It would:

- reverse the long-term trend towards the democratization of credit that has especially helped socially and economically disadvantaged individuals;
- reduce the number of jobs created in the economy by making it harder for the new firms that create most jobs to access critical consumer credit; and,
- slow economic growth through reduced consumer spending and job creation.

Under plausible yet conservative assumptions the CFPA could also:

- increase the interest rates consumers pay by 160 basis points;
- reduce consumer borrowing by at least 2.1 percent; and,
- reduce the net new jobs created in the economy by 4.3 percent.

These impacts would lead to a significant long-term drag on economic performance and slow economic recovery.

This section explains the basis for these conclusions. Our analysis proceeds in four steps. Part A provides an overview of the major provisions of the CFPA Act. It shows that the Act would lead to a radical change in consumer protection law in addition to creating a highly intrusive agency that would impose significant costs on lenders. Part B examines the impact of the provisions of the CFPA on the cost of providing credit and the availability of new and existing lending products. It finds that a combination of an increase in litigation exposure and increased regulatory compliance costs and risks would likely increase the cost of providing credit products, particularly new ones. It could also result in credit products being withdrawn from the market altogether while deterring the introduction of innovative products. Part C shows that under plausible assumptions, these

[101] *Id.*

increases in costs and restrictions in innovative products resulting from the CFPA could lead to a significant increase in the cost of credit, a reduction in credit availability, and a significant loss of jobs. Part D explores the implications of a CFPA-induced credit crunch on the overall economy.

A. Overview of the CFPA Act

There are two broad aspects of the CFPA Act that will affect the lending market. First, the CFPA Act would radically change existing laws on consumer financial protection. Second, the CFPA Act would create a new agency that would have the power to become directly and significantly involved in determining whether, how, and on what terms covered businesses would be able to provide credit to consumers.

1. Legal Changes

The CFPA Act would limit the federal preemption of consumer protection regulation of nationally chartered financial institutions.[102] The CFPA Act specifically allows states and municipalities to adopt more stringent regulations than those adopted by the CFPA.[103] Rather than providing a uniform set of regulations governing financial consumer protection, the CFPA effectively provides a "floor" on regulation, exposing banks to substantial compliance costs.[104] The Treasury Department's *Financial Regulatory Reform* plan seems to suggest even further that the CFPA would actively encourage state and local enforcement actions.[105] Consumer protection requirements for lending products could therefore vary across states and possibly municipalities.[106] Moreover, historically the FTC has imposed important restraints on the judicial interpretation of state consumer protection legislation, encouraging uniformity among states and consistency with federal consumer protection regulation as well as reducing the possibility of interpretations that are not in consumers' best interests. The CFPA Act would limit those constraints and thereby permit a greater degree of variety and inconsistency in regulations.[107]

[102] CFPA Act, *supra* note 1, at § 1041(a)(1).
[103] *Id.* at § 1041(b).
[104] *Id.* The CFPA Act further goes on to provide for consultation between the proposed Agency and state Attorneys General for potential simultaneous suits under the CFPA Act and more stringent state law. *Id.* at § 1042(b).
[105] New Foundation, *supra* note 1, at 50-51.
[106] CFPA Act, *supra* note 1, at § 1041(b).
[107] *See* Henry Butler & Jason Johnson, *Consumer Harm Acts? An Economic Analysis of State Consumer Protection Acts* (Northwestern Law & Economics Research Working Paper, No. 08-02, April 24, 2008), *available at* http://ssrn.com/abstract=1125305.

The CFPA Act would also *change* consumer protection laws as applied to financial products. The new agency is authorized to take action to "prevent a person from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service."[108] The new agency is not required to define which practices are "unfair" or "deceptive" in a manner that comports with longstanding and continually developing jurisprudence guided by the Federal Trade Commission under Section 5 of the FTC Act.[109] Moreover, the term "abusive" is new to the federal and state consumer protection landscape and thus the CFPA Act of 2009 creates a new legal theory under which lending practices can be found unlawful if deemed "abusive" to consumers.[110] Further, while the CFPA's ability to declare a practice "unfair" requires at least a superficial analysis of its costs and benefits, no such requirement exists with respect to its powers to identify and impose sanctions against practices it deems "abusive."[111] The CFPA Act also provides for a new "reasonableness" standard under which lenders could be liable if they have not provided "reasonable" disclosures to consumers.[112]

The combination of creating a floor for state and municipal regulation, adding the abusive practices and reasonableness standard, and reopening the interpretation of unfair and deceptive practices is a toxic brew. It would likely subject lenders to regulations that vary across geographic lines and uncertainty over how diverse federal, state and municipal regulators and ultimately the courts will define unfair, deceptive, abusive, and reasonable practices. We return to the cost implications of tbese legal changes below.

2. The New Agency

As discussed above, the CFPA would have the ability to impose administrative fines and other sanctions based on its interpretation of what constitutes "unfair, deceptive or abusive" practices and whether lenders have acted reasonably. Within this legal framework, the proposed CFPA would have far-reaching authority to ban consumer

[108] CFPA Act, *supra* note 1, at § 1031.
[109] *Id.* at § 1031(c). Specifically, the proposed Agency merely need "consider established public policies as evidence to be considered with all other evidence" in concluding whether or not a given business practice is "unfair" under the CFPA Act. *Id.* At least one Federal Trade Commissioner has expressed concerns about this feature of the CFPA. *See* William E. Kovacic, Commissioner, Federal Trade Commission, Statement on the Proposal to Create a Consumer Financial Protection Agency to the Committee on Energy and Commerce and the Committee on Financial Services (July 28, 2009), *available at* http://www.ftc.gov/speeches/kovacic/090728stmtrecord.pdf. Commissioner Kovacic notes that "conflicts in interpretation and in litigation strategies, along with an increase in litigation over jurisdictional questions, will adversely affect every core area of consumer protection for which the FTC will continue to exercise primary responsibility."
[110] CFPA Act, *supra* note 1, at § 1031.
[111] *Id.* at § 1031(e).
[112] *Id.* at §§ 1041(a)(1)-(a)(2).

lending products, to require lenders to offer products designed by the CFPA, and to require extensive disclosures.

Banning products. The CFPA would have the authority to restrict or ban consumer lending products.[113] Given the express disapproval of the proponents of the CFPA of widely used lending products such as subprime mortgages and credit cards, the CFPA would likely use its authority to prevent consumers from obtaining access to products that the consumers want but that the CFPA subjectively believes are bad for them. Professor Barr and his co-authors, for example, have suggested that the government should "specify terms and conditions that are 'safe' and qualify for being offered as a standard credit card." At the same time, they argue for restricting consumer access to credit cards that do not meet the government-imposed requirements and for "increased liability risk if the disclosure is found to have been unreasonable" after the fact.[114]

Mandated provision of "plain vanilla products". Under the Administration's plan the CFPA could consider requiring the lender to make another product of the CFPA's design also available to the consumer at the same time.[115] It could insist that consumers explicitly reject the "plain vanilla" product before the lender could offer its own product.[116]

Regulatory review of new products. The CFPA could subject new products to an extensive review process, including one in which the CFPA must approve mandatory disclosure language for the product.[117] The CFPA could also require firms to provide detailed information on consumer choices, including "warnings to consumers about the heightened risks" of using alternative products not pre-approved by the CFPA.[118]

B. Effect of the CFPA Act on the Cost of Providing Credit and the Availability of Consumer Lending Products

1. Impact of Costs

These provisions of the CFPA would likely raise the cost of providing credit significantly. We begin with the legal changes. To begin, it is important to recognize that any new regulation, no matter how simple or well intended, can result in (or add to) a

[113] *Id.* at §§ 1031, 1037.
[114] Barr et al., *supra* note 78, at 15.
[115] CFPA Act, *supra* note 1, at § 1036(b)(1).
[116] *Id.* at §§ 1036(b)(1)(B); 1036(b)(2).
[117] *Id.* at §§ 1032(a); 1034(a), (b).
[118] *Id.* at § 1036(b)(1)(A).

mass of conflicting interpretations and litigation, the net result of which is higher costs and greater uncertainty for covered businesses. The Truth in Lending Act provides a good example.[119] A week before the law became effective in 1969 there were 34 official interpretations of the regulation. Ten years later, federal courts were inundated with more than 13,000 Truth-in-Lending lawsuits. By early 1980, the Federal Reserve Board had published more than 1500 interpretations attempting to provide some clarity to minimize the uncertainty created by the varying decisions made by the courts. Today, compliance with the Truth-in-Lending law requires a great deal of resources. The CFPA Act is likely to lead to a bureaucratic and legal mess far greater than the Truth-in-Lending Law generated. That is because the CFPA Act is a much more expansive and far-reaching piece of legislation, and, most importantly, unlike the Truth-in-Lending law, the CFPA Act provides for the states and municipalities to have their own laws and regulations which will also require interpretation.

The CFPA Act would also result in financial institutions facing significant legal costs for lawsuits emanating from states and localities. To begin with, the states could sue lenders under Section 1031 of the CFPA Act which prohibits "unfair," "deceptive," or "abusive" lending practices.[120] Other industries that have been exposed to state litigation have incurred significant costs as a result, which they have had to pass on to consumers.[121] Consumers of pharmaceutical products have incurred costs in the tens of billions of dollars as a result of state product liability litigation according to one study.[122]

Lenders would also face significant costs in the form of hesitant reactions in the face of considerable uncertainty. They would not know for some years how the courts will ultimately define unfair, deceptive, and abusive practices and what constitutes a reasonable disclosure of information. During this period, lenders would have difficulty assessing what they are required to do under the new law or what their financial exposure

[119] *See* Thomas A. Durkin, *The Impact of the Consumer Financial Protection Agency Act on Small Business*, US CHAMBER OF COMMERCE MAGAZINE, September 23, 2009, *available at* http://www.uschambermagazine.com/publications/reports/090923_cfpa_sb.htm (last visited Sep. 26, 2009).

[120] CFPA Act, *supra* note 1, at § 1031.

[121] *See* Professor Michael J. Saks' letter to Sen. Ernest Hollings, S. 687. The Product Liability Fairness Act: Hearing Before the Subcommittee on Consumer of the Committee on Commerce, Science, and Transportation, United State Senate, One Hundred Third Congress, first session, September 23, 1993, 126. Even though the average price effect of liability costs may be small across industries, in some sectors it can be quite large. *See* Tomas J. Philipson & Eric Sun, *Is the Food and Drug Administration Safe and Effective?*, 22 J. ECON. PERSP. 85, 94–95 (2008) (suggesting that the deadweight losses to consumers and producers from the price increase due to product liability litigation in the pharmaceutical industry is in the tens of billions of dollars); Paul Rubin & Joanna Shepherd, *Tort Reform and Accidental Deaths*, 50 J.L. & ECON. 221 (2007) (estimating that product liability has increased accidental deaths by raising the prices of safety-enhancing goods and services); Richard L. Manning, *Changing Rules in Tort Law and the Market for Childhood Vaccines*, 37 J. L. & ECON. 247, 273 (1994) (suggesting that the price of vaccines went up twenty-fold after product liability imposed);

[122] *See* Philipson & Sun, *supra* note 121.

would be for failing to meet legal requirements across diverse geographic lines. In addition, the exposure to state and local litigation would pose the possibility that financial institutions would face penalties that could lead to severe losses or even bankruptcy. Businesses, of course, must be compensated for bearing risk and uncertainty.

As noted above, the CFPA Act simultaneously opens consumer financial protection to diverse and inconsistent state and local regulation, allows regulators to adopt new interpretations of traditional consumer protection terms such as unfair and deceptive practices, and adds new concepts of abuse and reasonableness which are undefined in the consumer credit context. These three features have a multiplier effect and would likely result in an exponential increase in the cost and uncertainty of complying with consumer financial protection laws and regulations.

In addition to the changes in the legal landscape the new agency created by the CFPA Act would likely impose other significant costs on consumer lending products and providers of those products. Each loan would require additional paperwork and other compliance costs. This increase in paperwork is not merely speculative. According to the Act, "The Agency may on a periodic basis . . . require reports from a covered person for purposes of ensuring compliance with the requirements of this title, the enumerated consumer protection laws, and any rules prescribed by the Agency . . ."[123] Granting the proposed Agency broad powers to create rules, this provision alone allows for potentially unlimited reporting on an as-of-yet undefined amount of as-of-yet unwritten administrative regulations.

The intensive review process envisioned by the CFPA Act would be particularly expensive for new products.[124] Firms introducing new products often make numerous subsequent adjustments in their designs in response to feedback from consumers and as they learn about the performance of those products and consumer preferences. Providers of new consumer financial products would have to submit these products to the CFPA's review process before they have gotten any market feedback and, in effect, before these products were "fully baked." Normal changes in product design following the introduction of the lending product could expose the firm to administrative or enforcement actions unless submitted to the CFPA beforehand for further review and approval, exponentially delaying a firm's ability to offer consumers improved products. The lack of consumer experience is also a problem for the agency which would be making judgments

[123] CFPA Act, *supra* note 1, at § 1022(c)(1).
[124] *Id.* at § 1036(b)(1).

on disclosure and other issues with at best limited information from consumers. As Federal Trade Commissioner Thomas J. Rosch has noted, "there is no evidence that this proposed new agency has any core competency in protecting consumers in the financial marketplace."[125] It is therefore likely that the CFPA Act's "plain vanilla" requirements would induce consumers to take products that would be poorer choices than the consumers would have picked on their own.[126] The CFPA Act would therefore likely impose a significant increase in the costs and risks of introducing new products.

The "plain vanilla" requirement is likely to impose even further costs and risks on lenders. Consider a lender that introduces a new lending product. The lender determines whether the introduction of that product will generate enough profit to justify its investment in the product along with its exposure to litigation and regulatory costs. Suppose it decides before considering the effect of the "plain vanilla" requirement that it would be profitable to make the product available to consumers. Now it must factor in the CFPA's decisions on a "plain vanilla" product. Some, and perhaps many, consumers may decide to take the "plain vanilla" version. That version may be less profitable than the version designed by the lender. As a result, the new product may not yield an adequate return when the profits from both the product designed by the lender and the "plain vanilla" product designed by the CFPA are taken into account. Alternatively, the lender may have to raise fees on both the "plain vanilla" product and its own product to cover revenue losses associated with the diversion of customers from its own product to the "plain vanilla" product. Finally, in any event, the lender would need to factor in the risks associated with the CFPA's decisions on how to design a plain vanilla product when making decisions on investment in a new lending product. To compensate for that added risk the lender would have to increase the interest rates and fees for new products that it introduces.

Overall, the CFPA Act would likely increase the costs of supplying credit to consumers. The variable cost of lending would increase as a result of the paperwork requirements and as a result of the increased litigation exposure that each loan presents. That would directly result in an increase in the interest rates and other fees associated with

[125] J. Thomas Rosch, Commissioner, Federal Trade Commission, Statement on the Proposal to Create a Consumer Financial Protection Agency Before the Committee on Financial Services (July 21, 2009), *available at* http://www.ftc.gov/speeches/rosch/090721roschstatement.pdf.

[126] The CFPA Act requires the new agency to subject its rules and regulations to a cost-benefit test. Other federal agencies have the same requirement yet there is little evidence that it is taken seriously. *See generally* Robert W. Hahn & Cass R. Sunstein, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis*, 150 U. PA. L. REV., 1489 (2002), Moreover, the proponents of the agency tend to see few benefits in consumer borrowing and many costs which suggest that the new agency, if it adopted a similar view, would find that restrictions on consumer credit availability pass a cost-benefit test.

extending a loan. In addition, the CFPA Act would increase the fixed costs of making a particular lending product available to consumers. New products in particular would face a lengthy and involved review process, require the development of disclosures that meet the agency's reasonableness requirement and could satisfy its unfair, deceptive and abusive practices requirements. Lenders offering new and innovative products could also face financial exposure from litigation over the provision of that product. As a result lenders would have to raise the interest rates and fees on products to cover these costs or alternatively not make those products available at all.

2. Impact on the Availability of Consumer Lending Products

We have just seen that the CFPA Act would likely increase the prices that consumers pay for credit products. Consumers are actually harmed in two ways. First, higher prices directly curtail the amount of credit available to consumers, who will be worse off because they no longer get to enjoy the benefits of that credit. For the credit that they would still obtain, consumers would pay higher prices and have less money to spend on other things. As we explain in the next section, these changes in prices and consumption are likely to be very costly.

The second and more serious concern with the CFPA Act is that it would prevent consumers from obtaining certain credit products at all. Consumers would lose the entire benefit they were previously obtaining from those products. In some cases consumers may have no other lending product to turn to and would be liquidity constrained. There are two reasons to believe that the CFPA Act would in fact completely cut off consumer access to certain credit products and possibly to credit altogether. The first follows directly from the preceding discussion: lenders would not make some lending products, particularly new ones, available because they would not be profitable given the costs and the risks they face under the CFPA Act regulatory regime. We focus on the second one here: the CFPA itself is likely to directly prevent consumers from obtaining lending products that they would like to use.

The CFPA would have the authority to ban or restrict certain lending products.[127] Of course, the likelihood that the new agency would ban various consumer lending products that consumers would use if they were available does not by itself mean that consumers would be harmed. The well-meaning scholars who have designed the CFPA

[127] CFPA Act, *supra* note 1, at §§ 1036(b)(1), 1039.

Act believe that they have provided theoretical and empirical evidence that demonstrates that various lending products, or significant variants of these products, harm consumers. They believe that many consumers use these products because they are misinformed and irrational. Their view is misguided for at least two reasons.

First, as we described in Section II, consumers borrow money for sound and rational reasons. They can improve their level of well-being by borrowing against future incomes so that their enjoyment of life is not unnecessarily concentrated in middle age. Consumers also benefit from borrowing for many other reasons: a temporary short-fall of income, sudden expenses, wanting to start a business, or wanting to make a long-term investment, such as a home. In short, the fact that consumer behavior does not conform to paternalist advocates' subjective valuation of future time or income does not *ipso facto* render consumer choices irrational or welfare-reducing. Indeed, the burden is on those who would deny consumer's own evaluation of their welfare to prove that consumers are wrong and that the CFPA would consistently make better judgments the gains from which exceed the costs the CFPA imposes on lenders and borrowers.

Second, consumers are necessarily in a better position than regulators to decide on what products are best for them in their particular circumstances. Individuals know their own preferences such as their tradeoffs between risk and certainty and between consumption and debt. Consumers also have more knowledge of their own aspirations, needs, future incomes, and other life plans than regulators could ever have. We are highly skeptical that regulators could better assess which consumer lending products should be offered to consumers than lenders who have a direct competitive interest in satisfying consumers' needs and tastes.

Professors Bar-Gill and Warren argue that regulators should prevent the sale of harmful consumer lending products just as they prevent the sale of exploding toasters. The analogy is inapt and, more importantly, does not reflect the type of consumer lending regulation that these designers of the CFPA have in mind. Consumers do *not* want to buy toasters that have a significant risk of explosion and they can benefit from government regulations that require manufacturers to make toasters safe. Consumers *do* want to borrow money even though there is a risk that they will have trouble paying it back or that the house they bought does not appreciate as much as they had hoped. Consumers knowingly choose to take these risks all the time. The advocates of the CFPA Act are *not* seeking to prevent lenders from offering consumers the credit equivalent of an exploding

toaster. Rather, the CFPA Act's advocates believe that consumers should be restrained from choosing products and services that significant numbers of consumers have willingly used safely, to their advantage personally, and to the great benefit of society as a whole. The CFPA Act's advocates would have consumers "nudged" into using only those particular products that the regulators have approved for them. This approach to regulation would be like having the Consumer Product Safety Commission prohibit the sale of particular toasters that they believe consumers do not really need, or requiring toaster manufacturers to offer consumers a "plain vanilla" toaster in addition to, and even in preference to, their feature-laden models.

We showed earlier that financial innovation expanded the supply and accessibility of consumer credit enormously between the start of the 1980s and the onset of the current financial crisis. During that period of time innovations in risk analysis and securitization, combined with the introduction of many new credit products, enabled millions of Americans to borrow, many of whom had limited, more expensive, or no previous access to credit. Millions were able to buy homes—which, for the vast majority, were good investments. They were also able to borrow against future income to buy many common consumer durables—everything from automobiles to refrigerators to televisions—that households buy especially when they are younger. The financial innovations helped American consumers weather some stormy economic times including the period of high interest rates and inflation uncertainty in the late 1970s and early 1980s, the stock market crash of 1987, and the collapse of the dot.com bubble and the uncertainty following 9/11. Innovative consumer lending products also helped accommodate a massive increase in household formation as a result of the baby boom generation–and their children–entering the workforce.

These financial innovations also relieved the liquidity constraints that prevented many socially and economically disadvantaged Americans from gaining access to credit at all or that had forced them to turn to very high cost alternatives. More minorities, single parents, and low-income households were able to get mortgages, credit cards, and other lending products that markedly improved their lives. Financial institutions were able to lend money to more high-risk households because these institutions had tools that enabled them to better identify and manage the risks and because these lenders could diversify their risks through securitization and other risk management tools.

Based on our analysis of the CFPA Act and how its proponents envisaged the CFPA Act to regulate consumer financial products, we believe that the most likely scenario is that, if enacted, the CFPA Act would reverse the increase in the availability and democratization of credit that consumers have benefited from over the last thirty years. The CFPA Act would result in a credit crunch for many Americans who would either not have access to credit or have to turn to inferior sources of credit such as pawn shops and payday lending.

C. The Estimated Effects of the CFPA Act on Economic Welfare[128]

The CFPA Act will impose a significant cost shock to lenders. One way to understand the possible impact of the Treasury's CFPA Act is to examine other shocks to the lending industry. A major part of our concern with the CFPA Act's impact on lending costs is that the Act will result in significant state-by-state variation in regulation, which will necessarily impose increased transaction costs on lenders. One might immediately intuit that the greater the variation amongst states, the greater these costs will necessarily be. The 1994 Interstate Banking and Branching Efficiency Act (IBBEA) is one such shock that provides empirical data by which one can assess the possible effect of the CFPA Act. The IBBEA allowed bank and bank holding companies to expand across state lines; prior to its passage there had been virtually no interstate branches. The IBBEA, however, preserved states' rights to impose various costs on the expansion of out-of-state banks in their states and some states did so. Thus, the "IBBEA shock" did precisely the same as the proposed CFPA Act would do: it ended federal preemption, causing a proliferation of divergent state laws impacting lending costs.

Rice and Strahan examine the impact of the IBBEA on the interest rates paid by small firms.[129] They estimate the effect of these state-imposed restrictions on the interest rates paid on bank loans by small businesses by comparing bank lending in states that imposed restrictions with those that did not. They find that the interest rates paid by small businesses were 80 to 100 basis points higher in states with the most restrictive rules on bank expansion compared with the states with the least restrictive rules.

[128] Professor Adam Levitin argues that these estimates are speculative, *A Critique of Evans and Wright's Study of the Consumer Financial Protection Agency Act* 1 (Georgetown University Law Center, Public Law Research Paper No. 1492471, October 22, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1492471. We disagree with his comments as discussed in David S. Evans and Joshua D. Wright, A Response to Professor Levitin on the Effects of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit (George Mason Law and Economics Research Paper No. 09-56, November 3, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1499261.

[129] Tara Rice & Philip E. Strahan, *Does Credit Competition Affect Small Firm Finance?* (forthcoming 2009), *available at* http://www2.bc.edu/~strahan/CreditCompetition_June2009.pdf.

We take the conservative 80 basis point regulatory penalty as a lower bound on the effect of that the CFPA Act would have on interest rates. The regulatory restrictions imposed by the states following the IBBEA were relatively modest and require little in the way of judicial interpretation. They included setting a minimum age of the target institution, restrictions on acquiring individual branches, imposing a statewide deposit cap, and preventing in some cases setting up a new branch. The scope of the CFPA Act is enormous in comparison. It would constitute a highly intrusive federal regulatory agency, require lenders to comply with differing regulations across 50 states and their component municipalities, create a costly product review process, and expose lenders to litigation under untested laws by federal, state and municipal enforcers. There is also an enormous difference in the degree of uncertainty that banks would face. The restrictions that banks faced in some states following the IBBEA were clear and known with certainty; there was a precise age requirement or deposit cap imposed by a state. These restrictions did not impose significant costs on banks deriving from uncertainty with regard to how the restrictions would be interpreted and change over time. The CFPA Act, on the other hand, creates considerable uncertainty because many of the federal and state rules concerning what lenders can and cannot do are vague and ambiguous, and because the application of the "unfair," "deceptive," "abusive," and "unreasonableness" standards by the regulators and courts will remain highly uncertain for many years.[130]

It is therefore plausible that the CFPA Act would impose a multiple of the costs on lenders than what the states imposed through geographic branching restrictions following the passage of the IBBEA. We report estimates based on the CFPA Act having the same, twice, and three times the impact on interest rates as the state-imposed geographic branch restrictions studied by Rice and Strahan. Those estimates imply that the CFPA Act would increase interest rates by 80 basis points if the impact of the CFPA Act's regulations was the same as the geographic restrictions, 160 basis points if the impact of those regulations was twice as costly and 320 basis points if it was three times as costly. We take 160 basis points as the likely lower bound on the effect of the CFPA Act on interest rates.

