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RULE BREAKER

In Washington, Tiny Think Tank Wields Big Stick on Regulation

With White House Ex-Staffers, Mercatus Helps Zap Codes It Says Restrict Business

The Cost of Protecting a Fish

By BOB DAVIS | Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON -- In 2001, the new Bush White House sought suggestions for government regulations to kill or modify. A small think tank called the Mercatus Center named 44 it didn't like -- among them, rules governing energy-efficient air conditioners and renovations to electric-utility plants.

Ultimately, 14 of the 23 rules the White House chose for its "hit list" to eliminate or modify were Mercatus entries -- a record that flabbergasted Washington lobbying heavyweights. A year later, the National Association of Manufacturers failed to persuade the administration to embrace even one item on its regulatory wish list. Now it's trying to copy Mercatus. "We said, 'Why were they more successful than we were?' " says Lawrence Fineran, the manufacturers' vice president for regulation.

When it comes to business regulation in Washington, Mercatus, Latin for market, has become the most important think tank you've never heard of. Staffed by veterans of the White House office that reviews and often scales back proposed rules, Mercatus, with its free-market philosophy, has become a kind of shadow regulatory authority. The White House's top regulator, John Graham, was briefly a member of Mercatus's board of advisers before taking the government post.

Many well-known independent Washington think tanks, such as the Brookings Institution or the American Enterprise Institute, issue analyses of regulations, but usually only on broad themes or prominent issues. Industry lobbyists -- representing, say, auto makers or drug companies -- circulate views on more obscure regulations, but with the specific purpose of boosting their sponsors' profits.

Mercatus is a rare hybrid. It is considered an independent think tank because it's part of George Mason University and gets funding from many sources. But Mercatus issues biting opinions on dozens of rules, including little-known ones that only lobbyists usually get excited about.

"Mercatus is the only academically respectable place I know that does what K Street lobbyists do," says Peter Van Doren, editor of Regulation magazine, a journal published by the libertarian Cato Institute. "They follow the minutiae of regulation to see how rules will affect particular industries."

Mercatus posts tips about new regulations on the RegRadar page of its Web site, dubbing rumored regulations "UFOs." It hosts workshops on Capitol Hill to court congressional staffers who delve into regulatory issues. To boost its visibility, Mercatus recently hired two former congressmen, a Democrat and a Republican.

Mercatus analysts amplify their impact by talking the language regulators understand. In formal comments, they detail whether costs of a new rule exceed the benefits, whether rules disadvantage consumers or small businesses, and whether agencies have considered less burdensome alternatives. Then they grade the proposals -- often giving Ds and Fs.

After a withering Mercatus critique, the Environmental Protection Agency changed its mind about the benefits of a rule that required utilities to kill fewer fish with their power plants. At federal agencies, "if they know that Mercatus is working on a rule, they'll be more careful," says Richard Belzer, a former government regulatory official.

Mercatus's rise owes much to the oil-and-gas company Koch Industries Inc., (pronounced "coke"), a privately owned company in Wichita, Kan., that contributes heavily to Republican causes and candidates. A Koch family foundation has given Mercatus and George Mason University a total of \$14.4 million since 1998, according to public documents analyzed by the Public Education Center, a Washington group that tracks environmental issues. A Koch spokesman says about half of the money went to Mercatus. In addition, the company's chief executive, Charles Koch, donated interests in limited partnerships to Mercatus that the think tank sold last year for \$6.1 million. Mr. Koch is a Mercatus director.

A predecessor to Mercatus was founded at Rutgers University by a former economics professor, Richard Fink, who also started an anti-tax group. Mr. Fink later moved the think tank to George Mason, a Virginia state university that has become a center for free-market economics. In 1990, Mr. Fink joined Koch Industries, where he is now an executive vice president overseeing lobbying and communications. He remains a Mercatus director.

Public Citizen, a consumer group founded by Ralph Nader, dismisses Mercatus as "a wholly owned subsidiary of Koch Industries and other corporate interests." But Mr. Fink says Koch has no intention of using the think tank to promote its interests in oil and gas, although it has had run-ins with state and federal regulators over pollution violations. Koch "has other means of fighting its battles" in Washington, Mr. Fink says. "We have never had a nonprofit advance our agenda."

In 1998, Wendy Gramm, who headed the White House Office of Information and Regulatory Affairs during the Reagan years, started Mercatus's regulatory review

group. She hired a small staff of regulatory experts to work with economists at George Mason and elsewhere. Ms. Gramm, wife of former Texas Republican Sen. Phil Gramm, says Mercatus differs from special interests because it analyzes "all impacts" of rules with the public interest in mind. Over the past six years, Mercatus has filed 100 comments to 31 agencies on rules ranging from auto safety to financial regulation.

William Kovacs, vice president for regulation at the U.S. Chamber of Commerce, says Mercatus acted as a coordinating center for lobbyists trying to block a flurry of regulations that the Clinton administration proposed in its last months in office. Lobbyists checked Mercatus's Web site (www.mercatus.org) for news on regulations, and sent information for Mercatus to post. Mercatus later put many of these regulations on the suggested hit list it sent to the Bush White House.

