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STATEMENT OF
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U.S. GENERAL ACCOUNTING OFFICE
BEFORE THE
SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
ON
GAO'S REPORT
THE DEPARTMENT OF THE INTERIOR'S OFFICE OF SURFACE MINING SHOULD MORE FULLY RECOVER OR ELIMINATE ITS COSTS OF REGULATING COAL MINING

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to appear here today as you consider the impact on the coal industry of the Office of Surface Mining's (OSM's) proposed rules to increase its mining permit fees. As you requested, I will discuss GAO's recent report on how OSM could more fully recover or eliminate its regulatory costs and the effects of doing so on coal demand and production.[1]

Our report recommends that OSM use its existing legal authority to recover or eliminate more than $51 million a year in regulatory costs. Specifically, we recommend that OSM assess coal operators permit fees to fully recover its own regulatory costs and phase out or substantially reduce its grants to states. These are grants that assist states--or in some cases reimburse them--for the costs of regulating surface mining. We also believe that

[1] The Department of the Interior's Office of Surface Mining Should More Fully Recover or Eliminate Its Costs of Regulating Coal Mining (GAO/RCED-85-33, May 28, 1985).

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the Congress may wish to consider enacting a special tax on coal operators to offset regulatory support costs of another $14 million. Our analysis indicates that recovery of all these costs would have little effect on coal demand and production.

In my testimony today I will describe the findings and conclusions that led to these recommendations, focusing on:

--the basis for full cost recovery,

--OSM's regulatory programs and their costs,

--the impact of recovering the costs of state and federal regulation on coal demand and production, and

--state and interest group comments on our report.

BACKGROUND

To control the environmental damage caused by coal mining, the Surface Mining Control and Reclamation Act of 1977 sets standards for coal mining operations and encourages the states to assume primary responsibility for regulating coal mining on state and private lands. The Office of Surface Mining was established within the Department of the Interior to oversee the development of the states' programs and to act as the regulatory authority when states decline to assume authority or do not adequately carry out their responsibilities. OSM also regulates coal mining on federal and Indian lands, in some cases sharing authority with state governments.

Under the Surface Mining Act, OSM is authorized to award grants to states to assist them in the development, administration, and enforcement of their regulatory programs. States can also receive grants to regulate mining on federal lands if they have approved programs and cooperative agreements with Interior.

Whether the regulatory authority is OSM or a state, it is required by section 507(a) of the Surface Mining Act to charge coal mine operators a fee when they apply for a mining permit. The fee--while it may be less--can cover up to the agency's full costs of reviewing, administering, and enforcing the permit.

COST RECOVERY GOALS

Although the law grants the regulatory agency the discretion to charge less than its full costs, administration and Interior Department policy require federal agencies to recover as much of their regulatory costs as possible through user fees. Likewise, we have long held that federal agencies should recover their costs as fully as possible whenever they provide goods, services, or privileges that benefit identifiable recipients.

This position has also been upheld in a series of court decisions that have found that costs may be recovered from regulated industries when the services provided are necessary to a company's operation.[2] We continue to believe that assessing costs against beneficiaries, rather than taxpayers in general, promotes more fair, efficient, and economical government operations.

Consequently, in reviewing OSM activities, our objectives were to estimate the agency's costs to regulate coal mining and to assess how it could more fully recover its costs through permit fees and other means available under the Surface Mining Act.

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[2]See, for example, Mississippi Power and Light Co. v. Nuclear Regulatory Commission, 601 F. 2d 223 (5th Cir., 1979).

OSM REGULATORY COSTS

We found that OSM spent about $65 million in fiscal year 1984 to regulate coal-mining operations. It spent about $9 million administering its own regulatory programs and $42 million to provide states with grants for mining regulation. We believe that OSM should exercise its existing authority to recover or eliminate these costs. OSM also spent about $14 million on research, oversight and other activities in support of both federal and state regulation. These support costs could also be offset if the Congress wished to enact a special tax.

OSM should seek full recovery of its own regulatory costs

We believe that as the first of its cost recovery measures, OSM should assess all operators that it regulates directly the actual costs it incurs to review, administer, and enforce their permits. OSM currently collects permit fees only from operators on federal lands that are regulated solely by OSM. Moreover, these fees are generally well below OSM's costs. As a consequence, in contrast to the $9 million it spent on permit-related activities in 1984, OSM collected only $29,000 in permit fees.