Consumers would not just pay more for credit. In response to the increased prices consumers would use less credit, with a resulting impact on consumer spending. Financial

[130] For an illustrative example, state Consumer Protection Acts (CPAs) modeled on the Federal Trade Commission Act's prohibitions of "unfair" and "deceptive" business practices have resulted in significant variation in substantive consumer protection regulation and remedies between states, with that variation creating significant uncertainty and litigation. See Searle Civil Justice Institute, State Consumer Protection Acts: An Empirical Investigation of Private Litigation (November 2009), *available at* http://www.law.northwestern.edu/searlecenter/uploads/CPA_Proof_113009_final.pdf.

economists have also used changes in nominal credit card interest rates to estimate a long-run debt elasticity in consumer credit markets of -1.3.[131] That is, a 1 percent (a 100 basis point) increase in the cost of debt would reduce the amount of long-run debt acquired by 1.3 percent. Combining these estimates, we can generate a rough prediction of the impact of the CFPA on interest rates and credit supply assuming that the regulatory costs would generate interest rate effects that are equal to, twice as bad, and three times as bad as the state restrictions on interstate banking. An 80 basis point increase would result in a 1.0 percent reduction in amount of long-term debt, a 160 basis point increase would result 2.1 percent reduction in the amount of long-term debt, and a 320 basis point increase would result in a 4.2 percent reduction in the amount of long-term debt. These estimates should be interpreted as lower bounds on consumer responsiveness to changes in interest rates since they are calculated with data from the 1990s and, at the current dramatically reduced levels of consumer credit available after the financial crisis, more consumers are liquidity constrained and thus more sensitive to interest rate changes. We take 2.1 percent as the likely lower bound on the reduction in credit borrowing for these reasons but also because the CFPA Act may also ban certain lending products that are the only way for some consumers to borrow.

The reduction in credit availability would be likely to generate significant losses for consumers. The economic literature provides some estimates of the effects of regulatory restrictions on access to credit products likely to fall under the CFPA's scope. For example, Morse finds that restrictions on financial products can exacerbate the negative impact of disasters, including 1.2 more foreclosures per 1,000 homes and 2.67 more larcenies per 1,000 homes.[132] This analysis suggests that the harmful consequences of restrictions on lending products will be felt not only by consumers facing personal emergencies, but also by communities that are left less able to rebound quickly from community shocks. Federal Reserve economists Morgan and Strain reach similar results, finding that restrictions on consumer financial products in Georgia and North Carolina resulted in more bounced checks, more complaints about lenders and debt collectors filed with the Federal Trade Commission, and more bankruptcies.[133] Similarly, Karlan and

[131] David Gross & Nicholas Souleles, *Consumer Response to Changes in Credit Supply: Evidence from Credit Card Data* (Wharton Business School, Working Paper, Feb. 4, 2000), *available at* http://knowledge.wharton.upenn.edu/papers/1161.pdf. These estimates are based on credit cards and could be different for other debt products.

[132] Adair Morse, *Payday Lenders: Heroes or Villains?* (Booth School of Business, Working Paper, January 2009).

[133] Donald P. Morgan & Michael R. Strain, *Payday Holiday: How Households Fare after Payday Credit Bans* 4-5 (Federal Reserve Bank of New York, Working Paper, Feb. 2008). *See also*, Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap* 2-5 (Dartmouth College, August 2009).

Zinman find that access to consumer financial products can significantly improve household outcomes ranging from job retention to staving off hunger.[134]

The CFPA Act credit squeeze is likely to negatively impact small businesses and job creation.[135] Small businesses can have a difficult time obtaining credit because they present lenders with significant adverse selection, moral hazard, and asymmetric information problems and because they have high failure rates. Indeed, one estimate suggests that approximately 20% of firms with fewer than 20 employees did not bother to apply for credit because they assumed they would be denied.

Small businesses necessarily rely extensively on consumer financial products. These include home equity loans, personal loans, auto title loans and credit cards.[136] Indeed, almost half of firms with fewer than 20 employees use a consumer credit card to help finance their businesses.[137] These small business owners would encounter the same increase in the cost of credit as regular consumers and face the same prospect of not being able to get credit at all. Since small businesses are notoriously fragile these increases in the cost of credit, or denial of credit, could have far reaching effects on the viability of small firms.

As a result of its impact on small firms that rely on consumer credit, the CFPA Act could have serious effects on job creation. Most net new jobs in the United States are created by new firms, which by-and-large begin small – often as sole proprietorships.[138] These small businesses account for a disproportionate share of new job creation in the United States.[139] Startup firms with fewer than 20 employees accounted for 86.7% of net job creation in the United States in 2005.[140] As noted above, about half of these businesses relied on credit cards for financing and others rely on other forms of consumer financing.

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[134] Dean Karlan & Jonathan Zinman, *Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts* (Innovations for Poverty Action, Working Paper, January 2008).

[135] Durkin, *supra* note 118, at 1.

[136] Charles Ou and Victoria Williams, *Lending to Small Businesses by Financial Institutions in the United States*, *in* SMALL BUSINESSES IN FOCUS: FINANCE, A COMPENDIUM OF RESEARCH BY THE SMALL BUSINESS ADMINISTRATION'S OFFICE OF ADVOCACY (2009).

[137] *Id.*

[138] Net new jobs takes into account the fact that new firms both create jobs and, when they fail, destroy jobs.

[139] John Haltiwanger, Ron Jarmin & Javier Miranda, *Business Formation and Dynamics by Business Age: Results from the New Business Dynamics Statistics*, (Working Paper, May 2008), *available at* http://econweb.umd.edu/~haltiwan/bds_paper_CAED_may2008_may20.pdf.

[140] In 2005 net job creation at new firms with less than 20 employees was 2,151,513 while total net job creation across all firms was 2,481,097. See US. Census Bureau, Dynamic Business Statistics, BDS Dataset List, Firm Age By Firm Size, available at http://www.ces.census.gov/index.php/bds/bds_database_list. Over the period 1987-2005 the net new jobs (taking jobs created minus jobs lost) by new firms with less than 20 employees exceed total net new jobs because many older and larger firms had net job destruction.

We believe that it is plausible that the CFPA Act could result in a significant number of aspiring new small business owners not being able to obtain the consumer credit necessary to get their businesses off the ground. An extensive body of economic literature demonstrates that entrepreneurs are liquidity constrained and that lack of access to credit deters many from starting new businesses; the flip side of this finding is that a contraction in the supply of credit increases the number of entrepreneurs that are liquidity constrained and thereby reduces the number of start-ups.[141] Suppose that the increase in credit prices and reductions in the availability of credit results in only a 5 percent reduction in the number of aspiring entrepreneurs were not able to start their firms. If we focus just on firms with fewer than 20 employees, that could lead to the elimination of roughly 4.3 percent (.05 x .867) of net new jobs. We believe that this is a plausible but hardly precise estimate of the order of magnitude that the CFPA Act could have on employment.

D. The CFPA Act of 2009 and the Economic Recovery

The timing of the CFPA Act of 2009 could not be worse. Suppose the Act became law by July 1, 2010. It would take many months, and perhaps years, before the agency envisioned by the CFPA Act would begin functioning. The Administration would have to make a number of appointments, the existing regulatory agencies would have to transfer staff, and the new agency would have to organize itself and hire additional staff to meet its new responsibilities. It would then take further time before the new agency would have the opportunity to interpret its legislative mandate and adopt rules and regulations. It would also take time before the courts had reviewed cases to test these interpretations. The severe limitations on federal preemption would also likely lead states and municipalities—who would not be required to wait for the CFPA to get organized and become fully operational—to adopt new and likely conflicting consumer lending regulations, creating a stilted, heterogeneous set of legal regimes at the state level.

For a substantial period of time financial institutions would face great uncertainty over the likely costs of lending to consumers for the reasons discussed above; whether their financial products would be approved by the new agency; the nature of the plain vanilla products and the effect of these product on the profitability of lending to

[141] *See* David S. Evans & Boyan Jovanovic, *An Estimated Model of Entrepreneurial Choice under Liquidity Constraints*, 97 J. POL. ECON. 808, 808-27 (1989).

consumers; and the scope of their institutions' litigation exposure. We would expect financial institutions to address these major new regulatory risks by reducing their lending to consumers in the face of this uncertainty. In consequence of these limitations on business activity, investors would shy away from placing their capital in firms subject to CFPA Act authority, limiting capital growth if not actually shrinking it.

That reduction in lending would occur almost immediately after the passage of the legislation. It would come at a time when the economy is just beginning a tenuous recovery from the deepest economic downturn in 75 years. A major obstacle to the economic recovery is that lack of access to financing for consumers and businesses. It is well known that many consumers and businesses in today's economic environment have great difficulty obtaining mortgages, educational loans, automobile loans, credit card loans, and other sources of credit. The Federal Reserve reported consumer credit dropped by historic rates in the last weeks of the summer 2009. It decreased from 2.74 trillion in July 2008 to 2.47 trillion in July 2009.[142] Small businesses which rely on consumer lending products to finance their operations have been especially hurt.[143] The CFPA Act would deter financial institutions from expanding consumer lending needed for the success of these very businesses.

The ramifications of this reduction in consumer lending in 2010 and 2011 that could occur if the Treasury's CFPA Act of 2009 were signed into law are quite serious. Consumer spending is vital to any economic recovery. Encouraging sustainable consumer spending requires encouraging policies that induce consumers to buy homes and consumer durable goods again as well as to engage in everyday shopping. As is well known, consumer spending has a multiplier effect, which leads to dramatic economic expansion and the growth in jobs. With an unemployment rate of close to 10 percent and weak consumer spending it would seem particularly counterproductive to have the government impede credit availability by raising the costs and risks on consumer lending by financial institutions. It is also not the time to further restrict lending to small businesses and dampen the creation of new jobs that are important for pulling the economy to recovery.

VI. Conclusions

[142] Federal Reserve Statistical Release G19, September 9, 2009, *available at* http://www.federalreserve.gov/releases/g19/Current/.
[143] *See, e.g.*, Joseph A. Mann, Jr., *Lack of Credit Hurts Small Businesses*, MIAMI HERALD, Feb. 25, 2009, *available at* http://www.miamiherald.com/business/5min/story/914255.html.

The CFPA Act of 2009 proposed by the U.S. Department of the Treasury is a misguided attempt to erect a supernanny agency that would substitute its own choices for how and under what circumstances consumers should be able to borrow money. The proponents of the CFPA Act have not provided a basis for adopting sweeping changes in the regulatory structure of consumer financial protection regulation. While improving consumer protection is needed, particularly for the non-bank institutions that virtually all commentators identify as the source of most problem mortgages, it is hard to maintain that the financial crisis would have been avoided by more consumer protection.[144]

Short-term the CFPA Act would jeopardize the current economic recovery, and recovery from high unemployment, because the Act would significantly raise the uncertainty over the costs of lending consumers money. It would take several years for the new agency to give lending institutions clear guidance and for the courts to interpret new legal obligations on lenders, suppressing lending activity (and investment in lending firms) in the meanwhile.

Over the longer term, the CFPA Act of 2009 would restrict the supply of consumer credit, reduce consumer choice over how consumers can borrow, and increase the cost of consumer credit. In doing so it would inflict collateral damage on small businesses that often rely on consumer credit products. A significant part of these increased costs would come from opening a flood gate of state regulation and litigation under a new vague legal standard. The CFPA Act would also turn back the clock on successful efforts to democratize credit—that is to make credit widely available so that all segments of American consumers can borrow to meet their short-term and long-term needs. It would further make it harder for the new firms that create most jobs to obtain credit and would thereby lead to a permanent reduction in job creation.

[144] FEDERAL RESERVE BOARD, STAFF ANALYSIS OF THE RELATIONSHIP BETWEEN THE CRA AND THE SUBPRIME CRISIS, November 21, 2008, *available at* http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf.

Communities First Act (CFA)

Title I
Targeted Regulatory Relief for Community Banks

Section 101. Call Reports: Permits highly rated, well-capitalized banks with assets of $10 billion or less to file a short form Call Report in two non-sequential quarters of each year.

Section 102. Sarbanes/Oxley: Exempts insured depository institutions with consolidated assets of $1 billion or less from the internal control attestation requirements of Section 404(b) of the Sarbanes Oxley Act. (Dodd-Frank provides relief for public companies with market capitalizations under $75 million).

Section 103. Small BHCs: Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors so that the policy applies to BHCs with pro forma consolidated assets of less than $1 billion, an increase from the current threshold of $500 million. Qualifying BHCs must not have a significant outstanding debt or be engaged in nonbanking activities that involve significant leverage. (we should propose comparable provision for thrift holding companies).

Section 104. SIPC: Amends Section 9 of the Securities Investor Protection Act of 1970 to provide banks with assets of up to $10 billion with insurance coverage for bank losses incurred in brokerage accounts due to the failure of a broker dealer.

***Section 105. SEC/ Accounting Standards**: Require the SEC to ensure that accounting standards truly reflect the business model of the preparer.

Section 106. FASB/ Accounting Standards: Require FASB to conduct both a cost/benefit analysis and economic benefit analysis for proposed changes to any existing accounting standard, as well as for any proposed new accounting standard. FASB may not issue an amended standard or a new standard unless the benefits of such standard significantly outweigh the costs. Also, FASB may not issue any standard which could create an undue negative economic impact upon community banks with assets of $10 billion or less.

Section 107. Shareholder Threshold: Increases SEC shareholder registration threshold to 2,000 from 500. To de-register stock, increase shareholder threshold from 300 shareholders to 1700 shareholders.

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*Underlined sections indicate new provisions not found in the CFA legislation introduced in 2007 during the 110th Congress.

Section 108. FSOC Review: Revise FSOC review of CFPB regulations by lowering the threshold and allowing FSOC to veto a rule that could adversely impact a subset of the industry in a disproportionate way.

Section 109. Fed Exam Authority: Amend sec. 1012 of Dodd-Frank to make it clear that the Fed may not delegate to the CFPB its authority to examine insured depository institutions with assets of $10 billion or less.

Title II
Regulatory Relief for Banks and their Customers

Section 201. Escrows: Amend Dodd-Frank to provide that mortgage loans held in portfolio by banks under $10 billion in assets are excluded from escrow requirements.

Section 202. Annual Privacy Notices: Requires a bank to provide annual privacy notices to consumers when it either shares consumer information (other than as provided by an exception) or changes its policies. Annual privacy notices would otherwise be eliminated.

Section 203. Agriculture Loans: Authorize the Secretary of Agriculture to reprogram unused monies from other programs into the Business and Industry loan program. Lower origination and program fees for borrowers of rural, small business loans under $5 million, and allow guarantee of up to 90% of principal.

Section 204. USDA Loan Program: Remove term limits applicable to borrowers using USDA's guaranteed farm operating loans. Also, allow family farms organized as LLCs to access guaranteed farm loan programs.

Section 205. Reimbursement for Mandatory Production of Records: Requires reimbursement by the Federal government to institutions with assets of $10 billion or less for the production of records for any law enforcement or investigative purpose, modeled after the provision in the Right to Financial Privacy Act.

Section 206. Loan Amortization: For purposes of regulatory capital, amend Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) to temporarily allow banks with assets of $10 billion or less to amortize over 10 years any mark-to-market losses on property acquired through foreclosure, or on impaired loans secured by real estate.(Smitty/Perlmutter language)

Section 207. GSE Preferred Stock: Restore dividend payments on GSE preferred stock to holders of record as of September 2008.

Section 208. Credit Ratings: Amend Dodd-Frank mandate which removes references to external credit ratings. Amend sec. 939A to direct bank regulators to

require that ratings-based determinations be confirmed by additional analysis in circumstances where ratings are likely to present an incomplete picture of the risks presented to an institution, or where those risks are heightened due to concentrations in particular asset classes.

Title III
Tax Relief for Bank Depositors, Rural Banks, Municipalities, Banks Organized as Limited Liability Companies, and Young Savers

Section 301. Long Term CDs: Reduces tax rate and defers income on long-term certificates of deposit (All Savers Account). Defers tax recognition of individual interest income on long-term CDs (term of 12 months or more) until maturity and reduces the tax rate to long-term capital gains tax rate.

Section 302. Enhanced Rural Lending: Excludes from taxable income of a bank or savings association income earned on agricultural real estate loans and mortgage loans in communities with a population of 2,500 or less. This mirrors exclusion available to the Farm Credit System.

Section 303. Update Tax-Exempt Bond Limits: Increases from $10 million to $30 million the annual issuance limitation for tax-exempt obligations. The limitation would be indexed for inflation prospectively.

Section 304. LLCs: Allows bank, bank holding company, savings association or savings association holding company with assets of under $10 billion to elect to be treated for tax purposes as a limited liability company in a tax-free transaction.

Section 305. Young Savers Accounts: Permits a Roth IRA account for individuals under age 26 to encourage early savings.

Title IV
Targeted Tax Relief for Community Banks and Holding Companies

Section 401. Limited Community Bank Credit: Allows banks, bank holding companies, savings associations and savings association holding companies with up to $5 billion in assets that are taxed as C corporations to take a 20% credit against their taxable income up to a cap of $250,000. Shareholders of financial institutions that are S corporations would be able to exclude 20% of the distributable income from the financial institution up to an aggregate cap of $1,250,000. Also creates a 50% tax credit for financial institutions with up to $5 billion in assets that are operating in distressed communities and/or designated enterprise or empowerment zones, or qualifying New Market Tax Credit Census tracts not to exceed $500,000. Financial institutions that are operating in these areas and that are S corporations would be able to exclude 50% of distributable income not to exceed $2.5 million of income.

Section 402. Community Bank AMT Relief: Repeals the alternative minimum tax for banks, bank holding companies, savings associations and savings association holding companies with assets of $10 billion or less.

Section 403. NOL Carry Back: Extend 5 year NOL carry back. Allow community banks with $15 billion or less in assets to spread out their current losses with a 5 year carry back allowed through 2011.

Title V
Small Business Subchapter S Reforms

Section 501. Shareholder Limit: Increase shareholder limit for S Corporations to 200 from 100.

Section 502. Preferred Stock: Allows the use of preferred stock for S Corporation banks

Section 503. IRA Shareholders: Allow IRA shareholders to invest in S Corporation banks.

Title VI
Small Business Lending Enhancements

Section 601. Extend SBA Loan Incentives. Increase government guarantees on SBA loans from 75 percent to 90 percent and waive borrower fees for 2 years from date of enactment.

Section 602. CFPB/Small Bank Burden: Modify Snowe amendment in Dodd-Frank that requires the CFPB to determine the impact of proposed rules on small businesses. Language should make it clear that community banks under $1 billion in assets are included within the definition of small businesses.

Section 603. Small Issuer Exclusions: Amend Dodd-Frank to provide exclusions for small issuers (market capitalization of $250 million or less) from: say-on-pay; compensation committee independence; and golden parachute provisions.

December 27, 2010

The Honorable Darrell Issa
Ranking Member
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Issa,

Thank you for the opportunity to voice the concerns of independent oil and natural gas producers in regard to the regulatory state. The Independent Petroleum Association of America (IPAA) represents thousands of small-business oil and natural gas producers, many of which operate on strict budgets in accordance with their respective business plans. Simply stated, any increases in regulatory costs that take capital away from investing in exploration and production will negatively impact job growth in the oil and natural gas industry.

Oil and natural gas production is a highly technical and complex industry. The correlation between job growth and regulatory certainty is not always a direct link. However, a stably priced and ample supply of energy is clearly linked to job growth. Furthermore, a fluid regulatory state or the implementation of a new draconian rule, can lead to negative circumstances for small-business companies due to the delicate relationship between their operational budgets, the cost of regulatory compliance, and allowing for the appropriate number of employees. Independents that must operate within limited financial parameters are often those most impacted by regulatory measures.

As the Committee on Oversight and Government Reform begins to examine the areas of economic impact due to existing and proposed regulations, please remember that the regulatory state cannot be viewed as stand-alone measures. Rather, as you will see, it is an aggregate dynamic that factors into the economic health of any industry.

Per your recommendation, IPAA has identified existing and proposed regulations that can have a negative impact on job growth. They are as follows:

Offshore Permitting

- Ongoing delays in the processing of permit and plan applications.
- The omission of allowing the use of NEPA Categorical Exclusions will cause major delays in permitting.
- The recently issued "guidance document" by BOEMRE is the latest in a long string of regulations on offshore producers from the Obama Administration. There has been no clarity or certainty provided by the Administration on whether there will be any further regulations implemented.

Onshore Federal Land Permitting

- The omission of allowing the use of NEPA Categorical Exclusions will cause major delays in permitting, parallel to concerns of the same issue involving offshore production.
- Resource Management Plans could be reconsidered adding extensive delays.
- Endangered Species Act designations can create, or contribute to, more uncertainty in the permitting process.
- These uncertainties have created a backlog of permits in the intermountain west that must be addressed, as capital is flowing out of the region during the delays.

Environmental Protection Agency

- EPA has altered permitting under the Safe Drinking Water Act for hydraulic fracturing when diesel is used.
- NRDC petitioned EPA to reopen the 1988 Regulatory Determination under RCRA to seek regulation of drilling fluids and produced water as hazardous waste.
- NRDC challenged and won litigation on EPA regulations on stormwater management during construction.
- Implementing new SPCC regulations
- Revising the ozone standard
- Implementing GHG regulations
- Aggregating air emissions to require additional controls
- Applying the Toxic Release Inventory to oil and natural gas production
- Adding hydrogen sulfide to the list of hazardous air pollutants
- Revising/creating Effluent Limitation Guidelines under the Clean Water Act
- Listing additional species under the Endangered Species Act
- Revising the national ozone standard
- EPA enforcement initiative targeting oil and natural gas production

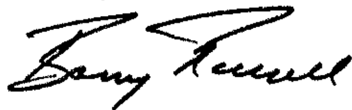
Financial Reform

- The CFTC will be developing regulations on commodity markets that will impact the availability and cost of hedging.

IPAA would like to recommend a follow-up meeting with you, or the appropriate staff, to further discuss each of these regulations in detail. Please contact Joel Noyes at (202) 857-4722 to arrange a meeting that fits your schedule.

Thank you again for the opportunity to represent the concerns of America's independent oil and natural gas producers on this critical topic.

Sincerely,



Barry Russell
President & CEO

cc: The Honorable Edolphus Towns, Chairman

International Dairy Foods Association
Milk Industry Foundation
National Cheese Institute
International Ice Cream Association

January 10, 2011

Chairman Darrell Issa
House Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman Issa,

Thank you for your letter asking for our comments on regulations that negatively impact the economy and jobs.

The International Dairy Foods Association (IDFA), Washington, DC, represents the nation's dairy manufacturing and marketing industries and their suppliers, with a membership of 550 companies representing a $110-billion a year industry. IDFA is composed of three constituent organizations: the Milk Industry Foundation (MIF), the National Cheese Institute (NCI) and the International Ice Cream Association (IICA). IDFA's 220 dairy processing members run more than 600 plant operations, and range from large multi-national organizations to single-plant companies. Together they represent more than 85% of the milk, cultured products, cheese and frozen desserts produced and marketed in the United States. IDFA can be found online at www.idfa.org.

The U.S. dairy industry has experienced significant growth over the past few decades and recent studies have shown that we are uniquely poised to take advantage of growing world markets for dairy. If we do, we can expect milk production to continue to increase as well as the associated jobs that come from additional dairy manufacturing plants across our country.

Milk is the most highly regulated of all agricultural products in the United States. The prices that are paid to dairy farmers are subject to a mind-bogglingly complex and outdated federal regulatory system. In addition, dairy products are subject to federally mandated "standards of identity" that are difficult and time-consuming to update to respond to new manufacturing practices or changing consumer tastes.

While IDFA supports regulations that safeguard the food supply, and the dairy industry has an excellent food safety record, this web of regulations is holding us back and keeping this industry from reaching its full potential as an economic engine for our country.

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The two broad categories of regulations that could benefit greatly from streamlining and review are: 1) USDA price regulations under the Federal Milk Marketing Order (FMMO) system, and 2) FDA food standards of identity for milk and other dairy products.

Simplify USDA Federal Milk Marketing Order Pricing

Milk is the only agricultural commodity for which the government sets minimum prices that buyers pay to farmers. The government regulated prices change every month and vary according to geographic location of dairy plants, and the types of dairy products that are made from the milk. This highly complex and rigid pricing system has stymied growth and innovation in the dairy industry as government regulations, not markets, impact manufacturing decisions and capital investment in the industry. The system was not designed, and has never functioned to give farmers a safety net.