The Office of Information and Regulatory Affairs, which drafted the actual hit list, says it chose so many Mercatus entries as high priorities in 2001 because the think tank was ready with suggestions and others weren't. "If there was a problem," an OIRA annual report said in 2002, "it was not that the Mercatus Center was too active but that other potential commenters were silent." When OIRA sought new suggestions for regulations to target in 2002, people got the message: The office received submissions from 1,700 groups and individuals. OIRA decided that was too many to sift through and ended up forwarding them to agencies without drawing up a hit list.

Members of the Mercatus "Founder's Circle" of contributors in 2002 -- those who give at least \$10,000 -- included ExxonMobil Corp., Fannie Mae, Freddie Mac, General Motors Corp., Gillette Co., Microsoft Corp., Morgan Stanley Dean Witter Co., the New York Stock Exchange and Pfizer Inc. The Chamber of Commerce recently donated \$50,000 to Mercatus to research tort reform.

Mercatus says it isn't beholden to any company. After Mercatus scholar Jay Cochran published a November 2001 report that detailed mortgage giant Fannie Mae's government subsidies, the company's top lobbyist at the time, Arne Christenson, chewed him out over the telephone for not showing the study to Fannie in advance.

Mr. Christenson says he felt blind-sided, and just wanted a chance to present Fannie's views. "I considered Mercatus to be a soul mate," he says. Mr. Cochran held firm. "Just because you're the subject of the study doesn't give you the right to shape it," he says. Fannie Mae no longer contributes to Mercatus; Mr. Christenson, who has left Fannie, says the incident didn't play a role in that decision. A Fannie Mae spokesman declined to comment.

Mercatus's 29-person staff works from a warren of small offices decorated with Mexican folk-art paintings in George Mason's law school in Arlington, Va. The center spends about 9% of its \$6.8 million budget on its in-house regulatory program. Much of the rest of the budget is devoted to seminars and outside research on economic issues including regulation. Ms. Gramm stepped down as director of Mercatus's regulatory unit last year, although she remains a Mercatus

fund-raiser. She was succeeded by a protégé, Susan Dudley, who had worked for Ms. Gramm at the Reagan White House.

Ms. Dudley, a 49-year-old graduate of Massachusetts Institute of Technology's Sloan School of Management, specializes in environmental regulation and drives a 2001 Toyota Prius hybrid to work with her husband, another alumnus of the White House regulatory office who ended up at Mercatus. She calls herself a "free-market environmentalist," explaining she wants to protect the environment through "market-based incentives."

One example of how Mercatus works the system was its 2003 effort to blunt an EPA rule on how many fish a power plant could kill when it sucked in river water for cooling. The rule would cost utilities money while benefiting commercial fisherman by giving them more fish to catch. The EPA argued that there was an additional benefit: the "sense of altruism [and] stewardship" consumers would feel by protecting river ecosystems. It contended this was worth hundreds of millions of dollars -- more than the benefit to fishermen.

Ms. Dudley and another Mercatus researcher poked at the calculation. They found it rested in part on a study of consumers in affluent eastern Long Island who were asked whether they would be willing to pay to protect the wetlands. By the EPA's logic, Ms. Dudley argued in formal comments and an opinion piece in the Washington Times last year, Americans "place a much higher value on a fish swimming free than one on your plate."

The article was passed around EPA headquarters, and agency officials say it added to the pressure on the EPA from the White House and the Energy Department to drop the altruism calculation. Mary Smith, an EPA official who worked on the rule, says some of Mercatus's criticisms were overstated but the EPA didn't have the time to do a fresh study.

The EPA issued the final fish-kill rule earlier this year, but acknowledged that the economic costs of the regulation far outweigh the benefits. Mercatus sees that as a victory because it helps the think tank make the broader case that many environmental rules are more expensive than they are worth.

Mercatus analysts sometimes contort themselves to build a case against regulation. Ms. Dudley and Ms. Gramm criticized one EPA rule to reduce surface ozone because the EPA didn't take into account that clearer skies would increase the rate of skin cancer. Later, two other Mercatus scholars blasted a different EPA rule on diesel engines, arguing that it was bad because it would increase surface ozone in some cities. This time they didn't say anything about the cancer-prevention benefits of more smog. "We didn't go to the next step," Ms. Dudley acknowledges.

Lisa Heinzerling, a Georgetown University law professor, says Mercatus "cites the most outlandish costs of regulation." She helped organize a liberal think tank called the Center for Progressive Regulation to counter Mercatus's influence.

Partly because of Mercatus's reputation for ideological fervor, White House

regulators have recently distanced themselves from the think tank. The White House regulatory office has approved a number of regulations that Mercatus criticized, including the diesel-engine rule.

Over the past year or so, Mercatus has tried to broaden its reach, hiring former Democratic Rep. Tim Roemer of Indiana. He has made an effort to invite Democratic staffers to Mercatus seminars. Another new hire is former Rep. J.C. Watts of Oklahoma, a Republican.

In May Mercatus staged a session, funded by Gillette, for staffers of the Congressional Black Caucus and the National Association for the Advancement of Colored People. Mercatus researchers argued that if lawmakers want to limit pollution, they should try market-based solutions, such as trading emission permits.

Although the Bush administration has drawn criticism from liberals for easing environmental regulations, Ms. Dudley argues that even under Republican rule overall regulatory costs continue to rise. The answer, she says: more Mercatus studies to show the real burden of red tape. "Clean air sounds so good," she says. "But what are the costs? They're hidden."

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