We therefore support OSM's actions to increase its permit fees and extend them to all mine operators regulated by it. However, while these fees--as proposed by OSM--would be based on the actual costs of processing permits, they would not include OSM's costs for routine inspections of mine operations or other enforcement activities, even though the Surface Mining Act

specifically allows such costs to be included. OSM's 1984 inspection and enforcement costs came to about $4 million out of the $9 million in OSM regulatory program costs.

OSM is concerned that recovering the costs of inspection and enforcement will impose an additional economic burden on mine operators. While recovery of these costs would add to operators' costs, coal industry officials told us that small coal operators are likely to be the ones most affected by any increase in fees. We note, however, that the Surface Mining Act singles out small operators for special treatment and protection from onerous regulatory requirements.[3] OSM proposes in its draft regulations to assist small operators by charging them a nominal fee of $500. By assisting them in this way, OSM could lessen the economic burden on small operators while still recovering the costs of enforcement activities from others.

OSM should phase out or substantially reduce grants to states

Of the $65 million in OSM regulatory costs, $42 million was for its grant programs. About $5 million of the $42 million was for states with cooperative agreements to regulate mining on federal lands. The rest--$37 million--was for administration and enforcement grants that help support state regulatory programs.

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[3]Under Section 507(c) of the act, small operators--defined by the law as producing less than 100,000 tons a year--can get assistance from OSM or state regulatory authorities in meeting certain permit requirements.

Although the states could fully recover their regulatory costs from operators under the same authority that OSM now proposes to exercise, the grants that they receive from OSM give them no reason to do so. Each of these states with approved programs now charges a permit fee, as required by law. In most cases, however, the fees are under $500, ranging from $5 to $2,500 plus $25 per acre. While we did not determine the states permit costs, we estimate that it costs OSM from $72,000 to $235,000 to process and enforce a mining permit, depending on the size and location of the mine and other factors. Even if the states' costs are much lower than OSM's, their fees will not approach program costs.

The Surface Mining Act does not require that OSM provide grants to the states; it simply authorizes the Secretary of the Interior to do so. As mentioned earlier, we have historically taken the position that when federal funds are used indirectly to subsidize identifiable beneficiaries, as in the case of grants to state and local governments, federal agencies should encourage the recovery of their expenditures by requiring reimbursement or eliminating grants altogether.

States can raise their permit fees to recover the costs of coal mining regulation that are now supported by federal grants. If the grant programs were phased out, the states would have incentive to exercise this authority. We therefore believe that OSM should begin phasing out both its administration and enforcement grants as well as its cooperative agreement grants, giving the states enough time to accommodate the loss of funding.

We recognize that this may not be always feasible. During the course of our review, a few state regulatory officials told us that many of the mine operators in their states are small and that for them, a large increase in permit fees could pose a substantial economic hardship, forcing them out of business. In Kentucky, for example, about 70 percent of the operators fall into this category.

As I noted earlier, the Surface Mining Act shows the intent on the part of the Congress to provide small operators special treatment; it is for this reason that OSM is proposing lower permit fees for them. If OSM wanted to extend this policy to support small operators, it could continue to provide grant support to the states.

But even with continued assistance to the states for small operators, OSM could still realize substantial savings by reducing or phasing out its grant programs. In the four states where 82 percent of the country's small operators are concentrated, OSM could cut back its grant programs by close to half if support were limited to small operators, and save about $10 million in those four states alone.

Together, these two measures--charging full cost permit fees and eliminating state grants--could save the federal government up to $51 million a year depending on the continued level of support provided to small operators. While our recommendations go considerably beyond OSM's current proposal, we believe, for the reasons I've discussed, that they merit serious consideration.

Recovery of support costs would require legislation

While OSM has the authority to recover or eliminate most of its regulatory costs, it cannot now recover the cost of activities that support both federal and state regulatory programs. These include mining-related research, technical assistance, development of regulations, and mine inspections and reviews of state-issued permits to check for compliance with federal law. Court decisions of recent years have established that federal agencies may not recover such costs through fees, holding that agencies may charge fees only for activities that benefit an identifiable recipient. Since OSM's support activities do not benefit any single permit-holder, OSM could recover its costs for these activities only if Congress were to levy a special tax on coal mine operators for that purpose.