Today, there is broad agreement between dairy manufacturers and dairy farmer cooperatives that the FMMO regulations should be simplified; however, impediments to change remain in place. Federal requirements need to be updated to get USDA on the right track. For instance, the Office of Management and Budget is routinely prohibited in annual appropriations bills from reviewing proposed FMMO regulations to conduct cost benefit analyses and other standard regulatory review requirements. Congressional oversight and support is needed to ensure that the FMMO system is reformed during the 112th Congress.

Modernize FDA Dairy Standards of Identity and Streamline Rulemaking

Growth in the dairy industry is also hindered by a disproportionately high number of FDA-mandated food standards, and the time intensive process required to update them. In order to be competitive in the food industry, dairy products standards must evolve quickly to keep pace with constantly changing consumer preferences, new technology, and global trade in dairy. However, this necessary innovation is effectively barred by our outdated standards of identity system.

FDA needs to modernize the food standards process. Food standards regulations date back to the 1950's and 1960's and preceded the nutrition and ingredient labeling that is now required. The key element of a food standard should be the characterizing ingredient of the product. Our industry should be allowed to make changes to any non-characterizing ingredients without requiring a formal change in FDA regulations. Any substitute non-characterizing ingredient would still be required to meet existing safety requirements, and be declared on the product's label, just as they would with the vast array of non-standardized foods. This would greatly facilitate innovation within the dairy industry and save FDA considerable resources, without any negative impact on

consumers. This approach is now pending before FDA in the form of a Citizen Petition filed by the Grocery Manufacturers Association in 2006, and joined by IDFA and a number of other food-manufacturing trade associations.

A current example of how a standard of identity is holding back innovation, consider the use of non-nutritive sweeteners in milk. Flavored milks that are sweetened by sucrose or fructose can be labeled as milk. Many dairy companies now produce a reduced-calorie, flavored milk using zero or low calorie sweeteners that fully meet FDA's safety standards and ingredient label requirements. However, because of the milk standard of identity, the lower calorie flavored milk cannot be labeled as "milk".

Although other food sectors can react to the marketplace quickly, it is not uncommon for the dairy industry to wait years for a food standard to be updated or for the FDA to resolve industry issues. In fact, our joint petition with the National Milk Producers Federation to allow the use of ultra-filtered milk in standardized cheese production has been pending for over 10 years. This is in part due to the FDA's inability to timely respond to petitions for change. But, these delays are also due in part to a Congressional mandate that standards of identity for dairy products be subject to formal rulemaking. No other food standard of identity is subject to a similar requirement and dairy products should not be subject to the more formal procedure.

Thank you again for inviting our input. I would be happy to discuss with you and your staff further information on any of these topics.

Sincerely,

Constance E. Tipton
President and CEO

CET/hs

Manufactured Housing Institute

January 11, 2011

The Honorable Darrell Issa
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Issa:

In response to your December 10, 2010 request for information, the Manufactured Housing Institute (MHI), a national trade association representing all segments of the factory-built housing industry including manufacturers, financial service companies, community owners and home sales centers, appreciates the opportunity to identify existing and proposed regulations that need to be addressed to help move our industry forward.

The manufactured housing industry plays a substantial role in the housing market. Over the past two decades, manufactured housing has accounted for more than one in every five new single family homes sold. There are nine million households (about 18 million Americans) living in manufactured homes.

Every manufactured home is constructed in the United States, and over one American job is created with every home built. As of November 2010, there were 132 manufacturing facilities operated by 51 corporations, with over 50,000 manufactured home communities and hundreds of retail home sales centers.

As an industry which is uniquely American, the manufactured housing industry is regulated at the federal level through the Office of Manufactured Housing at the U.S. Department of Housing and Urban Development (HUD).

The manufactured housing industry recognizes and supports the need for appropriate and fair regulation to both protect consumers and benefit industry. However, the regulatory environment can be improved for manufactured housing and our customers by addressing four particular issues.

IMPLEMENTATION OF THE GSE "DUTY TO SERVE"

Despite our significant housing presence, Fannie Mae and Freddie Mac have longstanding policies which have constrained growth in manufactured housing and adversely impacted customers. While the GSEs purchase a very small amount of conforming real property manufactured housing loans, they offer no funding for personal property loans which comprise the bulk of lending activity in the manufactured housing market.

As a result, Fannie Mae and Freddie Mac reject a disproportionate number of the manufactured home mortgages submitted, particularly loans for low-income borrowers. Manufactured home loans currently account for less than one half of one percent of the total GSE portfolio. Manufactured housing clearly did not contribute to the current situation of the GSEs.

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http://www.manufacturedhousing.org info@mfghome.org

In the Housing and Economic Recovery Act of 2008 (HERA), Congress indicated the GSEs have a "duty to serve" (DTS) the manufactured housing marketplace, with a specific focus to support "personal property loans." Congress believes it is vitally important that the GSEs play a major role in ensuring the availability of affordable financing for low-to-middle income borrowers in a responsible manner.

In June 2010 the Federal Housing Finance Agency (FHFA) issued a proposed rule ignoring Congressional guidance by specifically disallowing the GSEs to support manufactured housing personal property loans. The willful resistance by FHFA regarding the GSE's duty to serve manufactured housing is very troublesome, especially as they support the rest of the housing market during this difficult time, but ignore the millions of homeowners living in manufactured homes. The final rule must be revised to provide our customers access to capital and not place the manufactured housing industry at an unfair competitive disadvantage.

HUD OFFICE OF MANUFACTURED HOUSING

For thirty five years the manufactured housing industry has met federal building codes and standards regulated by HUD as required by the Federal Manufactured Housing Construction and Safety Standards Act of 1974. In 2000, the Manufactured Housing Improvement Act made important revisions to the law to improve the affordability and availability of manufactured housing.

A strong and healthy manufactured housing program must always be a priority within HUD. In the 2000 Act, Congress stipulated the appointment of a non-career administrator to oversee the Office of Manufactured Housing, however this appointment has not been filled since 2004.

The appointment of a non-career administrator is required by law, and we urge for this position to be filled immediately by HUD. MHI also believes increased Congressional oversight is beneficial to ensure that manufactured housing and the customers we serve and the individuals we employ are a priority.

FINANCIAL REFORM AND THE SAFE ACT

In 2008, the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) was passed by Congress. Last year, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted. The laws were intended to put into place a new regulatory framework for consumer finance and mortgage lending activity in the nation.

While the industry supports robust and transparent laws and regulations to protect consumers, the significant revisions to mortgage finance and predatory lending laws outlined in Dodd-Frank and the unfair application by regulators of the SAFE Act to our industry are essentially job-killers.

Congress did not intend to include individuals under the SAFE Act who perform administrative and clerical tasks as mortgage loan originators as long as they do not offer or negotiate loan terms for compensation or gain. Congressional intent to exclude certain activities performed by individuals is clear. However, regulators, particularly at the state level, have gone out of their way to broaden the scope of regulated activity. This has greatly increased the cost of homes for consumers, prevented access to affordable housing for many, and has even forced businesses in the manufactured housing industry to shut down.

The Dodd-Frank Act amends a number of consumer finance laws and adds new requirements on residential mortgages, including limitations on origination activities, high-cost mortgages and appraisals. While there are many sensible elements of the reform, there are a number of areas which add increased regulatory costs to businesses and consumers in the manufactured housing area, yet are not even applicable to our business activities.

MHI is seeking amendments to Dodd-Frank which would maintain a rigorous regulatory framework but one that is rational and appropriate for our industry. Given the complexity of the changes, we also urge strong Congressional oversight to ensure the law is implemented fairly and properly.

INDUSTRY REGULATION BY TWO SEPARATE FEDERAL AGENCIES

The Energy Independence Security Act of 2007 (EISA) directs the U.S. Department of Energy (DOE) to create new energy standards for manufactured housing. From a regulatory standpoint, this makes no sense. Since 1976 the manufactured housing industry has been regulated by one federal agency at HUD which oversees all aspects of home construction and safety standards, including energy. The industry is now forced to deal with government expansion of two federal agencies now regulating our construction. The need to streamline the regulatory enforcement process under the auspices of a single, cognizant agency, HUD, is imperative. A single regulator overseeing a single national preemptive code plays a major role in allowing our industry build homes economically, a cornerstone in our efforts to keep housing affordable.

The manufactured housing industry plays an important role in creating jobs, and providing high quality affordable housing to millions of Americans. Our industry has experienced a protracted decline over the past decade, due to difficult economic conditions but also because of adverse regulatory policies particularly in the areas of consumer finance. We believe addressing these four issues will greatly assist the industry in getting back to building homes, creating jobs, and serving more customers.

Feel free to contact me tlong@mfghome.org or at (703) 558-0678 if you or your staff has any questions.

Sincerely,

Thayer Long
Executive Vice President

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Alexandria, VA 22314
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January 18, 2011

Chairman Darrell Issa
House Committee on Oversight and Government Reform
B350A Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Issa:

It is very refreshing to see you, as the new Chairman of the House Committee on Oversight and Government Reform, reaching out to industry to examine the role of regulations and their impact on the economy and jobs. As the trade association for the global methanol industry, the Methanol Institute would like to take this opportunity to give you our thoughts on this critical issue. Specifically, we would like to bring to your attention three specific concerns:

1. EPA Chemical Health Assessments Under the Integrated Risk Information System (IRIS)

Background: When it comes to the regulation of chemicals by the Environmental Protection Agency, as well as other federal, state and international agencies, the EPA's chemical health effects database under the Integrated Risk Information System is the basis for determining a chemical's risk in the formulation of any regulations. In other words, an IRIS toxicological review finding that a chemical poses risks to the public from ingestion, inhalation or as a potential carcinogen can lead to quite dramatic regulations to restrict a chemical's use in global commerce.

Concern: On January 12th, 2009, the EPA released its draft toxicological review for methanol which includes a ***proposed oral reference concentration for methanol – a naturally occurring element – so stringent that drinking a 6-ounce glass of California orange juice each day could exceed the Agency's proposed threshold, and could trigger regulatory actions such as product warning labels.*** The EPA also proposed to classify methanol as a "likely human carcinogen" based largely on a single study by the Italian Ramazzini Foundation. On June 15th, the EPA placed the methanol assessment – and three others – on hold after a report from the National Toxicology Program questioned the credibility of the Ramazzini methanol study. Through a FOIA request, the Methanol Institute obtained the full records of the NTP review, finding that the U.S. scientists disagreed with the Ramazzini pathologists on most cancers, and that the NTP analysis does not support a conclusion of cancers from methanol exposure. It has now been seven months since the EPA put the methanol IRIS assessment on-hold, and no decision has been announced regarding a resolution of this issue.

2. EPA Requiring Industry to Conduct Endocrine Disruptor Screening for Chemicals

Background: On November 17, 2009, the EPA issued a notice providing a list of 134 chemicals – including methanol – for which the Agency expects to require Endocrine Disruptor Screening. This testing is being required as a result of a Congressional mandate to determine whether exposure to certain pesticides and

other chemicals adversely effects or "disrupts" the endocrine organs which produce hormones regulating growth, metabolism and reproduction.

Concern: ***It is estimated that this requirement will cost $500,000-$1,000,000 per chemical to conduct a series of 11 tests that have yet to be fully verified by the scientific community.*** In fact, the first proscribed round of endocrine disruptor screening involving 67 pesticides has been found to be so difficult that it is unlikely industry will be able to meet the EPA's tight two-year deadline. At this point, it is unclear whether there are even enough laboratories capable of performing the rigidly designed tests to get this work done, let alone whether there are any real benefits to protecting public health from this testing protocol.

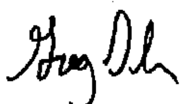
3. TSCA Reauthorization and REACH-Lite

Background: Reauthorization of the Toxic Substances Control Act is likely to be a significant part of the legislative agenda for the 112th Congress. ***There has been a good deal of discussion about morphing the U.S. chemical regulations to mirror the European Union's REACH program. That may be a mistake.*** In fact, the U.S. EPA has already signed a cooperative agreement with the European Chemicals Agency (ECHA) to co-operate on technical matters regarding chemical risk assessment.

Concern: The REACH program is still very much a "work in progress," and it remains to be seen if the huge bureaucracy being established by the EU can effectively manage the program. On January 3rd, ECHA received more than three million industry notices to register nearly 25,000 chemicals. The cost to industry to respond to the REACH mandate has been staggering, in the billions of Euros. To manage this vast amount of data, ECHA plans to expands its staff, with a target of 500 employees by the end of this year. Further, the program allows these government bureaucrats to restrict or even ban the use of chemicals without any concern for the impact on the European economy.

Again, we applaud your efforts to seek input from industry on the impact of government regulations. Product stewardship and the safe handling of chemicals to protect our employees, the public, and the environment has been always Job #1 for our industry. ***The development of chemical regulations should be a cooperative effort of industry and government around common goals and using the best available science.*** Too much is at stake for our economy and U.S. jobs for this relationship to be based on antagonism and distrust. Your efforts are an excellent beginning.

Sincerely,



Gregory Dolan
Executive Director
Americas/Europe

National Alliance of Forest Owners
Investing in the Future of America's Forests

January 10, 2011

The Honorable Darrell Issa
Chairman
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Issa,

The National Alliance of Forest Owners (NAFO) is pleased to submit a response to your December 29, 2010 request for assistance to identify existing and proposed regulations that have a negative impact on the economy and jobs.

NAFO is an organization of private forest owners committed to promoting Federal policies that advance the economic and environmental benefits of privately owned forests at the national level. NAFO membership encompasses 79 million acres in 47 states, including 4 million acres in California. Private forests provide 2.5 million jobs and $102 billion towards the national GDP including 190,883 jobs and $12.48 billion towards the GDP in the state California.

The Environmental Protection Agency's (EPA) treatment of biomass emissions under the agency's Prevention of Significant Deterioration of Title V Greenhouse Gas Tailoring Rule (the Tailoring Rule) and its treatment of silvicultural activities, such as pesticide applications and forest roads, as point sources of water pollution under the Clean Water Act have potentially significant negative impacts on jobs, the economy, and the environment. Attached is a summary of how these regulations impact our industry and the jobs we provide with responses to the four questions you have posed.

Thank you for seeking our input. We look forward to working with you in your new role as Chairman and are happy to visit with you to provide additional information regarding EPA's actions.

Sincerely,

Dave Tenny

cc: The Honorable Edolphus Towns, Ranking Member

Impacts of EPA Regulatory Actions on Forest Owners

How have EPA actions impacted our industry?

- On January 2, 2011, the EPA began regulating greenhouse gas emissions under the Clean Air Act through the "Tailoring Rule." The final Tailoring Rule, without appropriate notice and opportunity to comment, made a sudden change in policy by treating carbon emissions from biomass the same as those of fossil fuels and applying identical permitting requirements to both. The draft rule was consistent with government-wide policy, international conventions and well-established science recognizing that forest biomass recycles carbon from the atmosphere through tree growth and does not increase overall carbon in the atmosphere. EPA has suggested it will make a decision on whether to amend the rule by May of 2011, but has the capability to make that decision much earlier.

- Since 1976, EPA regulations (commonly known as the "silviculture rule") have defined most forest management activities, including "pest control" and "forest roads," as non-point sources of water pollution under the Clean Water Act (CWA). Under the CWA, only point sources must obtain permits (otherwise known as NPDES permits) for discharges of pollutants into waters of the United States; non-point sources are subject to state-developed best management practices (BMPs). Studies indicate that implementation of BMPs in forest management averages nearly 90% nationwide even though they are not mandatory in many states. EPA is now considering two actions that undercut this long-standing rule.

  First, pursuant to a court order, EPA issued in June of 2010 a draft general NPDES permit for application of pesticides over, into, or "near" waters of the United States. States are now developing state versions. This permit would provide coverage for some pesticide applications but not all. EPA suggests that the silviculture rule no longer applies to pest control, even though the rule has not been amended. The permit duplicates protections already adopted by EPA under the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), but adds additional paperwork and reporting requirements. EPA registers pesticides and herbicides by approving application criteria in FIFRA approved labels. Because pesticides undergo lengthy testing under FIFRA, including tests to ensure water quality and aquatic species preservation, and because they are useful products, EPA had considered NPDES permits to be unnecessary and duplicative prior to the court's decision.

  Second, the U.S. Court of Appeals for the Ninth Circuit issued a decision in August 2010 finding that the stormwater management systems on forest roads (e.g., ditches, culverts, etc.) are point sources that EPA lacked authority to define as non-point sources. The court further ruled that forest roads are included within the industrial activity category subject to mandatory NPDES permits under Phase I of the stormwater program. The defendants (the Oregon state forester and several companies that use state roads to haul logs), but not EPA, have

sought rehearing from the court, consideration of which will extend into next year. EPA, which filed an amicus brief supporting its rules in the original appeal, has been silent during rehearing. Further, EPA has indicated that it will shortly issue guidance allowing its regional offices outside the Ninth Circuit to provide coverage if anyone asks for a permit for forest roads, thus suggesting that the agency will abandon its rules and follow the decision if it becomes final.

- EPA has begun the development of large impaired watershed total maximum daily loads (TMDLs), beginning with the Chesapeake Bay. Concerns have been raised that the agency is forcing mandatory controls on non-point sources through the TMDL mechanism. NAFO is concerned because under the Clean Water Act, each state has the prerogative of determining how best to manage non-point sources. Most states accomplish this through voluntary best management practices (BMP) which, in the case of forest management, studies show are both effective and widely followed.

- Finally, EPA's risk assessment and registration process for pesticides and herbicides under FIFRA has long acknowledged that a small level of spray drift is unavoidable and, when used according to the drift reduction measures on the product's label, does not pose an "unreasonable adverse effect" to humans or the environment. On November 4, 2009, EPA proposed changing its spray drift policy from reliance on the FIFRA standard of "no unreasonable adverse effect" to a policy based on the precautionary principle that would prohibit applications if drift "could" cause an adverse effect. This would require substantial buffers around application areas, thus limiting the effectiveness of the application. EPA has not yet issued a final policy, but has not dropped its consideration of the change.

Are these actions mandated by statute, pursuant to an implementing regulation, required by a court decision or an independent action by the agency?

- EPA' action on the Tailoring Rule was an independent action by the Agency that is not mandated by statute, pursuant to an implementing regulation or required by a court decision. The draft rule recognized that forest biomass recycles carbon from the atmosphere through tree growth and does not increase overall carbon in the atmosphere. The final rule treats carbon emissions from biomass the same as those from fossil fuels and subjects both to identical permitting requirements.

- EPA's draft general NPDES permit for pesticide application is the agency's response to a decision by the U.S. Court of Appeals for the Sixth Circuit that application of pesticides into, over or near water as authorized by a label approved by EPA under FIFRA is a discharge of a pollutant and requires an NPDES permit under the Clean Water Act. The particulars of the permit, including how it treats long-standing policies, like the silviculture rule, are choices by the agency.

- EPA's response to the decision on forest roads is entirely an independent action by the agency. While the court considers whether to rehear its initial decision, the ruling has no force, and even if put in effect, only applies directly within the Ninth Circuit.

- The development of TMDLs for impaired waters is a statutory requirement; however, EPA's effort to require mandatory regulation of non-point sources is an agency initiative.

- EPA's proposed spray drift policy revision is an independent action of the agency.

What are the significant deadlines/dates of EPA action (i.e. comment period closes, implementation begins)?

- The Tailoring Rule was implemented on January 2, 2011. EPA has suggested it will make a decision on whether to amend the rule with respect to biomass, by May 2011. It has the capability to make that decision much earlier.

- The court ordered EPA to have a permit program for pesticide applications into, over, or near waters of the United States by April 2011. EPA itself administers the program in only six states. The other 44 states must adopt their own program, and many have begun this effort with their own processes. The states are also subject to the April 11 deadline.

- On the forest roads issue, there are no deadlines for rehearing, and there is certainly no deadline for EPA action.

- The Chesapeake Bay TMDL has been issued with provisions which mainly affect agriculture. EPA will now turn to other watersheds such as the Mississippi River.

- On the proposed spray drift policy revision, the comment period is closed and the matter is under agency consideration.

Please describe how EPA's action or proposed action will impact your industry. If applicable, please include the cost to the industry and the impact on jobs and the economy.

- Any one of these aforementioned actions will increase the cost of forestry; and all five together would have a substantial impact. The precise costs are dependant on the final content of the requirement, but all will demand paperwork and monitoring at a scale significantly greater than current practice, and will render forest management vulnerable to litigation.

- For example, the Tailoring Rule, by reversing longstanding policies and suddenly treating biomass emissions the same as fossil fuel emissions, requires unnecessary and costly permits for renewable energy producers and could subject biomass energy and forest management producing biomass to any cap on carbon emissions the government may impose. This unprecedented treatment of biomass has created marketplace uncertainty that is stalling investment in biomass energy projects and jeopardizing associated green jobs, because it removes a key advantage of biomass over fossil fuels.

- A recent study, conducted by Forisk Consulting, a nationally respected market analysis firm, found that the regulatory uncertainty created by the Tailoring Rule has negatively impacted at least 23 near-term projects representing 1,519 megawatts of potential electrical capacity. The study's authors also noted that there are developers of a number of additional projects already affected by the rule who have chosen to remain anonymous and have not publically disclosed the EPA's action as the reason for their projects stalling

- If left unchanged, the study also found the Tailoring Rule will jeopardize over 130 renewable energy projects, between 11,000 and 26,000 green jobs and ultimately $18 billion in capital investment across the country. The risk of reduced capacity in renewable electricity projects could also prevent as many as 30 states from meeting national renewable energy targets.

- The same study, by Forisk Consulting, also found that if left unchanged, the Tailoring Rule will remove 53.4 million tons of wood biomass demand from the market every year. Experts predict that as the biomass energy market matures, prices would likely normalize to around $8-$10/ton, which would translate to around $500 million annually in lost market opportunities for forest owners across the country as a result of this EPA rule.

Has the industry proposed alternatives to EPA's proposals regarding this action? If so, please briefly explain:

- We have submitted a petition to EPA asking for reconsideration of the Agency's treatment of biomass in the final Tailoring Rule and restore the status quo while the agency studies the issue further.

- On NPDES permits, we have encouraged EPA to stand by its existing regulation defining forest management as a non-point source.

- With respect to TMDLs, we have emphasized to EPA the statutory difference in the Clean Water Act between federal regulation of point sources and state management of non-point sources.

- On the proposed spray drift revision, we have encouraged EPA to comply with risk balancing principles of FIFRA.

What action or actions do you think Congress should take regarding this issue?

- In the near term, Congress should require EPA to propose a supplement to the Tailoring Rule to address the treatment of biomass under the rule as soon as possible. The EPA should also the stay the treatment of biomass in the Tailoring Rule until the supplemental rulemaking is completed. In the long term, Congress should require the Agency to fully recognize the biomass carbon cycle.

- Congress should consider legislative ratification of the EPA regulation defining forest management activities as "non-point sources."

- Congress should monitor the development of large watershed TMDLs to ensure compliance with the Clean Water Act. Congress should avoid new legislation that would authorize mandatory regulation of non-point sources.

- Congress should inquire why EPA is ignoring the law regarding the appropriate standard for risk assessment.

NACDS NATIONAL ASSOCIATION OF CHAIN DRUG STORES

Steven C. Anderson, IOM, CAE
President & Chief Executive Officer

January 14, 2011

The Honorable Darrell Issa
Chairman, Committee on Oversight and Government Reform
United States House of Representatives
Washington, DC 20515

Dear Chairman Issa:

Thank you for the opportunity to provide you with examples of existing and proposed regulations that negatively impact the economy and job growth in the chain drug store industry. As a critical driver of the economy, these issues are of the utmost importance to the NACDS membership.

NACDS represents traditional drug stores, supermarkets, and mass merchants with pharmacies – from regional chains with four stores to national companies. Chains operate 39,000 pharmacies and employ more than 2.7 million employees, including 118,000 full-time pharmacists. They fill nearly 2.6 billion prescriptions annually, which is more than 72 percent of annual prescriptions in the United States. The total economic impact of all retail stores with pharmacies transcends their $830 billion in annual sales. Every $1 spent in these stores creates a ripple effect of $1.96 in other industries, for a total economic impact of $1.57 trillion, equal to 11 percent of GDP.

Health Information Technology for Economic and Clinical Health (HITECH) Act

The Health Information Technology for Economic and Clinical Health (HITECH) Act, which passed into law in 2009, included among its provisions a comprehensive revision of the privacy and security regulations adopted by HHS under the Health Insurance Portability and Accountability Act (HIPAA). These revisions include new requirements for healthcare providers to report breaches of sensitive patient information, provisions for patients to exercise more control over their information, and an expansion of a requirement for healthcare providers to maintain a detailed accounting of all disclosures of patient information, to include daily, routine disclosures. This last provision is known as the "accounting of disclosures" requirement.

HHS regulations currently require healthcare providers to maintain a detailed accounting of only non-routine disclosures, with the understanding that patients would expect their sensitive health information to be routinely disclosed, or shared, for the purposes of healthcare treatment, payment, and operations. Patients expect their information to be shared for these purposes, and these interactions occur millions of times per day, by pharmacies alone—not including other healthcare providers, to deliver timely, safe, and efficient care. Maintaining detailed records would require an overwhelming amount of information to be stored.

The HITECH Act expands the accounting of disclosures requirement to include all disclosures, even daily, routine disclosures. HHS is currently drafting regulations to

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implement this requirement. If this expansion of the accounting requirement were to be imposed on pharmacies, it would cause chain pharmacies to have to completely replace their existing information technology systems nationwide. This would have a significant negative impact on many pharmacies that are currently struggling. In comment letters to HHS and in discussions with the agency, NACDS has urged that this expansion of the accounting of disclosures provision not apply to information technology systems that are not eligible for federal funding under the HITECH Act, as pharmacy systems are not.

DMEPOS Accreditation

The Medicare Modernization Act of 2003 (MMA) added requirements for suppliers (including state-licensed retail pharmacies) of Medicare Part B durable medical equipment and supplies (DMEPOS) to comply with accreditation quality standards to supply and bill for these items and services. Pharmacies are the most accessible provider in the community for patients to receive these items and services such as diabetic testing supplies, canes, crutches and other items. The process for pharmacies and other suppliers to become accredited by the CMS accreditation organizations requires considerable time, resources, and costs. NACDS actively sought an exemption from accreditation for retail pharmacies in view of the state-licensure requirements - both pharmacies and pharmacists must be licensed by the state to provide pharmacy services including medical equipment and supplies.

Section 3109 of the recently enacted healthcare reform law, the "Affordable Care Act" ("ACA") did establish a *conditional* set of criteria that would allow pharmacies that have been Medicare suppliers for 5 years or more and sell less that 5% DMEPOS to have the conditional exemption. Although NACDS is supportive of the conditional exemption as it provided some relief for pharmacies, we recognize that the negative impact on certain pharmacies remains. A significant number must still be accredited, e.g. new pharmacies and pharmacies with 5 years or less enrollment as a DMEPOS supplier and those that sell as little as 6% DMEPOS. As such these pharmacies face the economic choice of the costs of accreditation or foregoing providing DMEPOS to their patients.

Medicare Provider Enrollment, Chain and Ownership system (PECOS)

In 2009, the Centers for Medicare and Medicaid (CMS) announced the first phase of the requirement for the provider that orders or refers Medicare Part B items for a patient to have a current enrollment record in the Provider Enrollment, Chain and Ownership System (PECOS). If the provider did not have an enrollment record, the pharmacy that supplied the medical equipment or supplies to the patient would receive a message indicating the provider was not enrolled.

The unfortunate consequence for pharmacies is that they have no control over whether a provider is enrolled in PECOS and no ability to require them to be enrolled. As a result pharmacies who want to assure that their patients receive their ordered medical equipment and supplies face the difficult choice of denying patients their needed healthcare items or providing them and being at risk for no payment.

We are appreciative of recent actions by CMS to address the issue of a number of providers not being enrolled in PECOS and to not implement the second phase of the PECOS enrollment requirement. Phase two would have automatically rejected and denied payment to pharmacies for Part B claims. CMS had planned to start automatically rejecting payment of the supplier's Part B claims beginning January 3, 2011 if the provider did not have a current PECOS record. ACA contained a provision to implement this requirement on July 1, 2010 and CMS regulations set the requirement date of July 6, 2010. However, CMS has indicated that they will not implement phase two until a later time yet to be determined.

DMEPOS Competitive Bidding
On January 1, 2011, CMS implemented a Competitive Bidding Program (CBP) for Durable Medical Equipment and Supplies, including diabetes testing supplies (DTS) purchased through mail order. This initial round of the CBP is limited to 9 competitive bidding areas (CBAs) around the country and is planned to eventually become a nationwide program. As the most readily accessible health care providers, community pharmacies and pharmacists are uniquely positioned to assist Medicare beneficiaries with their DTS needs, their questions, and to assist them with the proper use of these items and supplies. CMS has thus far excluded retail pharmacies from Round 1 and future rounds of the CBP.

NACDS has urged that DTS obtained at retail community pharmacies should continue to be excluded from future rounds of the CBP as diabetic patients rely heavily on their local pharmacies for their prescription medications, including insulin. Limiting access to DTS at community pharmacies would fragment care, thereby increasing patient confusion and disrupting therapy, all of which can increase overall program costs. In addition to furnishing supplies, one-on-one patient consultations provided by local pharmacists are often the first opportunity to identify other chronic illnesses and changes in patients' conditions, and these consultations often result in early detection, referral, and treatment. Continued participation of community retail pharmacies in serving Medicare patients with diabetic supplies and medication should therefore be a priority of the Medicare program.

Thank you again for the opportunity to provide you with this information. We look forward to partnering with you in the 112th Congress on issues impacting chain pharmacy.

Sincerely,

Steve Anderson, IOM, CAE
President and CEO
National Association of Chain Drug Stores

Jay Timmons
Executive Vice President

January 7, 2011

The Honorable Darrell Issa
Chairman
Committee on Oversight & Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Issa:

On behalf of the National Association of Manufacturers (NAM), the largest manufacturing association in the United States, thank you for the opportunity to identify proposed or existing regulations that are negatively impacting jobs, the economy and our economic competitiveness. This list is not exhaustive but represents high priority regulations that will have a significant impact on our ability to compete globally and create jobs. We look forward to a continuing dialogue on the impact of regulation on manufacturing.

In your letter, you cite the statistics from the Small Business Administration's (SBA) Office of Advocacy analyzing the impact of regulatory costs on small firms. The study represents the best research available to identify the disproportionate burden placed on small business by regulation and the even more disproportionate burden placed on small manufacturers. Manufacturers bear the heaviest burden from environmental regulation, while facing similar or more stringent regulations in workplace safety, health, transportation, financial, trade, tax administration, homeland security and export controls. A study by the Manufacturing Institute and MAPI indicates that structural costs imposed on U.S. manufacturers including regulation create a 17.6% cost disadvantage when compared with nine major industrialized countries. For these reasons the NAM developed a strategy to enhance American manufacturing.

The NAM published its "Manufacturing Strategy for Jobs and a Competitive America" in June 2010. In that Strategy, we identified three overarching objectives: 1) to be the best country in the world to headquarter a company; 2) to be the best country in the world to do the bulk of a company's research and development; and 3) to be a great place to manufacture goods and export products. Comprehensive action is needed to counter the impact of unnecessarily costly regulation to achieve these objectives. We look forward to partnering with your committee, Congress and the Executive Branch to reform the regulatory policies outlined below, additional existing regulations and the regulatory process to produce a more thoughtful regulatory environment that encourages rather than discourages job creation in the United States.

While working on a larger reform agenda, immediate action and attention is needed on the following areas of regulatory policy this Administration is in the midst of proposing or implementing. If they are not substantially changed from their present form, they could cost millions of jobs and weaken an economy in a still fragile recovery.

EPA Regulation of Greenhouse Gas Emissions

On January 2, 2011, the EPA began regulating greenhouse gas (GHG) emissions from stationary sources under the Clean Air Act. While only the largest facilities will be regulated at first, this action sets the stage for future regulation of much smaller sources. Manufacturers are also concerned that states are unprepared for the new permitting requirements, which will cause significant delays. This permitting gridlock will discourage manufacturers from building new facilities or expanding their current facilities, hurting competitiveness and discouraging job creation. Furthermore, additional facilities – including hospitals, agricultural establishments and even the smallest businesses – will be phased in to the onerous permitting requirements in the near future.

EPA Boiler MACT

The Environmental Protection Agency (EPA) has proposed a rule that would establish more stringent emissions standards on industrial and commercial boilers and process heaters (i.e. Boiler MACT). This broad-reaching proposal could cost manufacturers over $20 billion in compliance costs and place hundreds of thousands of jobs in jeopardy. Furthermore, the NAM expressed concerns to the EPA that the proposed standards could almost never be achieved by any single, real-world source. In December 2010, the EPA asked the federal District Court for the District of Columbia for an extension to re-propose the rule, take industry comments and then finalize the package by April 2012. We welcome the additional time for a review, but the new proposal must ensure that the standards are economically feasible and achievable in practice for manufacturers.

EPA NAAQS for Ozone

The EPA in January 2010 issued a reconsideration of the National Ambient Air Quality Standards (NAAQS) for ground-level ozone. Despite continued improvement in the nation's air quality, the EPA has proposed to tighten the standard from the existing 75 parts per billion (ppb) to a range between 70 ppb and 60 ppb. The NAM's overriding concern with the proposal is that the high compliance costs associated with the more stringent ozone standard will hinder manufacturers' ability to add jobs and hurt our global competitiveness. One study estimated 60 ppb would result in the loss of 7.3 million jobs by 2020 and add $1 trillion in new regulatory costs per year between 2020 and 2030. The Agency has delayed finalizing the rule until July 2012 to allow for continued analysis of the epidemiological and clinical studies used to recommend the ozone standard.

SEC/CFTC Derivatives Regulation

As end-users of over-the-counter (OTC) derivatives to manage risk, manufacturers in the United States have a strong interest in the implementation of the new rules on OTC derivatives in the Dodd-Frank Act. In drafting these regulations, we urge the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to avoid any new regulations on derivatives that inadvertently harm economic growth. In particular, it is crucial that new regulations on derivatives include a strong and workable exemption for end-users, like manufacturers, that use derivatives to hedge commercial risk. In contrast, rules that impose margin requirements on manufacturers or that impose financial regulation (such as a swap dealer or major swap participant) on non-financial businesses, could seriously harm the

recovery by diverting companies' financial resources from much-needed business investment and job retention and creation. Similarly, regulations that make hedging too expensive will place manufacturers in the uncomfortable position of either having to divert additional money away from production or discontinue hedging business risk, which would require liabilities to reappear on corporate balance sheets, driving up the cost of capital.

OSHA On-Site Consultation

There has been a significant shift by the Occupational Safety and Health Administration (OSHA) from a more collaborative posture to a more adversarial approach toward business. Employers, particularly small businesses, should be able to consult with OSHA and receive its assistance to better understand and comply with existing workplace safety standards to enhance the safety of their workplaces without fear of citations and fines. Recently, OSHA proposed a rule that would subject small businesses to enforcement based on their voluntary participation in these programs. As a result, businesses will be more reticent to reach out to OSHA for help and less likely to participate in this program. We are troubled that OSHA performed no analysis to determine the impact of the proposed changes on small business participation in the On-Site Consultation Program. Instead of deterring participation in these effective programs, OSHA should focus on developing incentives and strategies that will encourage as many employers as possible to participate in these programs.

OSHA Noise Proposal

OSHA recently indicated that it plans to enforce noise level standards in a dramatically different way by redefining what is deemed "feasible" for employers to reduce overall noise in the workplace and requiring implementation of these actions unless an employer can prove making such changes will put it out of business. OSHA's proposal would alter a long-running and effective policy that allows employers to provide "personal protective equipment," such as ear plugs and ear muffs, if they are more cost-effective than engineering controls like noise-dampening equipment and muffling systems in order to protect their employees from high noise levels. Such changes would need to be made by employers of all sizes, regardless of their costs. We are concerned that preliminary estimates by manufacturers demonstrate that total compliance costs for fully implementing this proposal may reach billions of dollars. We are troubled that OSHA is pursuing this change outside the formal rulemaking process and, as such, is not following the Administrative Procedures Act that provides opportunity for full and fair public input and requires sensitivity to small entities.

OSHA Injury and Illness Protection Program

OSHA is also developing a new regulation that would mandate a standard for employers' safety and health programs, referred to as an Injury and Illness Prevention Program (I2P2). Such a concept is expected to be proposed in the spring of 2011 and would have sweeping ramifications on all aspects of both workplace safety enforcement and the promulgation of new regulations. We are concerned that this new proposal from the Agency may not take into account the efforts by employers who already have effective safety and health programs in place or how this new mandate would disrupt safety programs that have measurable successes. Based on preliminary information from the Agency, this proposal may allow OSHA investigators to substitute their judgment of the employer's plan on how to achieve compliance and whether some "injury" in the workplace should have been addressed in some way even if it was not

regulated under a specific standard, or did not amount to a "significant risk" as required under the OSH Act.

Commerce/State/Defense Export Control Regulations

U.S. export control regulations have not been significantly revised since the Cold War. The result is a system that no longer fully protects our national security, has not kept up with accelerating technological change and does not function with the efficiency and transparency needed to keep the United States competitive in the global marketplace. The current regulations are eroding America's global technology leadership, harming the defense industrial base and costing U.S. jobs. Recent studies by the National Academies of Science and the Defense Science Board have concluded that the current export control regulations and system are a threat to national security. The Milken Institute estimates that if the export control regulations are modernized, U.S. high-tech exports could increase by $60 billion, resulting in 350,000 new jobs. Modernization will enhance the government's ability to protect national security interests while removing the burdens and disadvantages placed on U.S. high-technology manufacturers. The government should thoroughly modernize export controls to strengthen the industrial base, enhance national security and improve economic competitiveness. In this area, we applaud the Obama Administration for the steps it has taken thus far to modernize the export control system, but more is needed to improve the system in 2011 to protect manufacturing jobs.

DOT Transportation of Lithium Batteries Rulemaking

The Department of Transportation's (DOT) Pipeline and Hazardous Materials Safety Administration (PHMSA) proposed new shipping and handling requirements for the transportation of lithium ion and lithium metal batteries in January 2010. The rule mandates changes in the way lithium batteries and cells and products containing these batteries are transported in passenger and cargo aircraft. Of note, the PHMSA rejected all requests for extensions of the comment period and has severely limited industry input and technical discussions in what is an extremely complicated proposal that creates serious inconsistencies between international and U.S. aviation regulations. The proposed rule impacts a variety of products and manufactured goods ranging from everyday consumer items to implantable medical devices. Billions of lithium batteries and products containing them are shipped annually by air without incident. The costs of the current proposal are conservatively estimated at a billion dollars annually. If implemented as currently written, manufacturers will face reductions in existing air freight capacity, new costs associated with massive supply chain redesigns, additional training costs, inefficiencies that could cause confusion with international partners who adhere to alternate standards and lost business to foreign companies who are not subject to these proposed rules. Manufacturers strongly support a rule that instead achieves harmonization with internationally agreed-upon requirements for lithium battery transport.

DOT Hours of Service Rulemaking

The DOT's Federal Motor Carrier Safety Administration (FMCSA) has announced changes to the trucking hours of service rules first implemented in 2004. It has proposed to reduce well-established 11-hour driving and 14-hour on-duty times for truckers and to introduce new rest mandates. Over the past six years, driver and motor carrier safety performance has improved, and truck-involved fatalities and injuries have markedly declined. For manufacturers and those dependent on a healthy manufacturing economy, changes to the rule will have major

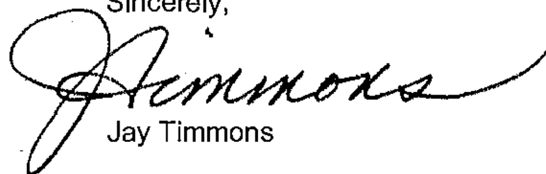
impacts on distribution patterns, supply chains, just-in-time delivery standards, trucking capacity and ultimately will add operational costs to be borne by shippers and motor carriers. In 2005, the American Trucking Association estimated that reducing the driving time by one hour and eliminating the 34-hour restart provision would cost over $2 billion to impacted industries. While the DOT is adhering to the terms of a 2009 court negotiated settlement reached with Public Citizen by reviewing and reconsidering the 2008 Final Rule on Hours of Service, the Department is not obligated to alter the rule. The Department's recent public commentary on poor truck driver health and longevity is drawing some concern because the scientific data to justify a change in the current rule is not strong. Approximately 80 percent of the nation's freight by value moves by truck.

CPSC Product Safety Information Database

In 2008, Congress passed and the President signed the Consumer Product Safety Improvement Act (CPSIA), which, among other provisions, directed the Consumer Product Safety Commission (CPSC) to produce a product safety database that would provide consumers with a meaningful tool to research product safety information that is accurate and includes first-hand accounts of consumers and public safety entities. There was significant debate in Congress on the appropriate types of reporters to include in the database. The final CPSC rule, however, recognizes that Congress provided an exhaustive list of reporters but strains credulity by expanding the definitions of consumers and public safety entities beyond their clear public meaning and the intent of the drafters of the legislation. It redefined the terms "consumer" to include trial attorneys and public safety entities to include "consumer advocacy organizations." As a result, the database will be filled with bogus reports inspired by political or financial motives rather than safety. Congress also struck an appropriate balance between the speed of publication of reports and the desire for accuracy as well as the protection of confidential business information. The final rule provided for no such balance and creates a default for immediate publication before any meritorious claims regarding trade secrets or material inaccuracy are resolved. Once a trade secret is posted within a report, for example, no remedy is available to undo the damage. These claims as well as claims of inaccuracy, impossibility, or product misidentification must be resolved before the information is made public if the database is to provide helpful information to the public.

We look forward to continuing a dialogue with you and your committee about regulation and regulatory policy. In future communications, we will outline additional regulations in need of reform and recommend options for reforming the regulatory process. Together we can help make the United States the best place in the world to do business and create jobs. But a very different approach to regulation will be necessary to accomplish this important objective.

Sincerely,



Jay Timmons

JT/rp

NATIONAL AUTOMOBILE DEALERS ASSOCIATION
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January 5, 2011

The Honorable Darrell E. Issa
Chairman
Committee on Oversight and Government Reform
United States House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Dear Chairman Issa:

On behalf of the approximately 16,000 franchised new car and truck dealer members of NADA, thank you for your letter of December 10, 2010 regarding the proliferation in recent years of regulations that negatively impact the economy and jobs. Because the vast majority of our members are small businesses, over-regulation has been a primary concern of dealers for some time, and we very much appreciate your leadership in this important area.

Auto retailing is one of the most highly regulated sectors of our economy. To demonstrate just how extensive the hand of government has become, I have enclosed the 2010 version of a publication that NADA prepares each year for its membership entitled the "Regulatory Maze." This document analyzes every department of the typical auto dealership, listing for each the major Federal regulations that govern its operation. As you will see, the extent of regulation has become truly staggering – at least 20 Federal departments and agencies through over 150 separate rules now regulate dealership operations. And this inventories only Federal regulations; it does not attempt to catalogue the vast array of state and local laws and rules with which dealers must also comply.

To be sure, most of the regulations that impact dealers are intended to serve useful purposes. However, many are unnecessary, duplicative, or overreaching, and our members constantly are confronted with the unintended – and adverse – consequences they produce. Even more important, the cumulative effect of these regulations is to increase substantially the dealers' costs of operations and exposure to liability without a commensurate benefit to the public. With these increased costs and exposure, the dealers' ability to grow their businesses and expand their workforces is significantly impaired. This is particularly problematic in light of the fact that most of our members are small businesses that lack the scale that larger enterprises have to address such regulatory mandates. Thus, in practice, the regulations impose a shadow cost structure that presents an ongoing impediment to the nation's economic vitality.

Your letter asks us to identify specific existing or proposed regulations that have negatively impacted job growth in the auto retailing sector or threaten to do so in the future. We accordingly bring to your attention the following examples of rules that impose costs and burdens with little or no commensurate benefit:

1. Fuel Economy/Greenhouse Gas (GHG) Rules. The joint NHTSA/EPA Model Year 2012-2016 fuel economy/GHG rules for light-duty vehicles we believe exceed Congressional mandates and involve duplicative agency involvement (both NHTSA and EPA) where one rule (NHTSA's) would provide a superior public policy outcome. These joint rules, which will cost an estimated $50 billion, were conceived behind closed doors as part of a so-called "historic national agreement" and will force manufacturers to build vehicles whether or not there is public demand for them. To add further economic uncertainty to the still-recovering auto industry, the Administration recently issued a Notice of Intent to raise the fuel economy/GHG rules up to 62 mpg by 2025, even though the recently adopted MY 2012-2016 rulemaking has yet to be implemented.

Moreover, when EPA reversed its prior decision and granted California a Clean Air Act pre-emption waiver as part of the "historic national agreement," the agency opened the door to forcing the auto industry to deal with a patchwork of state regulations. And now the California Air Resources Board (CARB) is expected to ask for – and EPA likely will grant – another waiver for California's next fuel economy/GHG rulemaking as early as this year. This next regulation will be a job killer since as many as 14 other states have adopted California's regulation, and CARB does not consider job loss outside of California when drafting its rules.

With the enactment of Energy Independence and Security Act (EISA) in 2007, the fuel economy debate ceased being focused on stringency and is now largely about structure. NADA has long supported fuel efficiency improvements and believes that full implementation of EISA would provide better fuel economy/GHG reduction benefits without undermining the recovery. We would welcome the opportunity to work with your committee to document the need to pursue economically feasible, consumer-oriented fuel economy/GHG improvements based on NHTSA's existing statutory authority.

2. Identity Theft and Related Consumer Credit Rules. The Fair and Accurate Credit Transactions Act of 2003 imposed a series of requirements to help prevent identity theft and educate consumers about the impact of credit reports on credit decisions. Some of the requirements, such as the need to truncate credit and debit card numbers on customer receipts, provide meaningful protections to consumers while imposing minimal compliance costs on retailers. Many of the others, however, have the opposite effect. We highlight two examples:

a. The 2008 Red Flags Rule requires dealers, who already have a compelling business incentive to prevent identity theft, to erect unduly burdensome Identity Theft Prevention Programs that require (i) risk assessments, (ii) developing processes to identify, detect, and respond to identity theft indicators, (iii) ongoing training and oversight of employees and service providers, and (iv) extensive reporting. Because of dealers' limited in-house resources, many have been forced to incur considerable costs to secure compliance assistance from attorneys, accountants, and other professionals.

b. The 2011 Risk-Based Pricing Rule requires the overwhelming majority of dealers, who do not engage in risk-based pricing, to issue either a Risk-Based Pricing Notice to an ill-defined subset of their credit customers or an alternative Credit Score Disclosure Exception Notice to all of their consumer credit applicants. Issuing a Risk-Based Pricing Notice is not a viable compliance option. Consequently, many dealers will be compelled to purchase a credit score for each consumer credit applicant, at the cost of potentially tens of thousands of dollars per year, solely to meet the compliance expectations of the agencies that issued this requirement.

3. Cargo Capacity Labeling Rule. A NHTSA rule which requires manufacturers to place a cargo capacity label on new light-duty vehicles also requires dealers to redo the label whenever even *de minimis* changes (that is, changes that increase a vehicle's weight by the lesser of 1.5% of GVWR or 100 lbs.) are made to the vehicle. With few exceptions, motorists cannot and do not weigh passengers and cargo before loading vehicles. Since the label does little if anything to increase safety, it is of limited or no utility.

4. E-15 Ethanol Fuel Rule. EPA has proposed a rule which would allow for the marketing of gasoline with a 15 percent ethanol content. This content level is in excess of manufacturer design specifications and could dramatically impair vehicle and emissions performance and even damage the vehicle itself. Auto retailers will be forced to bear the brunt of the significant increase in motorist dissatisfaction that could result.

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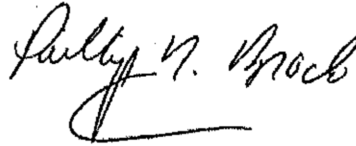
Auto and truck dealers are economic engines that power local communities all across the country. In fact, in many towns and cities, dealers are the largest private employers. But the growth of excessive and often unneeded Federal regulation represents a true impediment to the dealers' ability to continue in this capacity.

We trust the information we have provided will be helpful and ask that your staff contact Michael Harrington at (202) 547-5500 or mharrington@nada.org if you have any

questions. In addition, as we uncover other specific examples of regulatory excesses, we will continue to advise you and your staff. Thank you for your consideration.

Very truly yours,



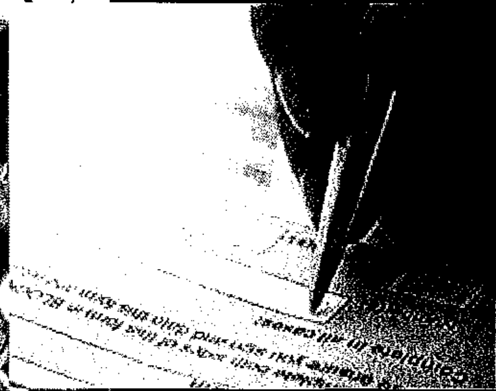
Phillip D. Brady
President

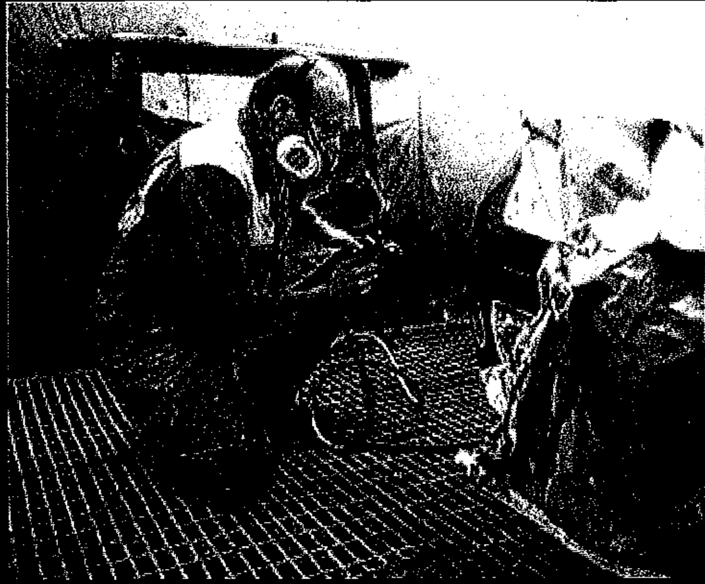
Enclosure

cc: The Honorable Elijah Cummings, Ranking Member, Committee on Oversight and Government Reform
The Honorable Edolphus Towns
The Honorable Jim Jordan

THE REGULATORY MAZE

NADA's Annual Update on Federal Regulations





Service and Parts Department
- Clean Air Act
- Clean Water Act
- DOT hazardous-materials-handling procedures
- IRS Core Inventory Valuation
- LIFO/FIFO Inventory Accounting Method
- NHTSA tampering regulations
- NHTSA tire rules
- OSHA asbestos standards
- OSHA Hazard Communication Standard
- OSHA lock-out/tag-out procedures
- OSHA workplace health and safety standards
- RCRA
- Safe Drinking Water Act
- Superfund
- UNICAP

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- CAN-SPAM Act
- Driver's Privacy Protection Act
- FTC Privacy Rule
- FTC prohibition against deceptive and unfair trade practices
- FTC Safeguards Rule
- FTC Telemarketing Sales Rule
- FTC Written Warranty Rule
- IRS cash-reporting rule
- Magnusson-Moss Act
- OFAC restrictions
- Telephone Consumer Protection Act
- USA PATRIOT Act

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- COBRA
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- Electronic records retention
- Emergency-response planning
- Employee drug testing
- Employee Polygraph Protection Act
- ERISA
- Employee verification
- Equal Pay Act
- Estate tax
- Family and Medical Leave Act
- Federal child-support enforcement regs
- Federal Civil Rights Act
- FTC Repossession Rule
- Federal wage-hour and child labor laws
- Genetic Information nondiscrimination
- Health Insurance Portability and Accountability Act
- IRS treatment of car shuttlers
- IRS treatment of demo vehicles
- IRS treatment of tool plans
- Mandatory workplace posters
- Mental Health Parity Act
- Miscellaneous record-keeping requirements
- Newborns' and Mothers' Health Protection Act
- OSHA blood-borne pathogens rule
- SBA Loan Guarantee programs
- Section 89 of the Tax Reform Act
- Section 179 Expensing
- USERRA
- WARN

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Body Shop
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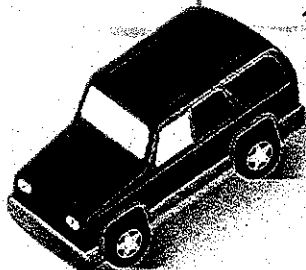
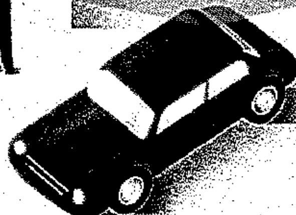
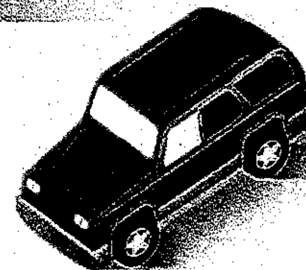
- Fair Credit Reporting Act
- FACT Act
- FTC Credit Practices Rule
- Gramm-Leach-Bliley Act
- Producer-Owned Reinsurance Companies
- Truth in Lending and Consumer Leasing acts







THE REGULATORY MAZE

Our annual update on major federal regulations; state laws also apply and sometimes include additional requirements

In addition to this guide to laws and regulations, be sure to consult the *NADA & ATD Federal Regulatory Compliance Chart Second Edition*, available at www.nada.org/regulations (requires member access). It lists federal laws and regulations by agency, notes to whom they apply, and offers Web addresses for further information.

All Departments (General Management/Personnel)

■ **Age Discrimination in Employment Act:** Protects older individuals against age-based employment discrimination.

■ **Americans With Disabilities Act (ADA):** Businesses with 15 or more employees must reasonably accommodate disabled workers and job applicants.

■ **Consolidated Omnibus Budget Reconciliation Act (COBRA):** Requires employers with 20 or more employees to continue health-care coverage for ex-employees and their families for 18 to 36 months, depending on circumstances.

■ **Electronic deposit of taxes:** All employers having more than $200,000 in aggregate depository taxes must deposit through the Electronic Federal Tax Payment System.

■ **Electronic records retention:** Revenue Procedure 98-25 explains the IRS requirements for retaining computerized accountiug records.

■ **Emergency-response planning:** Federal, state, and local laws require dealers to have emergency-response plans.

■ **Employee drug testing:** Unionized dealerships must bargain with unions before implementing employer drug policies. Not uecessary for preemployment dmg testing. The ADA prohibits employers from discriminating against employees or applicants who have completed a drug treatment program or are currently undergoing such a program, as long as they aren't currently abusing drugs.

■ **Employee Polygraph Protection Act:** Prohibits employers from using polygraphs in preemployment screening; allows polygraph use only in limited cases where an employee is reasonably suspected of a workplace incident involving economic loss to the employer.

■ **Employee Retirement Income Security Act (ERISA):** Dealers offering retirement or health plans must, among other things, provide employees with plan info, keep records, abide by fiduciary responsibilities, and set up a grievance process.

■ **Employee Verification Rules:** Must verify the employment eligibility of prospective new employees using I-9 form and E-verify.

■ **Equal Pay Act:** Prohibits wage discrimination on the basis of sex.

■ **Estate tax:** The 2010 status of the Estate Tax is unsettled. The Estate Tax is set to expire in 2010, but efforts are underway in Congress to extend the tax.

■ **Family and Medical Leave Act:** Must post a notice informing employees of their right to take this limited, unpaid leave for personal and family medical emergencies and must comply with appropriate requests for such leave. New provisions apply to leave related to military service.

■ **Federal child-support enforcement regs:** Requires states to have procedures under which liens can be put on personal property—including vehicles—for overdue child support. Dealers should check that child-support liens don't exist on used cars, and must place liens on wages of employees who are delinquent on child-support payments.

■ **Federal Civil Rights Act:** Bars employment discrimination on the basis of race, sex, color, religion, or national origin. Prevents employers from asking job applicants certain questions (such as age, marital status, or childbearing plans). Prohibits workplace sexual harassment, including behavior that creates a hostile work environment.

■ **FTC's Repossession Rule:** Requires formal accounting of money collected for repossessed vehicles.

■ **Federal wage-hour and child labor laws:** Minimum wage and overtime pay standards; exemptions for employees from minimum wage and overtime requirements, and standards for employing minors, including teen driving restrictions. The federal minimum wage is now $7.25 per hour, but state minimum wage rates may be higher.

■ **Genetic Information Nondiscrimination:** Prohibits discrimination based on DNA information that may affect an employee's health.

■ **Health Insurance Portability and Accountability Act:** Generally prohibits health insurers from denying coverage to workers who lose or change jobs and bars insurers from excluding coverage for preexisting conditions for more than a year.

■ **IRS treatment of car shuttlers:** Although nnder general IRS rules, shuttlers may be considered employees, versus independent contractors, the IRS may consider prevailing industry practices on a case-by-case basis. The agency may ask, for example, how many days a week an individual works at a dealership and whether he or she works for any other dealership.

■ **IRS treatment of demo vehicles:** Revenue Procedure 2001-56 offers dealers alternative methods for determining the value of demo use by qualified salespeople and other dealership employees. It defines what constitutes limited personal use and streamlines record-keeping requirements.

■ **IRS treatment of tool plans:** Tool and equipment plans for service technicians and other employees must comply with the IRS's business connection, substantiation, and return of excess payment requirements.

■ **Mandatory workplace posters:** Notices, such as "Your Rights Under the FMLA", "Equal Employment Opportunity Is the Law," "Federal Minimum Wage," and "Notice: Employee Polygraph Protection Act," must be conspicuously displayed.

■ **Mental Health Parity Act:** Requires insurers and employers to offer mental illness coverage comparable to that for physical illness. Group health plans may not set dollar limits on mental health care lower than limits for general medical and surgical services. Nothing requires employers to provide mental health coverage, and certain exemptions apply.

■ **Miscellaneous record-keeping requirements:** A multitude of requirements govern the length of time records must be maintained. Examples: Personal and corporate income tax records must be kept at least three years; notification forms for underground storage tanks must be kept indefinitely; and copies of Form 8300 cash reports must be kept for five years.

■ **Newborns' and Mothers' Health Protection Act:** Employers and insurers must provide minimum hospital-stay benefits.

■ **OSHA Blood-borne Pathogens Rule:** Dealerships not within four minutes of an emergency health facility must have a program to respond to employees who suffer cuts. All dealerships should have proper first-aid kits.

■ **SBA loan guarantee programs:** Small business dealers seeking working capital, floorplan, or real estate financing may be eligible for federal loan guarantees on loans up to $2 million.

■ **Section 89 of the Tax Reform Act:** Employers are prohibited from discriminating against lower-paid employees in their employee benefits packages.

■ **Section 179 Expensing:** The 2009 Stimulus bill (PL 111-5) extended enhanced Small Business Expensing under Sec. 179 of the tax code through the 2009 tax year (ending Dec. 31, 2009). The package doubled the amount businesses could immediately, or in the first year, write-off their taxes for capitol investment in 2009 from $125,000 to $250,000 for purchases of new, qualifying equipment of up to $800,000 (increased from $500,000).

The law also includes an accelerated Bonus Depreciation provision. For 2009, companies could also write-off an additional 50 percent of new investment expenditures for items subject, under current law, to depreciation over 20 year or less. The remaining value of the investments would be depreciated over the life of the item.

In addition, the depreciation limitation on the amount of certain passenger automobiles (Sec.280F) is increased from $2,690 to $10,690 in the first year.

■ **Uniformed Services Employment and Reemployment Rights Act (USERRA):** Governs the employment and reemployment rights of members of the U.S. uniformed services.

■ **Worker Adjustment and Retraining Notification Act (WARN):** Reqnires dealers to give 60 days' notice to workers prior to termination or store closings under certain circumstances.

All Departments (Customer)

■ **Americans With Disabilities Act (ADA):** Prohibits discrimination against the physically handicapped in areas of public accommodation. Must make reasonable accommodations to make facilities accessible—for example, installing ramps, and accessible parking lots, drinking fountains, public toilets, and doors.

■ **CAN-SPAM (Controlling the Assault of Non-Solicited Pornography and Marketing) Act:** E-mailers must identify a commercial message as an advertisement or solicitation and provide their postal addresses and a mechanism to opt out of future commercial e-mails. If recipients opt out, senders must stop sending them commercial e-mail within 10 business days. The disclosure requirements don't apply to e-mails that relate to transactions or relationships, such as for warranty or recall-repair issues or the completion of transactions requested by the consumer. No one may send commercial e-mails to wireless devices unless recipients provide express prior authorization to receive them. So that senders can recognize wireless addresses, the FCC maintains a list of wireless domain names at www.fcc.gov/cgb/policy/DomainNameDownload.html. Commercial e-mailers must check the list monthly. (Additional provisions prohibit deceptive headers, misleading subject lines, and other spam tactics.)

A text message may also be considered an email and therefore subject to the CAN SPAM Act if it is sent to an email address – that is, if it has an internet domain

name after the "@" symbol (whether the email address is displayed or not). This means that NO commercial text message (deemed to be an email) may be sent to a wireless device without "express prior authorization." Merely having an "established business relationship" with the recipient is not enough.

■ **Driver's Privacy Protection Act:** Denies access to personal info in state motor vehicle records except for limited purposes, such as driver safety, theft, and recalls. Also restricts the release of personal info for marketing.

■ **FTC Privacy Rule:** Dealers must issue notices of their privacy policies to their finance and lease customers and, in some circumstances, when the dealer discloses nonpublic information about consumers to third parties. Also restricts disclosures of nonpublic personal information. Beginning December 31, 2009, dealers who correctly use a new FTC model privacy notice will have safe harbor protection for the language used to describe their privacy policy. Although the use of the new model notice is voluntary, dealers whose privacy notices continue to use sample language from the appendix to the 2001 privacy rule will lose safe harbor protection for the use of that language after December 31, 2010.

■ **FTC prohibition against deceptive and unfair trade practices:** Prohibits deceptive or unfair practices. For example, merchants must disclose to would-be buyers previous material damage. More than half the states specify a dollar amount or formula for determining how much damage must have occurred to a new vehicle before disclosure is required.

■ **FTC Safeguards Rule:** Dealers must develop, implement, and maintain—and regularly audit—a comprehensive, written security program to protect customer information.

■ **FTC Telemarketing Sales Rule (TSR):** Imposes many of the TCPA restrictions (below) on dealers who telemarket across state lines. Requires dealers who sell, or obtain payment authorization for, goods or services during interstate phone calls to abide by the prohibition against numerous deceptive and abusive acts and to maintain certain records for 24 months. A recent amendment to the rule prohibits prerecorded telemarketing calls without a consumer's express written agreement, requires such calls to provide a keypress or voice activated opt-out mechanism at the outset of the calls, and requires the calls to ring for 15 seconds or 4 rings before disconnecting.

■ **FTC Written Warranty Rule:** Dealers must display warranties near products or post signs in prominent places telling consumers that copies of the warranties are available for review.

■ **IRS Cash-reporting Rule:** Dealers receiving more than $10,000 in cash in one transaction or in two or more related transactions must file IRS/FinCEN Form 8300 with the IRS within 15 calendar days and must provide written notice that the report was filed to the person named on the report by January 31 of the following year. "Cash" includes certain cashier's checks, traveler's checks, money orders, and bank drafts.

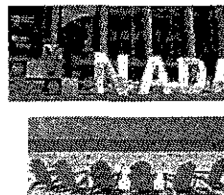
■ **Magnusson-Moss Act:** Dealers must give consumers certain required information on warranties and limited warranties.

■ **Office of Foreign Assets Control (OFAC) restrictions:** Dealers may not enter into transactions with certain sanctioned countries, governments, and specially designated organizations and individuals, including those appearing on an electronic list maintained by OFAC.

■ **Telephone Consumer Protection Act (TCPA):** Imposes numerous restrictions on telemarketing, including the national and company-specific do-not-call rules, calling-time restrictions, caller ID requirements, fax advertising rules, and restrictions on the use of autodialers and prerecorded messages. Fax ads must only be sent to authorized recipients and must include a phone number, fax number, and toll-free opt-out mechanism (each available 24/7) on the first page of the fax ad.

The FCC considers text messages to be "phone calls" under the TCPA. This means that you cannot send a text message "solicitation" to a phone number that is on your dealership company-specific "do not call" ("DNC") list; you cannot send a text message "solicitation" to a phone number that is on the national DNC list (subject to the "established business relationship" and other provisions of the national DNC rules), and; you cannot send any text message whatsoever to a cellular telephone number – solicitation or not, whether the number is on a DNC list or not - using an "automated dialer system" unless you have the called consumer's "prior express consent."

■ **USA PATRIOT Act:** Dealers must search their records and provide information about individuals or entities identified by the federal Financial Crimes Enforcement Network with whom they conducted transactions or created accounts. Dealers are temporarily exempt from the law's anti-money-laundering program requirements.



Get to Know Your Business Partner –

The Federal Government

- Have you heard about the new Risk-Based Pricing Notice requirement? What about the new model privacy notice? Is your Identity Theft Prevention Program fully compliant? Find out what's required from an FTC attorney at the Federal Agency Outreach Pavilion.
- Are you aware of the September 2009 IRS field directive on UNICAP audits? How about the IRS's recent private letter ruling on tool plans and its Chief Counsel Advice on LIFO? Visit the IRS Motor Vehicle Technical Advisor.
- Are your painters trained on EPA's new body shop rule? EPA has the solution.
- Need the latest on vehicle safety and emissions? NHTSA and EPA have the info for you.
- Are your employees trained to properly handle hazmat? See CCAR experts about this program.
- Want to reduce energy use and save cash? EPA's Energy Star program has the tools.
- Interested in an SBA guaranteed loan? SBA experts will be on hand to advise.

This is YOUR OPPORTUNITY to ASK QUESTIONS, PROVIDE FEEDBACK, and OBTAIN COMPLIANCE ASSISTANCE.

Visit NADA's

Federal Agency Outreach Pavilion

at the NADA Convention in Orlando

Booth #2013

New- and Used-Vehicle Sales Departments

■ **American Automobile Labeling Act:** New cars and light trucks must have a domestic-parts content label showing percentage of U.S. or Canadian parts; countries contributing more than 15 percent of the parts; origin of engine and transmission; and location of vehicle assembly. Dealers must ensure that labels remain on vehicles until sold.

■ **DOE/EPA gas-mileage guide:** Dealers must make this guide available to prospective new-vehicle buyers. May download the guide from www.fueleconomy.gov and may also download a fact sheet, *8 Simple Steps to Lower Fuel Costs*, from www.nada.org.

■ **EPA emissions certification:** Dealers must provide a form to new-vehicle customers certifying the vehicle's compliance with emissions standards.

■ **Federal bankruptcy law:** A finance company (and the dealership acting on its behalf) should perfect its security interest within 30 days after a customer takes possession of a vehicle, regardless of state law. If the company fails to do so and the customer files for bankruptcy within 90 days of when the financing agreement is signed, the bankruptcy trustee may avoid the lien. Dealerships that fail to perfect a lien in a timely manner on behalf of a finance company may be liable for any loss.

■ **FTC Door-to-door Sales Rule:** Gives consumers a three-day "cooling off" period for sales not consummated at the dealership. Does not apply to vehicle sales at auctions, tent sales, or other temporary places of business if sold by a seller with a permanent place of business.

■ **FTC guidelines for fuel-mileage advertising and alternative-fueled-vehicle advertising and labeling:** Dealer and manufacturer fuel-economy advertisements must state that the numbers are estimates and come from EPA; alternative-fueled vehicles must be properly labeled.

■ **FTC Used Car Rule:** "Buyer's Guide" stickers are required on used vehicle side windows, disclosing make, model, year, VIN, whether vehicle is offered "as is" or with a warranty (and, if so, what kind of warranty), and availability of a service contract. Stickers must warn that all promises should be in writing. For sales in Spanish, the "Buyer's Guide" and required cross-reference in the sales contract must be in Spanish.

■ **Gray-market vehicles:** EPA, Department of Transportation, and Customs restrict the importation/sale of vehicles lacking safety or emissions certification.

■ **IRS treatment of salesperson incentives:** Factory incentives paid directly to salespeople are not wages for tax purposes.

■ **LIFO (Last-In/First-Out) inventory accounting method:** The use of the LIFO inventory method requires compliance with the conformity requirement.

■ **Motor vehicle tax credits:** Buyers of hybrid, fuel-cell, alternative-fuel, and certain clean-burning diesel vehicles qualify for tax credits depending on the vehicle's fuel efficiency (subject to phaseout rules). For sales of vehicles used by tax-exempt entities, the seller is treated as the taxpayer and is able to claim the credit so long as the amount allowable as a credit is clearly disclosed to the user.

■ **Monroney sticker (Price Labeling Law):** Requires dealers to keep stickers on new passenger cars showing the manufacturer's suggested retail price, plus other costs, such as options, federal taxes, and handling and freight charges. Stickers also should show recently revised EPA fuel economy and NHTSA crash-test star ratings. NHTSA also requires dealerships that alter covered vehicles to attach a second label adjacent to the Monroney label, stating, "This vehicle has been altered. The stated star ratings on the safety label may no longer be applicable." The rule does not specify the size or form of this label, only that it be placed as close as possible to Monroney labels on automobiles that (1) have been altered by the dealership and (2) have test results posted.

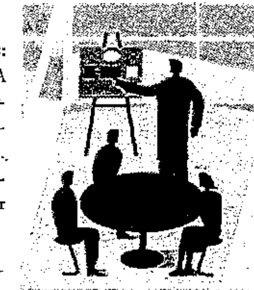
■ **National Highway Traffic Safety Administration (NHTSA) alteration regulation:** Dealers who significantly alter new vehicles must affix a label identifying the alteration and stating that the vehicle still meets federal safety and theft standards. NHTSA tire-placarding and relabeling requirements: FMVSS No. 110 requires a new tire information placard/label whenever parts or equipment are added that arguably reduce a vehicle's cargo-carrying capacity, or when replacement tires differ in size or inflation pressure from those referred to on the original.

■ **NHTSA collision-loss guide:** Dealers must make this guide available to prospective new-vehicle buyers.

■ **NHTSA Odometer Rule:** Prohibits odometer removal or tampering, as well as misrepresenting a vehicle's true odometer reading. It forces recordkeeping to create a "paper trail," and it requires odometer disclosures on state titles. Vehicles with a greater than 16,000-lb. gross vehicle weight rating (GVWR) are exempt from the disclosure requirements, as are vehicles 10 model years old or older.

■ **NHTSA recall regulations:** New vehicles and parts held in dealership inventory that are part of a recall must be brought into compliance before being delivered; dealers may not deliver these products and wait for the new buyers to bring them back to the dealership for repairs.

■ **NHTSA regulations on school bus sales:** Dealers may not sell, lease, or give away large, new passenger vans with more than 10 seating positions if they know the vehicle will be used to transport students to or from school or school activities. Schools must purchase or lease a school bus or multifunction school activity bus for such purposes.



■ **NHTSA safety belt/airbag regulations:** At-risk individuals can apply to NHTSA to have airbag switches installed. Dealerships may install switches for consumers with NHTSA authorization letters. Dealerships must be responsive to consumer requests for rear-seat lap/shoulder safety belt retrofits in older vehicles.

■ **NHTSA tire regulations:** Require proper replacement or modification of the information label when replacing tires or adding weight to vehicle prior to first sale or lease. Also require that consumers be given a registration card when buying new tires. Other rules govern handling and disposal of recalled new and used tires.

■ **Truck excise tax:** A 12 percent excise tax generally applies to the first retail sale of: (1) truck chassis and bodies with a GVWR in excess of 33,000 lb. (Class 8); (2) truck trailer and semitrailer bodies with a GVWR in excess of 26,000 lb. (Class 7 and 8); and (3) "highway tractors," unless they have a GVWR of 19,500 lb. or less (Class 5 and under) *and* a gross combined weight rating of 33,000 lb. or less. Dealers selling Class 5 vehicles with more than 33,000-lb. gross combined weight rating or Classes 6 or 7 vehicles should apply the "primary design" test to determine if a vehicle is a taxable tractor or a nontaxable truck.

■ **Uniform capitalization (UNICAP):** Dealers who (1) "produce" property or (2) acquire it for resale, if their average annual gross receipts over the three preceding tax years exceed $10 million, must comply with the UNICAP requirements contained in Section 263A of the Internal Revenue Code. IRS Field Directive LMSB-4-0909-035 (September 15, 2009) provides IRS field examiners with a UNICAP "audit tool kit" and announces the suspension of new UNICAP audits through December 31, 2010 to allow dealer taxpayers "an opportunity to comply with the legal reasoning outlined in TAM 200736026."

F&I Department

■ **Equal Credit Opportunity Act (ECOA):** Regulation B prohibits discrimination in credit transactions based on race, sex, color, marital status, religion, national origin, age, and public-assistance status. The dealer/creditor is required both to notify applicants in a timely fashion of actions taken on—and reasons for denying—applications, and to retain certain records.

■ **Fair Credit Reporting Act (FCRA):** Dealers are restricted in their use of credit reports for consumers, job applicants, and employees. Consumers' reports generally may be obtained only pursuant to consumers' written instructions or if consumers initiate a business transaction (not if they merely talk with salespeople). Dealers must give job applicants and employees a separate document informing them that a credit report may be obtained and must obtain prior, written authorization to access the report. Dealers may not share credit information with affiliates unless they give consumers notice and the opportunity to opt out. If dealers take adverse action based on the report, they must notify consumers and follow additional procedures with job applicants and employees. Dealers with buy-here/pay-here operations have other responsibilities.

■ **The Fair and Accurate Credit Transactions (FACT) Act of 2003** significantly amended FCRA by adding several identity theft prevention and other duties with differing implementation dates. Duties include requests for records from victims of ID theft; fraud and active-duty alerts on credit reports; disposal requirements for credit report info; opt-out disclosure formatting requirements for prescreened credit solicitations; the Federal Reserve's Regulation FF restrictions on obtaining, using, and shar-

ing "medical information" in credit transactions; the FTC Red Flags Rule, which requires creditors and financial institutions to develop and implement a written Identity Theft Prevention Program that contains procedures to identify, detect, and respond to "red flags" indicating the possibility of identity theft (presently in effect but FTC enforcement delayed until June 1, 2010); the FTC Address Discrepancy Rule, which requires users of credit reports to develop and implement procedures to verify a customer's identity when receiving a "Notice of Address Discrepancy" from a consumer reporting agency; and the FTC Affiliate Marketing Rule, which generally requires a business to offer customers the opportunity to opt out of receiving solicitations from the business's affiliates before affiliates may market to the customers. Beginning January 1, 2011, dealers who obtain credit reports on their credit customers also must comply with the Risk-Based Pricing Rule, which involves a new notice requirement.

■ **FTC Credit Practices Rule:** Dealers are required to provide a written disclosure statement to a cosigner before the cosigner signs an installment sales contract. Dealers cannot "pyramid" late charges (that is, add a late charge onto a payment made in full and on time when the only delinquency was a late charge on a previous installment).

■ **Gramm-Leach-Bliley Act:** See "FTC Privacy Rule" and "FTC Safeguards Rule" under "All Departments (Customer)."

■ **Producer-Owned Reinsurance Companies (PORCs):** IRS Notice 2004-65 removed certain reinsurance arrangements as "listed transactions," but states that the IRS will continue to scrutinize transactions that shift income from taxpayers to related companies "purported to be insurance companies that are subject to little or no U.S. federal income tax."

■ **Truth in Lending and Consumer Leasing Acts:** Regulations Z and M cover consumer credit and consumer leasing transactions, respectively, specifying information to be disclosed to a consumer before completing the transaction, and information to be disclosed when advertising consumer credit transactions or leases. For example, dealers who advertise a lease down payment or monthly payment amount must disclose in lease ads that the advertised deal is a lease; the total amount due at lease signing; number, amount, and period (for example, monthly) of payments; and whether a security deposit is required.

Service and Parts Department

■ **Clean Air Act:** Dealerships are prohibited from tampering with, replacing, or removing emissions-control equipment, such as catalytic converters. CFC recycling regs require dealership air-conditioning techs to obtain certification and to use certified recycling and recovery equipment to capture spent refrigerant, including HFC-134a and other non-ozone-depleting refrigerants. The act also regulates any fuels dealers store and dispense as well as the alternative fuels dealers use and sell, including ultra-low-sulfur diesel. It restricts emissions from solvents and chemicals.

■ **Clean Water Act:** Sets standards for federal, state, and local regulation of wastewater and storm water at dealerships and comprehensive rules governing aboveground oil storage tanks.

■ **Department of Transportation (DOT) hazardous-materials-handling procedures:** Require parts employees who load, unload, and package hazardous products, such as airbags, batteries, and brake fluid, to be trained in safe handling practices.

■ **IRS Core Inventory Valuation:** Revenue Procedure 2003-20 creates an optional method for valuing core inventories for taxpayers who use Lower of Cost or Market Valuation Method.

■ **LIFO/FIFO inventory accounting method:** Revenue Procedure 2002-17 provides a safe-harbor method of accounting that authorizes the use of replacement cost to value year-end parts inventory.

■ **NHTSA tampering regulations:** Prohibit dealers from rendering inoperative safety equipment installed on used vehicles in compliance with federal law.

■ **NHTSA tire rules:** Dealers must report sales of defective tires when the tires are sold separately from vehicles, and must properly manage recalled tires.

■ **OSHA asbestos standards:** Dealerships must use certain procedures during brake and clutch inspections and repairs to minimize workplace exposure. Water, aerosol cleaners, or brake washers may be used to comply with the standard.

■ **OSHA Hazard Communication Standard (Right-to-Know laws):** Must inform employees about chemical hazards they may be exposed to in the workplace; keep chemical product info sheets on-site and accessible; and train staffers to properly handle the hazardous materials they work with. Also, under EPA's Community Right to Know regulations, dealers must list annually with state and local authorities any tank holding more than 1,600 gallons.

■ **OSHA lock-out/tag-out procedures:** Explain what service departments must do to ensure machines, including vehicles, are safely disengaged before being serviced.

■ **OSHA workplace health and safety standards:** Extensive regulations cover a multitude of workplace issues and practices, from hydraulic lift operation to the number of toilets required. One standard requires employers to determine if workplace hazards warrant personal protective equipment, then train employees on its use. Verbal reports must be made within eight hours of any incident involving hospitalization of three or more workers or any death.

■ **Resource Conservation and Recovery Act (RCRA):** Comprehensive environmental law regulating many dealership functions, including underground storage tanks and the storage, management, and disposal of used oil, antifreeze, mercury products, and hazardous wastes. Underground tanks must be monitored, tested, and insured against leaks; leaks and spills must be reported to federal and local authorities and cleaned up. The law also regulates new-tank installations. Dealers must obtain EPA ID numbers if they generate more than 220 lb. per month (about half of a 55-gallon drum) of certain substances and must use EPA-certified haulers to remove the waste from the site; dealers must keep records of the shipments. Used oil should be burned in space heaters or hauled off-site for recycling. Used oil filters must be punctured and drained for 24 hours before disposal.

■ **Safe Drinking Water Act:** To protect underground drinking water from contamination, dealerships may be barred from discharging waste liquids—such as used oil, antifreeze, and brake fluid—into septic system drain fields, dry wells, cesspools, or pits.

■ **Superfund (Comprehensive Environmental Response, Compensation, and Liability Act [CERCLA]):** As waste generators, many dealerships are subject to Superfund liability. Dealers must be careful when selecting companies to haul waste off-site. Dealers can deduct the cost of cleaning up contaminated soil and water in the year it's done. Dealers may qualify for an exemption from liability at sites involving used oil managed after 1993. The Service Station Dealer Exemption Application (SSDE) requires dealers to properly manage their oil and to accept oil from do-it-yourselfers.

■ **UNICAP:** See "New- and Used-Vehicle Sales Departments."

Body Shop

■ **Clean Air Act:** National paint and hazardous air pollution rules require reformulated, environmentally safer paints and finishes, special handling procedures, and recordkeeping

■ **EPA hazardous-waste rules:** See "RCRA" under "Service and Parts Department."

■ **OSHA Hazard Communication Standard (Right-to-Know laws):** See "Service and Parts Department."

■ **OSHA Respiratory Protection Standard:** Requires written programs describing how to select, fit, and maintain respirators to protect body shop workers from hazardous chemicals.

■ **OSHA workplace health and safety standards:** These extensive regulations affect body shops in many ways, including mandating the use and care of protective equipment, such as face masks, gloves, and respirators. Hex chrome standard limits air emissions during sanding and painting. (See also "Service and Parts Department.")

■ **UNICAP:** See "New- and Used-Vehicle Sales Departments."

■ **VIN and parts marking:** Dealers may not alter, destroy, or tamper with vehicle identification numbers or anti-theft part-marking ID numbers and should use properly marked replacement parts. ■

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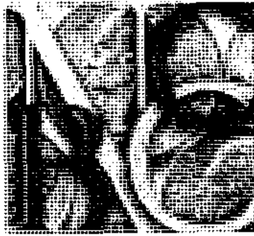

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DECEMBER 28, 2010

The Honorable Darrell E. Issa
Ranking Minority Member
Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515

Re: Regulations that Negatively Impact Jobs and the Economy

The National Black Chamber of Commerce (NBCC) is pleased to provide this response to your request for information regarding the impact the federal regulatory process is having on the economy and jobs. The NBCC thanks you for your dedication to this highly important issue, and looks forward to working with you as you explore this and other matters as the next Chairman of the Oversight and Government Reform Committee.

I am the NBCC's President and CEO, and I represent for minority business and small business development on many issues including environmental and energy issues, housing, civil rights, e-commerce, entrepreneurship, corporate responsibility, and health. My response will focus on environmental regulations that will stifle job creation as well as existing programs with the potential to create jobs but for a lack of oversight and agency implementation. If you have any questions or requests for additional information on these issues, I urge you to follow up with me.

A. Impact of EPA Regulations on Minority Jobs and Businesses

In 2009 and 2010, the Environmental Protection Agency (EPA) has taken an aggressive approach to environmental regulation. EPA has spent the past two years churning out major regulations that impact every sector of society and adversely impact the economic well being of minorities more than society at large. EPA's actions not only go against what was initially intended when the environmental laws were enacted, but they also threaten to jeopardize economic development and employment rates.

According to the Department of Labor, there are 15.1 million unemployed people as of November 2010, with the national unemployment rating increasing up to 9.8 percent. The American people are suffering, but the plight of minorities is even more disturbing. Unemployment rates among racial groups differ dramatically with whites at 8.9 percent; Hispanics at 13.2 percent; and Blacks at 16 percent.[1] This growing trend cannot be ignored. Minorities, who constitute a large majority of low- to very low-waged population, continue to get the short end of the stick.

While EPA continues to forge ahead with regulations sure to hinder economic recovery, not only for business owners, but the general public alike, of particular concern is the economic impact on minorities, specifically African Americans and Hispanics. An economic impact analysis commissioned by the Affordable Power Alliance[2] on the potential impacts of the EPA Endangerment Finding on minorities and low-income populations indicates that GHG regulation will have the effect of a discriminatory tax based on race, and unemployment among low-wage workers, who are disproportionately African American and Hispanic, is expected to increase exponentially. This is because a disproportionate percentage of their income will be spent on energy, including gasoline, residential electricity and residential natural gas prices, which are predicted to increase significantly by 2030. The same rationale applies to Black- and Hispanic-owned businesses, which tend to be smaller and less well capitalized than white-owned businesses and thus are much more vulnerable to economic turmoil likely to result from EPA GHG regulation.

The impact does not stop at cost of living expenses. Unemployment rates for African Americans and Hispanics will also be disproportionately affected by GHG regulation, given that the minority population will comprise the majority of citizens in the U.S. by 2050. If history is any indicator of what's to come, unemployment rates for African Americans have been about twice that of whites. Not only do unemployment rates for minorities tend to increase more during recessions, and decrease less during recoveries than their white counterparts, but the duration of unemployment also tends to be longer. Minorities already affected by the current economic downturn will suffer even more so if EPA regulates GHGs as proposed. According to the Affordable Power Alliance economic impact analysis, cumulative loss of jobs by African Americans is predicted to be 1.7 million by 2015 and 4.9 million by 2030; and for Hispanics, 2.4 million by 2015 and 6.5 million by 2030.[3] The negative impacts cited in this study portend serious national, if not global, implications. The negative impacts cited in the study portend serious national, if not, global implications.

B. HUD Section 3 Program and Job Creation

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[1] Employment Situation Summary (December 3, 2010). The unemployment rate for Asians was 7.6 percent.

[2] Roger Bezdek, Management Information Services, Inc., *Potential Impact of the EPA Endangerment Finding on Low Income Groups and Minorities* (March 2010), *available at* http://www.affordablepoweralliance.org/LinkClick.aspx?fileticket=GBqH57mHH5w%3d&tabid=40

[3] *Id.*

Since you requested information on existing regulations that impact employment, I would like to call attention to the U.S. Department Housing and Urban Development's (HUD) Section 3 Program, which I have championed for decades. The purpose of this program is to utilize the billions of dollars in federal funding, which is allocated annually to HUD for the specific purpose of creating jobs and training opportunities for residents of low- and very low- income communities, through the community development process.

I, along with the U.S. Chamber of Commerce, have been working to push HUD to implement and enforce Section 3 of the HUD Act of 1968, which requires that employment opportunities generated by HUD financial assistance for housing and community development programs be targeted toward low- and very low-income persons. Notwithstanding mandatory regulatory language and case law, recipients of HUD funding have continuously failed to comply with Section 3, without sanction, for several decades. Instead of providing training and employment opportunities for the targeted local population, a majority of the fund recipients often times ignore the mandate altogether to the detriment of the poor.

In December 2008, the Chamber filed two Freedom of Information Act (FOIA) requests for documents relating to the implementation and effectiveness of HUD's Section 3 Program. After nine months and at least a dozen inquiries to HUD's FOIA office and Office of General Counsel, HUD finally relinquished the documents in August 2009.

An objective review of HUD's own documents revealed not only the potential deprivation of benefits intended for the poor, but also a systematic failure to monitor program compliance. Under the Section 3 Program, fund recipients must monitor their own compliance and compliance of their contractors and subcontractors as well as submit a report to HUD annually. For FY 2008, a paltry 349 out of 3193 Public Housing Authorities and 143 out of 1137 Block Grant Entitlement Communities submitted annual reports. Although nearly 90 percent of HUD fund recipients completely disregarded the reporting mandate, HUD has consistently failed to apply appropriate sanctions.

In September 2009, the U.S. Chamber and I met with Staci Gilliam-Hampton, Director for the Section 3 Program, to discuss the program's failures and suggest courses of action to remedy the situation. As a result of our efforts, HUD launched a new campaign to increase program compliance in October 2009. As of March 2010, 3100 local and state government agencies had responded, revealing the creation of 17,000 new employment and training opportunities for Section 3 residents and facilitated the award of more than $340 million in HUD-funded construction contracts to Section 3 businesses. The funding also enabled about 3,600 Section 3 businesses to receive contracts to complete work on HUD-funded projects.

While I applaud HUD's accomplishments, the fight is far from over. Now that HUD has established a seemingly effective monitoring system, the next and primary goal should be ensuring compliance with the job creation mechanisms of the program. If implemented properly, Section 3 could generate substantial employment opportunities for those who need it most in a time when jobs are most scarce.

It should be noted that in addition to the millions of federal funding allocated to HUD annually for implementation of the Section 3 program, HUD received $13.6 billion in funding under the American Recovery and Reinvestment Act (ARRA), approximately **$7.8 billion or 57 percent**[4] of which is subject to the statutory and regulatory requirements of Section 3 of the Housing and Urban Development Act of 1968.[5] John Trasviña, HUD Assistant Secretary for Fair Housing and Equal Opportunity, stated that "Section 3 is the law. We will work with state and local governments, public housing authorities, labor organizations, businesses, and community leaders to create job opportunities and vigorously enforce the law."[6] I completely agree with this proclamation, and I am simply requesting that these funds be utilized in the way Congress intended.

To ensure that implementation of Section 3 does not fall by the wayside as it has in the past, we continue our efforts to monitor its progress. For example, the U.S. Chamber followed up with a FOIA request in October 2010 to obtain an update on compliance statistics for FY 2009, however HUD's FOIA office reported that it had no record of the request. Accordingly, another FOIA request was submitted December 15, 2010. Our efforts, which can and have been thwarted by bureaucratic red tape in the past, are not enough. After decades of haphazard implementation and oversight by HUD, you are in the best position to achieve program implementation by holding HUD accountable for properly utilizing federal funds and complying with the requirements of the Section 3 program. I strongly urge you to take a hard look at HUD's execution of the Section 3 Program and consider the benefits that the successful implementation this program can bring to low-income communities.

C. How to Fix the Problem of Overregulation

Rising energy costs have long been a major concern for the business community, especially with the recent anti-dependence on foreign oil sentiment and the realization that domestic energy independence is not imminent due the debacle that is the permitting process for building and operating energy facilities in the U.S.[7] EPA's proposed GHG regulations has done nothing to assuage these fears. Almost every major environmental law requires EPA to conduct a real, meaningful analysis of the economic and job-loss impacts of the regulations it issues there

[4] The majority of Section 3 covered ARRA funding was provided under the following program areas: PIH Public Housing Capital Funds $4 Billion; Neighborhood Stabilization Program $2 Billion; Community Development Block Grants $1 Billion; Native American Housing Block Grants $510 Million; Assisted Housing Energy & Green Retrofits $ 250 Million; and Lead Hazard Control $ 78 Million (LHC Grants Only).

[5] HUD Economic Stimulus Funding and The Creation of Jobs, Training, and Contracting Opportunities *available at* http://www.hud.gov/offices/fheo/section3/Econ-Stimulus-sec3-final.pdf

[6] HUD Press Release, HUD Steps up Enforcement of Job Creation Requirements for State and Local Governments, March 8, 2010 *available at* http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-044 .

[7] The U.S. Chamber of Commerce's *Project No Project* initiative is a running inventory of energy projects that have been stalled, stopped or otherwise thwarted by "Not In My Back Yard," or "NIMBY" activism. It is important to note that NIMBYs do not confine their opposition only to coal-fired power plants; by far the largest portion of the nearly 400 energy projects detailed on the PNP website is renewables. The U.S. Chamber is currently in the process of developing an economic analysis of the investment and jobs foregone by failing to move forward with these energy projects. They expect to release the final study in early 2011. I urge you to review this information when complete and take it under consideration when addressing some of the above stated issues.

under. For example: Section 317 of the Clean Air Act requires economic impact assessments for most major rules; and Section 321 of that same law, requires the Administrator to make a continuing evaluation of potential loss or shifts of employment (including plant closures) that may result from one of EPA's regulations. EPA has confirmed to Congress that it refuses to do a Section 321 jobs analysis for any of its greenhouse gas-related regulations, nor does it appear to have done similar assessments for any of its other rules. Without EPA's insight into the real-world impact of its policies, other groups have had to pick up the slack.

According to the Manufacturers' Alliance estimates, EPA's reconsideration of the National Ambient Air Quality Standards for Ground-Level Ozone could cost as much as $1.013 trillion annually between 2020 and 2030 (a 5.4% net reduction in GDP) and could sacrifice 7.3 million jobs by 2020 (4.3% of projected labor force). EPA's "Boiler MACT" industrial emissions standards for boilers, which EPA admitted were "simply too tight to be able to be achievable," could reduce GDP by as much as $1.2 trillion. Moreover, every $1 billion spent on compliance costs could put 16,000 jobs at risk, according to a study prepared for the Council of Industrial Boiler Owners by the research firm IHS Global Insight.

The North American Electric Reliability Corporation (NERC) found that EPA's suite of rules on electric power generators could force up to 19 percent of our nation's fossil-fired electric generation to retire in the next ten years. The impact on jobs resulting from such a large-scale retirement of capacity could be colossal. However, EPA must complete more economic and jobs impact analysis in order to be sure. We have data for the handful of rules mentioned above. But we do not have it, nor does EPA appear ready to provide it, for dozens of other major rules that are plaguing NBCC's members and preventing long-term investment.

I emphatically recommend requiring EPA to conduct the statutorily-required analyses for all major regulations. Moreover, I urge the preemption of all EPA regulations issued in 2009 and 2010 that did not adequately comply with Sections 317 and 321 of the Clean Air Act.

Thank you once again for your request for information on existing and proposed regulations that have negatively impacted job growth and the economy. The NBCC looks forward to your leadership of the Oversight and Government Reform Committee, and stands ready to work with you on these issues.

Sincerely,

HARRY C. ALFORD
President/CEO

Enclosure

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March 2010

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EXECUTIVE SUMMARY

On December 7, 2009 the U.S. Environmental Protection Agency issued its long-anticipated "Endangerment Finding," which was a prerequisite to finalizing EPA's proposed greenhouse gas emission standards. Implementation of this Finding could affect millions of entities and lead to the most comprehensive, restrictive and intrusive environmental regulations in U.S. history. A major impact of this Finding would be restrictions on the availability and increases in the prices of fossil fuels, especially coal. The economic impacts of the Finding in terms of GDP, incomes, industrial activity, jobs and other indicators likely would be severe. Due to their economic vulnerability, low-income groups, African Americans, and Hispanics and senior citizens would be seriously and disproportionately impacted..

This report analyzes the likely economic, employment, and energy market impacts of the EPA Finding with special emphasis on the impacts on low-income groups, the elderly, African Americans, and Hispanics. No comprehensive analyses of the economic impacts of the EPA Finding have thus far been conducted, and here we used the results of various studies conducted in recent years on the impacts of different CO_2 restriction programs and proposed legislation.

Major Finding

Our major finding is that the CO_2 restrictions implied in the EPA regulation would have serious economic, employment, and energy market impacts at the national level (Figures EX-1 and EX-2) and for all states, and that the impacts on low-income groups, the elderly, African Americans, and Hispanics would be especially severe. We estimated that implementation of the EPA Finding would:

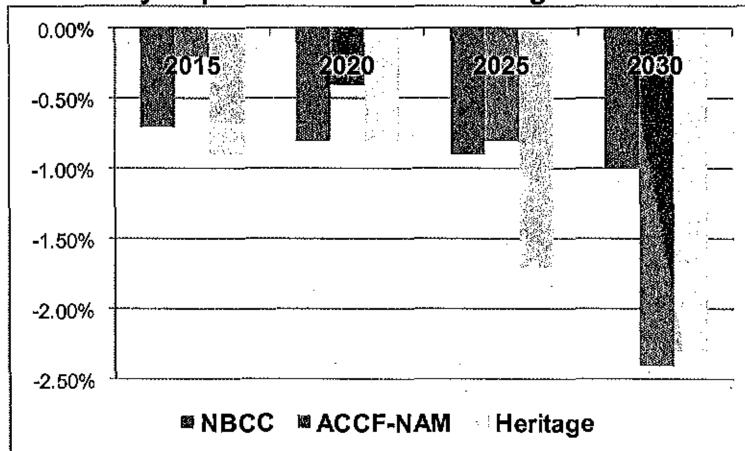
- Significantly reduce U.S. GDP every year over the next two decades, and by 2030 GDP would be about $500 billion less than in the reference case – which assumed no EPA carbon restrictions.
- Significantly reduce U.S. employment over the next two decades, and by 2030 would result in the loss of 2.5 million jobs
- Significantly reduce U.S. household incomes over the next two decades, and by 2030 average household income would be reduced by about $1,200 annually

In addition, the EPA carbon restrictions would greatly increase U.S. energy costs, and by 2030 these increases (above the reference case) could total:

- 50 percent for gasoline prices
- 50 percent for residential electricity prices
- 75 percent for industrial electricity prices
- 75 percent for residential natural gas prices
- 100 percent for industrial natural gas prices

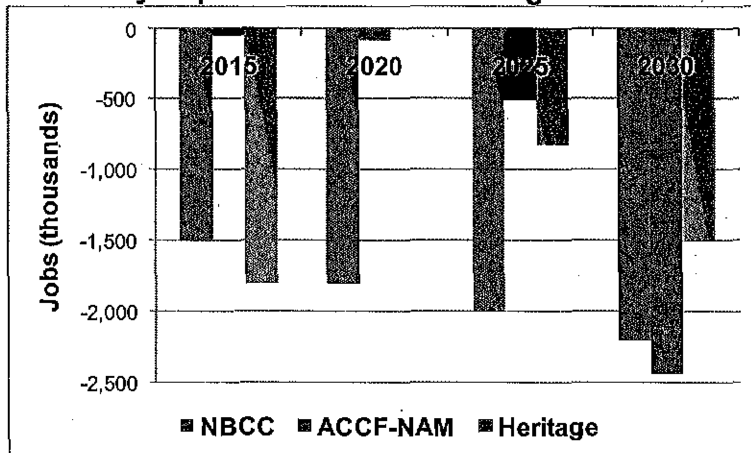
- 40 percent for jet fuel prices
- 40 percent for diesel prices
- 600 percent for electric utility coal prices

Figure EX-1
Likely Impact of the EPA Finding on U.S. GDP



Source: Management Information Services, Inc., 2010.

Figure EX-2
Likely Impact of the EPA Finding on U.S. Jobs



Source: Management Information Services, Inc., 2010.

The EPA regulation will impact low income groups, the elderly, and minorities disproportionately, both because they have lower incomes to begin with, but also because they have to spend proportionately more of their incomes on energy, and rising energy costs inflict great harm on minority families. Lower-income families are forced to allocate larger shares of the family budget for energy expenditures, and minority families are significantly more likely to be found among the lower-income brackets. This disparity between racial groups means that rising energy costs have a disproportionately negative effect on the ability of minority families to acquire other

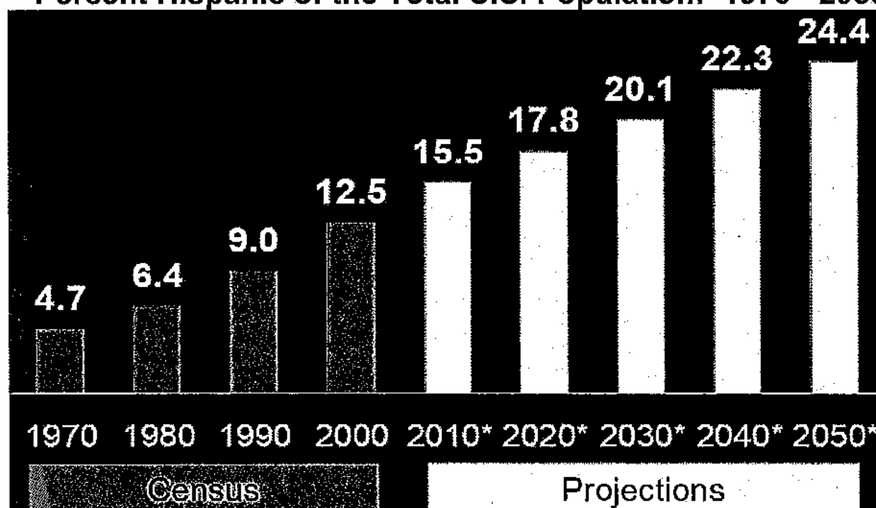
necessities such as food, housing, childcare, or healthcare. Essentially, the EPA Finding will have the effect of a discriminatory tax based on race.

Demographic Changes

Figure EX-3 indicates that the growth in the Hispanic population is the salient U.S. demographic development:

- In 1970, less than five percent of the U.S. population was Hispanic.
- In 2000, about 13 percent of the U.S. population was Hispanic.
- In 2030, about 20 percent of the U.S. population will be Hispanic.
- In 2050, about 25 percent of the U.S. population will be Hispanic.
- In recent years, about one of every two persons added to the U.S. population was Hispanic.

Figure EX-3
Percent Hispanic of the Total U.S. Population: 1970 - 2050



Source: U.S. Census Bureau, 2010.

Hispanics have displaced African Americans as the largest U.S. minority group, and their numerical dominance will continue to increase. The portion of the population that is non-Hispanic White declines from 80 percent in 1980 to about 50 percent in 2050. The portion of the U.S. that is Black will remain at about 13 percent over the next several decades.

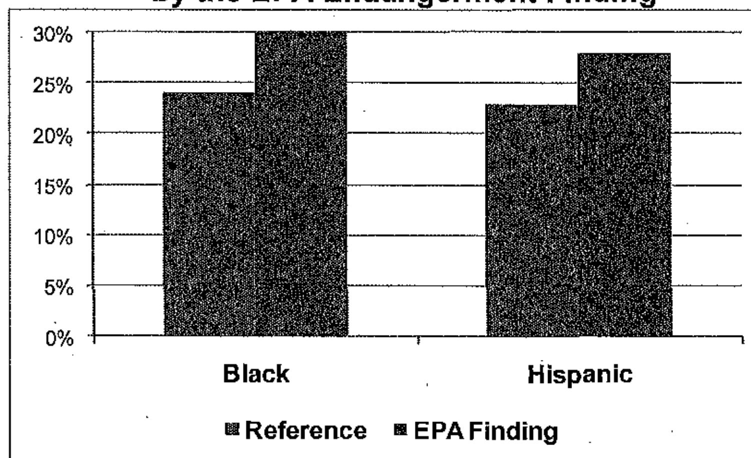
Impact on Poverty Rates

Black and Hispanic workers -- and their families – will likely be adversely affected threefold if the EPA Endangerment Finding is implemented: Their incomes will be substantially less than they would without the regulation, their rates of unemployment will increase substantially, and it will take those who are out of work much longer to find another job. These impacts on earnings and employment will increase the rates of

poverty among African Americans and Hispanics, and we estimate that one of the impacts of implementing the EPA Finding will be to, by 2025 (Figure EX-4):

- Increase the poverty rate for Hispanics from 23 percent to about 28 percent. This represents an increase in Hispanic poverty of nearly 22 percent.
- Increase the poverty rate for African Americans from 24 percent to about 30 percent. This represents an increase in Black poverty of 20 percent.

Figure EX-4
Increases in 2025 Poverty Rates Caused by the EPA Endangerment Finding



Source: Management Information Services, Inc., 2010.

This must be considered one of the more troubling potential impacts of the EPA Finding. An unintended result of the EPA regulation will likely be to force millions of African Americans and Hispanics below the poverty line -- many of whom have only recently managed to work their way out of poverty.

In addition, the EPA CO_2 restrictions, by increasing the costs of energy and energy-intensive building materials, will increase the costs of housing. This will seriously affect African Americans and Hispanics because they have higher housing costs and a lower rate of home ownership than Whites:

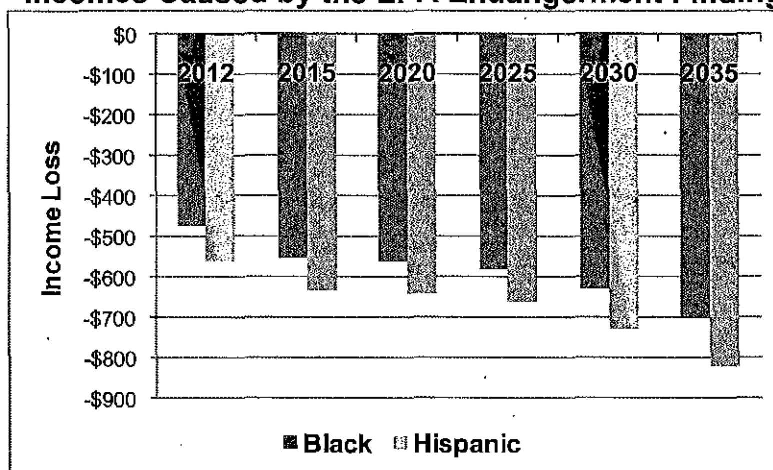
- Only about ten percent of Whites pay 50 percent or more of their income in housing costs; the comparable percentage for African Americans and Hispanics is about 20 percent.
- Whereas 25 percent of Whites pay 30 percent or more of their income in housing costs, the comparable percent for African Americans is 40 percent, and for Hispanics it is 45 percent.

Impact on Incomes

Consumers and households will ultimately bear the added costs that will result from the EPA Endangerment Finding, and implementation of the Finding will reduce Black and Hispanic household incomes by increasing amounts each year (Figure EX-5):

- In 2015, Black median household income will decrease about $550 compared to the reference case (which assumes that the EPA Finding is not implemented), and Hispanic median household income will decrease $630 compared to the reference case.
- In 2025, Black median household income will be nearly $600 less than under the reference case, and Hispanic median household income will be about $660 less than under the reference case.
- In 2035, Black median household income will be $700 less than under the reference case, and Hispanic median household income will be $820 less.
- The cumulative loss in Black median household income over the period 2012 – 2035 will exceed $13,000.
- The cumulative loss in Hispanic median household income over the period 2012 – 2035 will exceed $15,000.

Figure EX-5
Losses in Black and Hispanic Median Household Incomes Caused by the EPA Endangerment Finding



Source: Management Information Services, Inc., 2010.

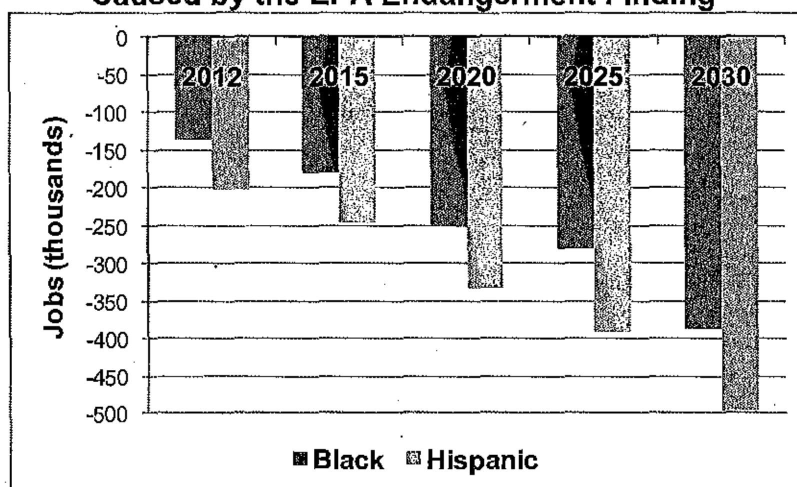
Impact on Jobs

The most salient characteristic of the employment status of African Americans and Hispanics is the fact that their unemployment rates have consistently been much higher than average and than those for Whites. African Americans and Hispanics are also at a disadvantage in the labor force when they are employed, for they tend to

be disproportionably concentrated in lower paid jobs. Nationwide, implementation of the EPA Finding would result in the loss of an increasingly large number of Black and Hispanic jobs (Figure EX-6):

- In 2015, 180,000 Black jobs would be lost and nearly 250,000 Hispanic jobs would be lost.
- In 2025, more than 300,000 Black jobs would be lost and nearly 400,000 Hispanic jobs would be lost.
- In 2030, nearly 390,000 Black jobs would be lost and nearly 500,000 Hispanic jobs would be lost.

Figure EX-6
Black and Hispanic Job Losses
Caused by the EPA Endangerment Finding



Source: Management Information Services, Inc., 2010.

The job losses increase every year, and the cumulative losses for African Americans and Hispanics will grow rapidly over the next two decades if the EPA regulation is enacted:

- By 2020, cumulative job losses for African Americans will total nearly 1.7 million.
- By 2030, cumulative job losses for African Americans will total about 4.9 million.
- By 2020, cumulative job losses for Hispanics will total 2.4 million.
- By 2030, cumulative job losses for Hispanics will total more than 6.5 million.

Impact on Basic Expenditures and Discretionary Income

African Americans and Hispanics have, on average, significantly lower incomes than Whites, and have to spend proportionately larger shares of their incomes on basic necessities such as food, housing, clothing, and utilities. Implementing the EPA Finding

will significantly increase the costs of all fossil fuels and, since energy is a basic component in the production of all commodities, the prices of all goods will increase as the energy price increases work their way through the economy. Thus, the EPA Finding will likely have a doubly negative impact on the living standards of African Americans and Hispanics:

- First, implementing the Finding will decrease Black and Hispanic incomes below where they would be in the absence of the regulation.
- Second, the Finding will increase the costs of the basic goods upon which African Americans and Hispanics must spend their reduced incomes.

In the face of reduced incomes and rising prices, the trade-offs that African Americans and Hispanics will face involve reallocating spending between food, clothing, housing, and heat. For example, proportionately:

- African Americans spend 20 percent more of their income on food, ten percent more on housing, 40 percent more on clothing, and 50 percent more on utilities than do Whites.
- Hispanics spend 90 percent more of their income on food, five percent more on housing, 40 percent more on clothing, and 10 percent more on utilities than do Whites.

Implementing the EPA Finding will exacerbate this situation by forcing African Americans and Hispanics to spend an even more disproportionate share of their incomes -- which will have been reduced due to the effects of the CO_2 restrictions -- on basic necessities.

Finally, the cumulative impact of increased unemployment, reduced incomes, and increased prices for housing, basic necessities, energy, and utilities resulting from the EPA Finding will be to further reduce Black and Hispanic discretionary incomes. Discretionary income is the money that remains for spending or saving after people pay their taxes and purchase necessities. It is an important concept both because of the financial flexibility it gives individuals and because many businesses depend on discretionary spending for sales and profits. Implementing the EPA Finding will reduce the average discretionary incomes of both African Americans and Hispanics.

Increased Energy Poverty

One of the more serious, but less recognized effects of implementing the EPA Finding will be to significantly increase the energy burdens for the elderly, African Americans, and Hispanics and increase the numbers of African Americans and Hispanics suffering from "energy poverty." For tens of millions of low-income households, higher energy prices will intensify the difficulty of meeting the costs of basic human needs, while increasing energy burdens that are already excessive. At the

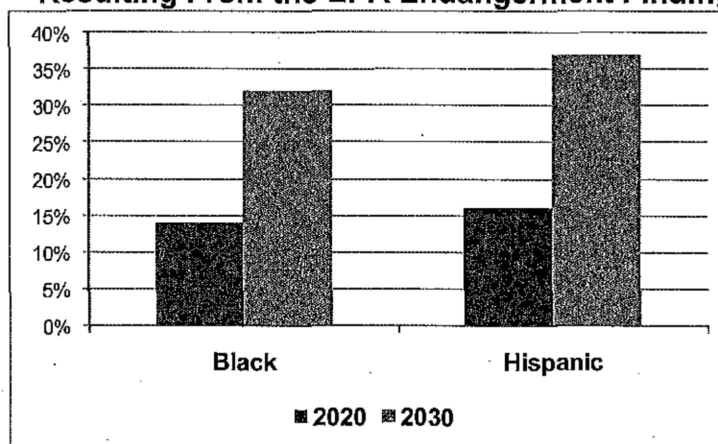
same time, the EPA regulation will threaten low-income access to vital energy and utility services, thereby endangering health and safety while creating additional barriers to meaningful low-income participation in the economy.

For the low-income elderly who are particularly susceptible to weather-related illness such as hypothermia, a high energy burden can represent a life-threatening challenge.[1] Implementation of the EPA Finding would place many elderly households at serious risk by forcing them to heat and cool their homes at levels that are inadequate for maintenance of health. The price increases resulting from carbon restrictions would be highly regressive -- they would place a relatively greater burden on lower-income households than on higher-income ones. In addition to health risks, excessive energy burdens cause a variety of difficulties for low-income households, and "Inability to pay utilities is second only to inability to pay rent as a reason for homelessness."

A major negative effect of promulgating the EPA regulation would be to significantly increase the energy burdens for African Americans and Hispanics and to force large numbers of both groups into energy poverty. Implementing the EPA Finding would (Figure EX-7):

- In 2020, increase the energy burden of African Americans by 14 percent and Hispanics by 16 percent
- In 2030, increase the energy burden of African Americans by nearly one-third and Hispanics by more than 35 percent

Figure EX-7
Increases in Black and Hispanic Energy Burdens Resulting From the EPA Endangerment Finding



Source: Management Information Services, Inc., 2010.

[1]The energy burden is defined as the percentage of gross annual household income that is used to pay annual residential energy bills.

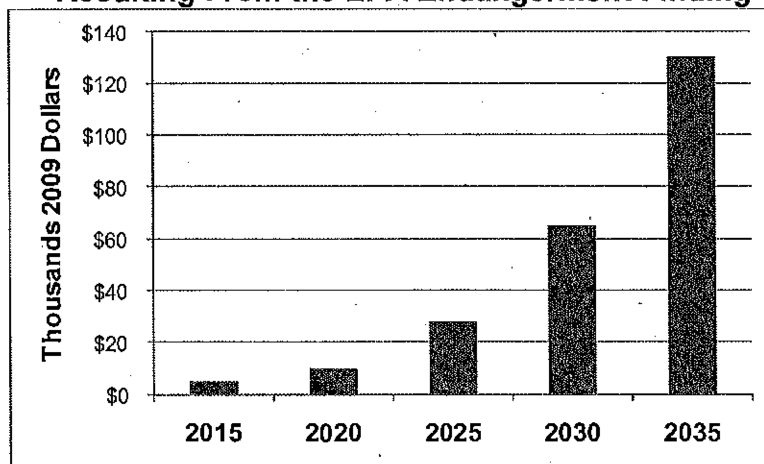
Impacts on Minority Small Businesses

Small businesses will face higher costs for energy and other products as a result of the EPA Finding, and the impact on Black and Hispanic small businesses will be especially severe. Black- and Hispanic-owned businesses represent a disproportionately small share of total businesses, tend to be smaller and less well capitalized than White-owned businesses, and are much more vulnerable to the economic dislocations likely to result from the EPA CO_2 restrictions. Thus, the potential impact of the EPA regulation on Black and Hispanic Businesses is significant.

Impacts on the Federal Debt Burden

As the economy adjusts to a reduced GDP the negative economic impacts accumulate, and the national debt will be affected. We estimate that the EPA regulation could increase the federal debt by nearly 30 percent by 2035 – over and above what it would be without the regulation (Figure EX-8). This represents an additional $33,000 per person, or more than $130,000 for a family of four. Since Black and Hispanic incomes are well below the U.S. average, the increased burden of this incremental debt would be 25 percent higher for Hispanic families and about 33 percent higher for Hispanic families.

Figure EX-8
Increased Federal Debt Burden For a Family of Four Resulting From the EPA Endangerment Finding



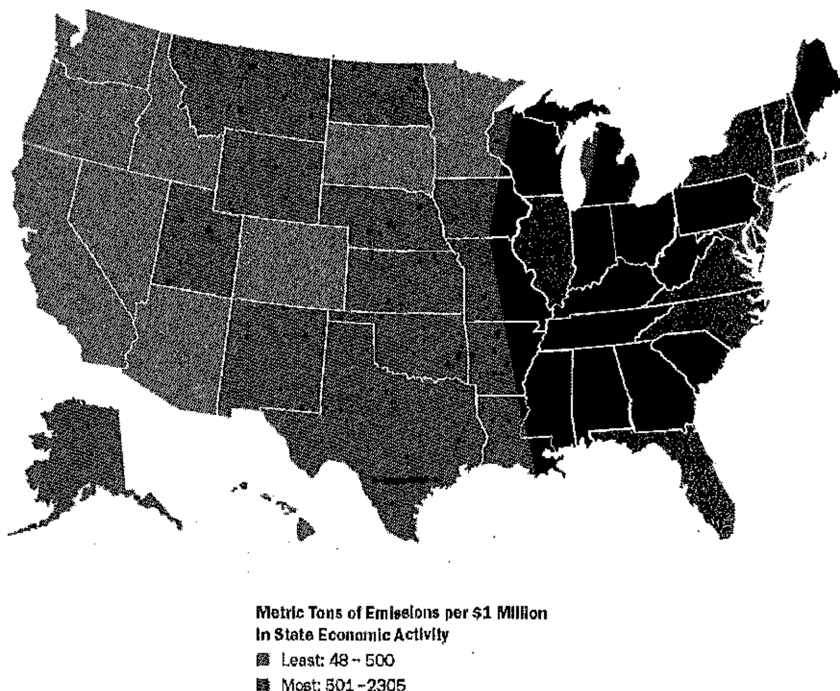
Source: Heritage Foundation and Management Information Services, Inc., 2010.

Impacts on African Americans and Hispanics by State

The impact of implementing the EPA Finding on the U.S. economy, and on low-income groups, African Americans, and Hispanics, will be severe. The regulation will cause higher energy costs to spread throughout the economy as producers try to cover their higher production costs by raising their product prices, and these impacts will be felt to varying degrees in different states. For example, because virtually all businesses rely on electricity to produce and sell goods and services, the economic impacts of coal-

based energy extend far beyond the generation and sale of electricity. The availability of low-cost electricity produces powerful ripple effects that benefit state economies as a whole, but implementation of the EPA regulation would greatly increase electricity prices – much more in some states than in others. For example, consumers in the Midwest and the Southeast will literally face double the impacts of carbon caps than consumers elsewhere in the country (Figure EX-9).

Figure EX-9
Relative CO_2 Emissions Per State



Source: U.S. Environmental Protection Agency, 2009.

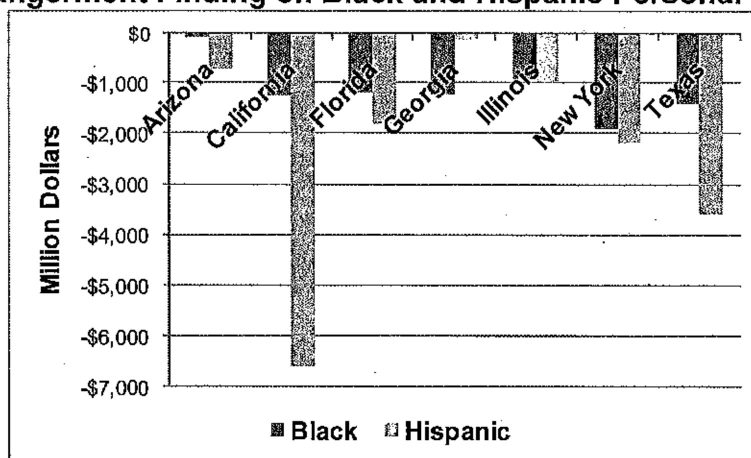
Since the proposed CO_2 restrictions would require continuing and increasingly severe reductions in the use of fossil energy to produce electricity in the states and cause large energy price increases, if the regulation is implemented all states will suffer substantial and increasingly severe economic and jobs impacts:

- Residents of all states will face increased costs for energy, utilities, and for other goods and services and will experience increased costs of living, beginning in 2012.
- Energy and electricity prices in each state would increase substantially, but to different degrees.
- The growth rates of state wages and incomes would be negatively affected over the next two decades, and by 2030 state per capita personal incomes would be significantly lower than in the absence of the EPA regulation.

- Millions of jobs would be lost in the states, employment would be lower, and unemployment higher.
- Industries and firms will relocate among states, thus causing a further loss of jobs in many states.
- New firms will hesitate to locate in some states, thus causing a reduction in the number of new jobs created.
- The combination of reduced economic activity in the states, decreased personal incomes for states' residents, and increased unemployment will strain state and local government budgets and result in reduced public services and increased taxes.

African Americans and Hispanics are disproportionately located in certain states, and their population concentration in these states will increase over time. We estimated the impacts of the EPA Finding on incomes in the seven states with the highest concentrations of African Americans and Hispanics: Arizona, California, Florida, Georgia, Illinois, New York, and Texas (Figure EX-10). In all states (except Georgia), the impacts on Hispanic incomes exceed the impacts on Black incomes, since there are more Hispanics than African Americans residing in these states. Further, the growth rates of the Hispanic population exceed those of African Americans in all of these states.

Figure EX-10
Average Annual Impact in Selected States, 2012-2035, of the EPA Endangerment Finding on Black and Hispanic Personal Incomes



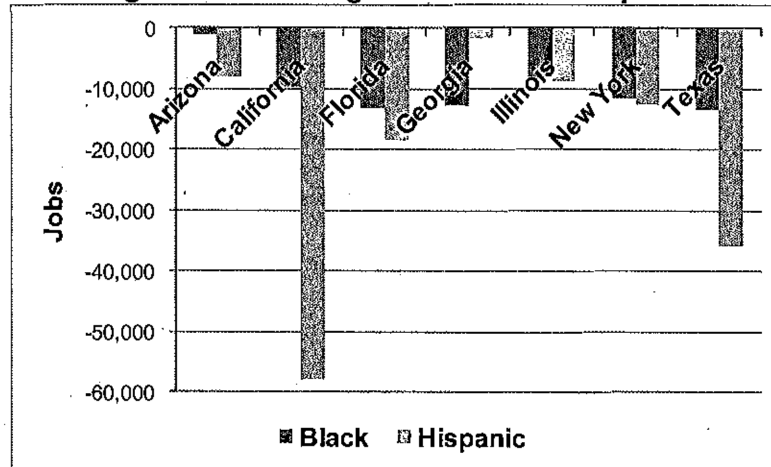
Source: Management Information Services, Inc., 2010.

The impacts vary widely among the states. The greatest loss of income will be experienced by Hispanics in California, since this state has, by far, the largest number of Hispanic residents and the most rapidly growing Hispanic population.

We estimated the average annual impacts in the seven states, 2012-2035, of the EPA Finding on Black and Hispanic jobs (Figure EX-11). In all states (except for

Georgia), Hispanic job losses exceed Black job losses, since there are more Hispanics than African Americans residing in these states.

Figure EX-11
Average Annual Impact in Selected States, 2012-2035, of the EPA Endangerment Finding on Black and Hispanic Jobs



Source: Management Information Services, Inc., 2010.

The greatest job losses will be experienced by Hispanics in California, since this state has, by far, the largest number of Hispanic residents. Nevertheless, the job losses are substantial in every state. For example, every year 2012 – 2035, average Hispanic job losses will total:

- Nearly 70,000 in California
- Nearly 40,000 in Texas
- Nearly 20,000 in Florida
- Nearly 13,000 in New York

Every year 2012 – 2035, average Black job losses will total:

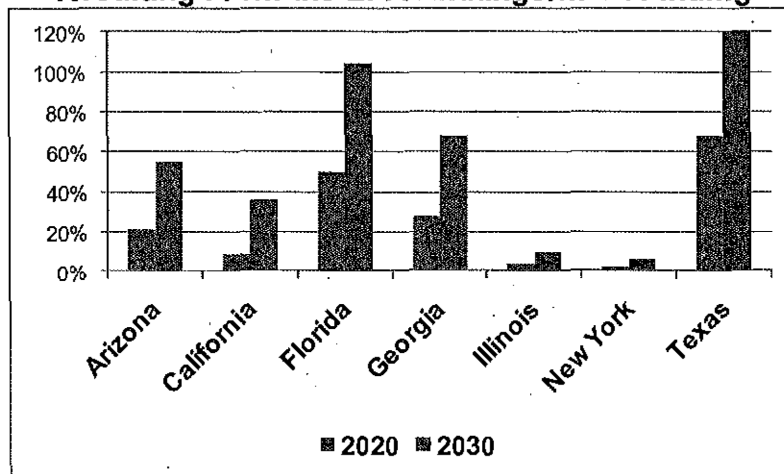
- More than 13,000 in Texas
- More than 13,000 in Florida
- Nearly 13,000 in Georgia
- Nearly 12,000 in New York

While Hispanic jobs losses exceed Black job losses in all of the states except Georgia, in some states job losses for the two groups are about the same – for example, in New York and in Illinois.

We estimated the increases in Hispanic and Black energy burdens in the states in 2020 and 2030 resulting from the EPA Endangerment Finding and found that (Figures EX-12 and EX-13):

- The energy burdens for both African Americans and Hispanics increase in each year.
- For each group, the increases in energy burdens in 2030 are much larger than those in 2020.
- For each group, the increases in energy burdens are the largest in Texas, Florida, Georgia, and Arizona.
- In some states, such as Florida, Georgia, and Texas, the increased energy burden is larger for African Americans than for Hispanics.
- In some other states, such as Arizona, California, and Illinois, the increased energy burden is larger for Hispanics than for African Americans.

Figure EX-12
Increase in Hispanic Energy Burdens in Selected States Resulting From the EPA Endangerment Finding

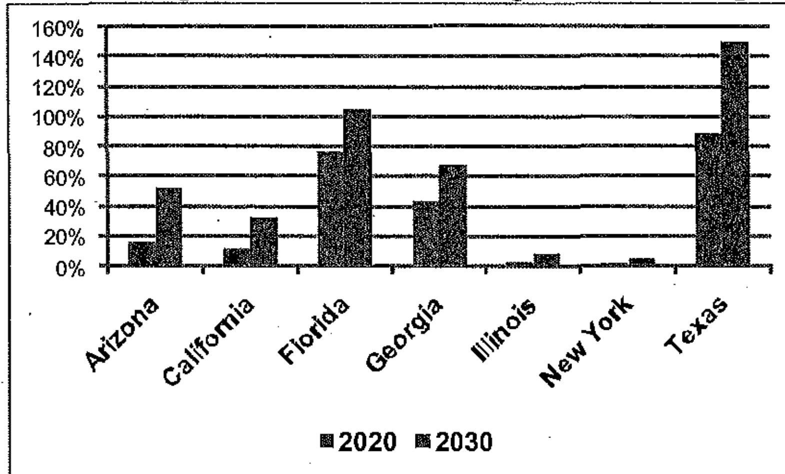


Source: Management Information Services, Inc., 2010.

Conservative Estimates

The results derived here should be viewed as conservative and as indicating the minimal negative effects that may be expected. The reason is that the CO_2 restriction programs and legislation that have been analyzed contain numerous subsidy, rebate, compensation, and incentive provisions to lessen the burden of the CO_2 restrictions – at least in the short run. The EPA Finding contains no such provisions, and EPA is not permitted to consider economic impacts in developing regulations. Thus, the impacts of the EPA Finding on the economy and labor market are likely to be even more severe than those estimated here.

Figure EX-13
Increase in Black Energy Burdens in Selected States Resulting From the EPA Endangerment Finding



Source: Management Information Services, Inc., 2010.

I. INTRODUCTION

On December 7, 2009 the U.S. Environmental Protection Agency issued its long-anticipated "Endangerment Finding," which was a prerequisite to finalizing EPA's proposed greenhouse gas emission standards. Implementation of this Finding could affect millions of entities and lead to the most comprehensive, restrictive, and intrusive environmental regulations in U.S. history. A major impact of this Finding would be restrictions on the availability and increases in the prices of fossil fuels, especially coal. The economic impacts of the Finding in terms of GDP, incomes, industrial activity, jobs, and other indicators would likely be severe. Due to their economic vulnerability, the impacts on low-income groups, African Americans, and Hispanics would be disproportionate and especially serious.

Accordingly, this report analyzes the likely economic, employment, and energy market impacts of the EPA Finding with special emphasis on the impacts on low-income groups, the elderly, African Americans, and Hispanics. No comprehensive analyses of the economic impacts of the EPA Finding have thus far been conducted, and here we use the results of various studies conducted in recent years on the impacts of different proposed CO_2 restriction programs and legislation. The results derived here should be viewed as conservative, indicating the minimal negative effects that may be expected. The reason is that the CO_2 restriction programs and legislation that have been analyzed contain numerous subsidy, rebate, and incentive provisions to lessen the burden of the CO_2 restrictions – at least in the short run. The EPA Finding contains no such provisions, and EPA is not permitted to consider economic impacts in developing regulations. Thus, the impacts of the EPA Finding on the economy and labor market are likely to be even more severe than those estimated here.

The report is organized as follows:

- Chapter II discusses the EPA Endangerment Finding.
- Chapter III reviews recent studies of the economic impacts of CO_2 restrictions upon which the estimates derived here are based.
- Chapter IV discusses the impacts of CO_2 regulation on the national economy and jobs.
- Chapter V discusses state impacts.
- Chapter VI analyzes Black and Hispanic population and demographic trends at the national and state levels.
- Chapter VII analyzes the likely impacts of the EPA endangerment finding on low-income persons, African Americans, and Hispanics.
- Chapter VIII discusses the findings and implications derived here.

II. THE EPA CO_2 ENDANGERMENT FINDING

On December 7, 2009 the U.S. Environmental Protection Agency issued its long-anticipated "Endangerment Finding."[2] EPA Administrator Lisa P. Jackson stated that "This finding confirms that greenhouse gas pollution is a serious problem now and for future generations. In both magnitude and probability, climate change is an enormous problem. The greenhouse gases that are responsible for it endanger public health and welfare within the meaning of the Clean Air Act (CAA)."[3]

On December 7, the EPA Administrator signed two distinct findings regarding greenhouse gases under section 202(a) of the CAA:

- Endangerment Finding: The Administrator finds that the current and projected concentrations of the six key greenhouse gases (GHGs) pose a potential threat: Carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride.
- Cause or Contribute Finding: The Administrator finds that the combined emissions of these GHGs from new motor vehicles and new motor vehicle engines contribute to the greenhouse gas pollution which threatens public health and welfare.

These findings do not themselves impose any requirements on industry or other entities. However, this action was a prerequisite to finalizing EPA's proposed greenhouse gas emission standards for light-duty vehicles, which EPA proposed in a joint proposal including the Department of Transportation's proposed corporate average fuel efficiency (CAFE) standards on September 15, 2009.[4]

EPA contends that climate change may lead to higher concentrations of ground-level ozone and that additional impacts of climate change include increased drought, more heavy downpours and flooding, more frequent and intense heat waves and wildfires, greater sea level rise, more intense storms, and harm to water resources, agriculture, wildlife, and ecosystems. The agency also stated that that climate change has serious national security implications. Further, EPA stated that climate change would have a disproportionate impact on the health of certain segments of the population, such as the poor, the very young, the elderly, those already in poor health, the disabled, those living alone and/or indigenous populations dependent on one or a few resources.

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[2] www.epa.gov/climatechange/endangerment.html.

[3] "Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act," Environmental Protection Agency press release, December 7, 2009.

[4] U.S. Environmental Protection Agency, "EPA and NHTSA Propose Historic National Program to Reduce Greenhouse Gases and Improve Fuel Economy for Cars and Trucks," EPA-420-F-09-047a, September 2009.

The Finding has entered the public comment period, which is the next step in the deliberative process EPA must undertake before issuing final findings. The Finding did not include any proposed regulations, and prior to taking any steps to reduce GHGs under the CAA EPA must conduct an appropriate process and consider stakeholder input.[5]

The Finding was long-anticipated because of an April 2007 Supreme Court ruling (Massachusetts v. EPA) which found that Congress authorized EPA to regulate GHGs for climate change purposes when it enacted the 1970 CAA. That decision all but ensured that EPA would issue an Endangerment Finding for GHGs which, in turn, would compel EPA under the CAA to establish first-ever GHG emission standards for new motor vehicles. The timeline for the Finding was:

- On April 2, 2007, in Massachusetts v. EPA, the Supreme Court found that GHGs are air pollutants covered by the CAA. The Court held that the Administrator must determine whether or not emissions of GHGs from new motor vehicles cause or contribute to air pollution which may reasonably be anticipated to endanger public health or welfare, or whether the science is too uncertain to make a reasoned decision. In making these decisions, the Administrator is required to follow the language of section 202(a) of the Clean Air Act. The Supreme Court decision resulted from a petition for rulemaking under section 202(a) filed by more than a dozen environmental, renewable energy, and other organizations.
- On April 17, 2009, the EPA Administrator signed proposed endangerment and cause or contribute findings for GHGs under Section 202(a) of the Clean Air Act. EPA held a 60-day public comment period, which ended June 23, 2009, and received over 380,000 public comments. These included both written comments as well as testimony at two public hearings in Arlington, Virginia and Seattle, Washington. EPA reviewed, considered, and incorporated public comments and then issued its final findings.
- The findings were signed by the Administrator on December 7, 2009.
- On December 15, 2009, the final findings were published in the *Federal Register*.
- The final rule was effective January 14, 2010.

However, there is a Catch 22 involved: Once EPA adopts the GHG motor vehicle standards, CO_2 automatically becomes a pollutant "subject to regulation" under the CAA Prevention of Significant Deterioration (PSD) pre-construction permitting program and the Title V operating permits program.[6] Under the CAA, firms must obtain a PSD permit in order to construct or modify a "major emitting facility," and a permit to

[5]"The EPA Endangerment Finding," *Energy Bulletin*, December 9, 2009.
[6]See Roger H. Bezdek, "Despite Legislative Successes, Increased Federal Regulation Threatens U.S. Oil and Gas," *World Oil*, February, 2010, pp. 41–44.

operate such a facility. A facility is major under PSD if it is in one of 28 categories and has a potential to emit 100 tons per year (TPY) of a regulated pollutant, or 250 TPY if it is any other type of establishment. Millions of currently unregulated buildings and facilities -- office buildings, apartment buildings, commercial and retail stores, shopping malls, heated agricultural facilities, small manufacturing firms, commercial kitchens, etc. -- emit enough CO_2 to meet these thresholds.

EPA estimates that if PSD were to be applied as written to CO_2 sources, the number of PSD permit applications per year would increase from 300 to more than 41,000, and the number of Title V permit applications would increase from 15,000 to 6.1 million. This is clearly neither technically nor politically feasible, and EPA has proposed a Tailoring Rule to limit the number of permits required by suspending the PSD and Title V requirements for any source emitting less than 25,000 TPY of CO_2-equivalent GHGs.

However, it is unclear whether EPA's Tailoring Rule will survive judicial challenge because it conflicts with statutory language. Further, to show that EPA is not amending the CAA, the Agency contends in the Tailoring Rule that its goal is to apply PSD and Title V to smaller and smaller CO_2 sources over time, eventually including sources emitting 250 TPY and 100 TPY. EPA proposes to spend five years developing "streamlined" permitting procedures for smaller sources, but the legality of such a plan is questionable.

Further, the Tailoring Rule itself is subject to legal uncertainty because of the clarity in which the CAA specifies the 250-ton threshold, seeming to leave little room for the EPA to raise the threshold to 25,000 tons arbitrarily.[7] While that issue appears likely to play out in court, many smaller emitters are faced with considerable uncertainty as to whether they will actually be temporarily protected under the tailoring rule. If not, as noted, EPA estimates that more than 6 million new sources could be subject to regulation, including 1.4 million commercial buildings, and at least one million mid-sized to large commercial buildings emit enough CO_2 per year to become EPA regulated stationary sources.[8] For example, the threshold would be reached by one-fifth of all food services, one-third of those in health care, half of those in the lodging industry, even 10 percent of buildings used for religious worship.[9]

Most important, the Tailoring Rule, if upheld by courts, could result in the imposition of national ambient air quality standards (NAAQS) for CO_2 that could seriously harm the U.S. economy.[10] The endangerment finding asserts that current atmospheric CO_2 concentrations endanger public health and welfare, and a NAAQS for CO_2 would thus have to be set below current levels. Environmental organizations have already petitioned EPA to establish NAAQS for CO_2 set at 350 parts per million (PPM).

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[7]U.S. Environmental Protection Agency, "Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule," October, 27, 2009.
[8]Ibid.
[9]M. Portia, E. Mills, and Mark P. Mills, "A Regulatory Burden: The Compliance Dimension of Regulating CO_2 as a Pollutant," U.S. Chamber of Commerce, September 2008.
[10]Ben Lieberman, "Small Business Impact of the EPA Endangerment Finding," Heritage Foundation, January 20, 2010.

The present atmospheric CO_2 level is about 390 PPM. Even if the entire world et the emissions reduction target of the Waxman-Markey bill -- 83% below 2005 levels by 2050 -- this would only "stabilize" CO_2 concentrations at about 450 PPM. Not even a worldwide depression lasting decades would be sufficient to reduce CO_2 concentrations to 350 PPM. Nevertheless, under established legal interpretation, EPA is prohibited from considering compliance costs when establishing NAAQS. Thus, according to EPA, the endangerment test cannot legally weigh the economic impacts of the GHG regulations that will be promulgated pursuant to this finding.[11]

Industry groups have also initiated legal challenges, and their prospects may be favorable. EPA derives its authority to regulate pollutants from the CAA, but to use that law to regulate GHGs the agency must prove those gases are harmful to human health. That is, it must prove that a slightly warmer climate will cause Americans injury or death. Given that many climate scientists contend that a warmer earth could provide net benefits to the U.S., this may be difficult. Further, the leaked emails from the Climatic Research Unit in England ("Climategate") are providing rich fodder for those who want to challenge the science underlying the theory of manmade global warming.

Nevertheless, while Congress continues to debate the merits of climate change legislation and legal challenges to the Finding are filed, EPA has been steadily moving forward with a process to regulate GHGs under the framework of the CAA. As noted, on January 14, the first major step of that process -- a final rule concluding that GHGs endanger public health and welfare -- took effect, and with it the obligation to move forward with what could become the most expensive and intrusive set of regulations in U.S. history. The implementation of these rules will have a significant impact on the economy and all segments of the population, even if the "Tailoring Rule" survives legal challenges.

[11]"EPA Finalizes Endangerment Finding for Greenhouse Gases," Van Ness Feldman Law Firm, Washington, D.C., December 9, 2009.

III. STUDIES OF THE IMPACTS OF CARBON REGULATION ON THE ECONOMY AND JOBS

Numerous studies of the economic and jobs impacts of GHG control programs and legislation have been conducted over the past decade. The more significant of these are summarized below in three categories: Recent studies conducted in 2009 and 2008 of the impact of the American Clean Energy and Security Act of 2009 (ACESA) -- H.R. 2454, also known as Waxman-Markey, recent studies of the Impact of other climate change legislation, and EIA analyses of specific climate change legislation.

III.A. Recent Studies of the Impact of Waxman-Markey

American Council for Capital Formation and National Association of Manufacturers

The American Council for Capital Formation (ACCF) and the National Association of Manufacturers (NAM) contracted with SAIC to analyze ACESA, which is designed to substantially reduce U.S. GHGs over the 2012-2050 period.[12] The ACCF and NAM believe it important to fully and realistically examine the potential costs that enactment of the Waxman-Markey bill would impose on the U.S. economy.

ACCF and NAM applied input assumptions under two scenarios (high cost and low cost) that assessed the sensitivity of assumptions that have proven in the past to significantly impact the cost of limiting CO_2 emissions from energy. These input assumptions embody judgment on the likely cost and availability of new technologies in the early decades of a long-term effort to reduce GHGs as well as energy efficiency and renewable electricity standards.[13]

As summarized in Table III-1, the study's findings indicate substantial and growing impacts to consumers and the economy of meeting the increasingly stringent emission targets through 2030 established by Waxman-Markey (W-M). The most significant findings are summarized below.

[12]American Council for Capital Formation and the National Association of Manufacturers, *Analysis of the Waxman-Markey Bill "The American Clean Energy and Security Act of 2009" (H.R. 2454)*, August 2009. This study uses the NEMS/ACCF-NAM 24 model. The ACCF-NAM analysis of the Waxman-Markey bill used the most recent version of the EIA *Annual Energy Outlook*, the April AEO 2009.

[13]The assumptions include the availability of nuclear power technology for electric generation, the availability of carbon capture and storage for more efficient coal and natural gas-based power generation technologies, and the availability of wind and biomass technologies. The ACCF-NAM input assumptions also included assumptions regarding the likely availability of domestic and international offsets -- key factors influencing analysis of the cost of limiting greenhouse gas emissions.

Table III-1
Economic Impact of the Waxman-Markey Bill on the U.S. Economy

	Baseline (ACCF-Ref) 2020	Baseline (ACCF-Ref) 2025	Baseline (ACCF-Ref) 2030	Low Cost Case (W/M) 2020	Low Cost Case (W/M) 2025	Low Cost Case (W/M) 2030	High Cost Case (W/M) 2020	High Cost Case (W/M) 2025	High Cost Case (W/M) 2030
GDP (Billion 2007$)	$ 18,443	$ 21,016	$ 23,802	$ 18,403	$ 20,905	$ 23,384	$ 18,374	$ 20,853	$ 23,231
Loss in GDP (Billion 2007$)				$ 40	$ 112	$ 419	$ 68	$ 164	$ 571
% Loss				0.2%	0.5%	1.8%	0.4%	0.8%	2.4%
Employment (Millions)	157.2	160.7	165.8	157.2	160.4	164.0	157.1	160.2	163.4
Job Loss (Millions)				-0.01	0.33	1.79	0.08	0.52	2.44
% Loss				0.0%	0.2%	1.1%	0.0%	0.3%	1.5%
Industrial Output (Billion 2007$)	$ 7,962	$ 8,570	$ 8,839	$ 7,817	$ 8,305	$ 8,368	$ 7,790	$ 8,254	$ 8,263
Loss in Industrial Output (Billion 2007$)				$ 144	$ 265	$ 471	$ 172	$ 316	$ 575
% Loss				1.8%	3.1%	5.3%	2.2%	3.7%	6.5%
Coal Mining Output (Billion 2007$)	$ 27.4	$ 28.6	$ 29.2	$ 17.6	$ 12.9	$ 7.5	$ 17.0	$ 12.8	$ 7.0
Loss in Coal Mining Output (Billion 2007$)				$ 9.8	$ 15.7	$ 21.7	$ 10.4	$ 15.8	$ 22.2
% Loss				36%	55%	74%	38%	55%	76%
Primary Metals (Billion 2007$)	$ 188	$ 187	$ 164	$ 176	$ 166	$ 127	$ 171	$ 158	$ 116
Loss in Primary Metals Output (Billion 2007$)				$ 12	$ 21	$ 37	$ 17	$ 29	$ 48
% Loss				6%	11%	23%	9%	15%	29%
Carbon Allowance Price (2007$ / Ton CO2)				$ 47.50	$ 76.50	$ 123.21	$ 61.24	$ 98.63	$ 158.85
Average Household Income (2007$)	$ 98,929	$ 110,009	$ 121,731	$ 98,811	$ 109,670	$ 121,001	$ 98,679	$ 109,445	$ 120,483
Loss (2007$)				(118)	(339)	(730)	(250)	(564)	(1,248)
% Change				-0.1%	-0.3%	-0.6%	-0.3%	-0.5%	-1.0%
Energy Expenditures (Billion 2007$)	$ 1,480	$ 1,549	$ 1,682	$ 1,538	$ 1,652	$ 1,996	$ 1,584	$ 1,728	$ 2,136
Increase(2007$)				$ 57	$ 103	$ 313	$ 104	$ 179	$ 454
% change				3.9%	6.7%	18.6%	7.0%	11.6%	27.0%
Retail gasoline prices (2007 $/gallon)	$ 3.61	$ 3.69	$ 3.85	$ 3.92	$ 4.13	$ 4.62	$ 4.01	$ 4.28	$ 4.86
% Change				8.4%	12.1%	20.0%	11.1%	16.1%	26.1%
Residential Electricity Price (2007$ Cents/Kwh)	$ 11.10	$ 11.22	$ 11.69	$ 11.66	$ 11.77	$ 15.36	$ 11.98	$ 12.51	$ 17.54
% change				5.0%	4.9%	31.4%	7.9%	11.5%	50.0%
Industrial Electricity Prices (2007 Cents/Kwh	$ 6.45	$ 6.57	$ 6.91	$ 7.26	$ 7.78	$ 10.30	$ 7.84	$ 8.68	$ 12.17
% change				12.5%	18.4%	48.9%	21.5%	32.0%	76.0%
Residential Natural Gas Prices (2007$/Mcf)	$ 12.88	$ 12.93	$ 14.27	$ 12.46	$ 13.55	$ 22.31	$ 12.90	$ 14.24	$ 24.75
% change				-3.3%	4.8%	56.3%	0.1%	10.1%	73.5%
Industrial Natural Gas Prices (2007 $/Mcf)	$ 7.65	$ 7.62	$ 8.85	$ 10.19	$ 12.26	$ 16.55	$ 11.56	$ 14.19	$ 18.89
% change				33.3%	61.0%	87.1%	51.1%	86.3%	113.5%
Electric Utility Coal Prices (2007 $/Ton)	$ 38	$ 39	$ 40	$ 124	$ 180	$ 269	$ 151	$ 224	$ 345
% change				224%	359%	565%	295%	472%	755%
Manufacturing Employment (Millions)	12.0	11.6	10.1	11.8	11.2	9.5	11.7	11.1	9.4
Job Loss (Millions)				0.21	0.38	0.58	0.28	0.49	0.74
% Loss				1.8%	3.3%	5.8%	2.3%	4.2%	7.3%

Source: American Council for Capital Formation and the National Association of Manufacturers, 2009.

First, U.S. economic growth slows under W-M, especially in the post 2020 period as the free emission allowances are phased out for both energy producers and energy consumers. In 2030, the inflation adjusted, annual GDP level is reduced by 1.8 percent ($419 billion) under the low cost scenario and by 2.4 percent ($571 billion) under the

high cost scenario, compared to the baseline forecast.[14] Over the entire 18 year period (2012-2030) covered by the analysis, cumulative GDP losses are substantial, ranging from $2.2 trillion dollars under the low cost case to $3.1 trillion under the high cost case. The loss to federal and state budgets is large, and cumulative tax receipts will be reduced by between $670 billion and $930 billion compared to the baseline forecast.

Second, industrial production begins to decline immediately in 2012 under W-M, relative to the baseline forecast. In 2030, U.S. industrial output levels are reduced by between 5.3 percent and 6.5 percent under the low and high cost scenarios. A hallmark of economic downturns and recessions is a slowdown in the growth rate or an absolute decline in the level of industrial output. Clearly, the negative impact on industrial output of W-M would make it harder to keep the U.S. economy out of recession or prevent sluggish growth insufficient to restore job growth.

Third, employment is negatively impacted, even when additional "green" jobs are factored in. Over the 2012-2030 period, total U.S. employment averages between 420,000 and 610,000 fewer jobs each year under the low and high cost scenarios than under the baseline forecast. By 2030, there are between 1.8 and 2.4 million fewer jobs in the overall economy. Manufacturing employment is hard hit: In 2030 there are between 580,000 and 740,000 fewer jobs, or between a six and seven percent reduction in total manufacturing employment in the U.S compared to the baseline forecast. On average, over the 2012-2030 period, the manufacturing sector absorbs 59 to 66 percent of the overall job losses caused by W-M.

Fourth, energy prices rise over the 2012-2030 period, due to the various features of W-M, including prices for carbon permits, which gradually rise to between $123 and $159 dollars per ton of CO_2 by 2030 as well as the renewable portfolio standards, low carbon fuel standards, and energy efficiency standards. Over the past decade, each one percent increase in GDP in the U.S. has been accompanied by a 0.3 percent increase in energy use, thus higher energy prices will make it harder to recover from the current recession and to reduce the current high rate of unemployment. The ACCF/NAM study shows that residential electricity prices are 5 to 8 percent higher by 2020, by 2030 electricity prices are between 31 to 50 percent higher. Further, by 2030 Gasoline prices are up to 20 to 26 percent higher than under the baseline forecast.

Finally, household income drops under W-M, even after accounting for rebates to consumers mandated in the bill. In 2030, the decline in annual household income ranges from $730 in the low cost case to about $1,250 in the high cost case. However the impacts on household income in individual states, especially in the Midwest are more than 40 percent higher than the national average. For example, household income in Illinois is $1,100 lower in 2030 under the low cost case and $1,800 lower

[14]To put these GDP losses in perspective, in 2008 the Federal government spent $612 billion on social security payments to retirees. Looked at another way, if GDP levels are reduced by $571 billion in 2030, Federal and State tax receipts will be approximately $170 billion lower that year, since federal and state governments take approximately 30 cents out of every dollar of GDP. Thus, government budgets will be harder to meet.