As you know, the Surface Mining Act does not authorize such a tax. But because these support activities primarily benefit coal mine operators as a group, rather than the general public, we believe Congress may wish to consider enacting a special tax, thereby offsetting costs of about $14 million a year for support activities. Since OSM now collects a tax from operators to pay for reclaiming abandoned mine lands, it already has the administrative capability to collect additional taxes.[4]

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[4]Under the Surface Mining Act, coal operators are assessed a tax of 35 cents per ton of coal produced by surface mining, 15 cents per ton for underground mining, and 10 cents per ton for lignite (or 10 percent of the coal's value at the mine and 2 percent of the lignite's value at the mine, whichever is lower.)

To sum up, if OSM were to charge fees that fully reflected its costs to process and enforce its permits, and if it were to eliminate its grants to states, it could save over $51 million a year. If, in addition, Congress were to authorize a special tax to offset the costs of OSM's support activities, the total savings realized would be about $65 million annually.

EFFECTS OF COST RECOVERY

The basis for these savings, of course, is the transfer of costs from the government to coal operators and, ultimately, consumers. Consequently, as part of our review, we examined the impact of recovering regulatory costs on coal demand and production, both at the national and state or regional levels. In some ways, our analysis could be considered a worst-case scenario, since it assumes that OSM would recover all of its permitting and enforcement costs, as well as the costs of its support activities. It also assumes that each state would recover all of its permit and enforcement costs from coal operators, even though a number of states now use other revenues to support their programs and might continue to do so in the future. In all, these state and federal regulatory costs amounted to about $94 million a year in 1984.

Thus, assuming full cost recovery, about $94 million would be added to the annual costs of coal production in the United States. On the basis of the level of coal production in 1982, this would add 11.7 cents per ton on a nationwide average. State by state, the increase in production costs would vary considerably, depending on the costs of permitting and enforcement and the amount of coal mined. We found that costs could increase by as

little as 3.8 cents a ton in Arizona to as much as 38.8 cents a ton in Tennessee.

Our analysis found that if production cost increases were fully reflected in coal prices, there would be no significant effect on demand. According to Energy Information Administration (EIA) data, coal enjoys a considerable price advantage over other fuels used for electricity generation, which accounts for 80 percent of the demand for U.S. coal. Because of this price advantage, the EIA staff told us that coal prices might have to rise by $5 a ton before any change in coal demand might occur. Moreover, the highest production cost increase of 38.8 cents a ton was less than 1 percent of the delivered price of coal per ton to consumers in 1984. EIA staff also said that a 3 to 40 cents-a-ton price increase would have only a negligible effect on electricity costs to consumers.

EIA data also suggests that exports of U.S. coal would be unaffected because the price increases would be such a small portion of the delivered price of coal--hardly more than half a percent per ton in some cases. In addition, U.S. coal historically has been $10 to $20 a ton more expensive than coal from other countries, indicating that other factors--such as security of supply--are more significant than price competitiveness in determining demand for U.S. coal.

Although we found that overall demand for coal was not likely to be affected by full cost recovery, there remained the possibility that the variations in regulatory costs from state to state could cause regional shifts in demand, with coal production moving

from states with higher regulatory costs per ton of coal to lower-cost states. Here again, however, we found little change resulting from production cost increases.

With the help of EIA staff, we used their Coal Supply and Transportation Model, which simulates the choices in supply sources and transportation modes that coal customers within various regions of the country will make, depending on variations in coal costs. The model assumes that operators would pass along their costs in the delivered price of coal. In this way we found that by 1990, only Pennsylvania--where we estimate regulatory costs to be about 17 cents a ton (or 20 cents a ton with support costs added)--could lose about 1.5 million tons of coal production a year to West Virginia, where regulatory costs are close to 6 cents a ton (9 cents with support costs). No other significant changes in production and distribution were projected, including any major interregional shifts, such as from East to West. For Pennsylvania, this loss represents about 1 percent of the state's production, and a shift of about a tenth of a percent of the nation's production.

In its own, later analysis, the Interior Department reached much the same conclusions. Using a U.S. Geological Survey model, which examines U.S. coal production in 100 coal-mining regions rather than by state, Interior found that the recovery of regulatory costs, as calculated by OSM, would have no effect on coal production. The cost increase, Interior found, was not large enough to change the relative cost advantage of even a few coal-supply regions. Interior then ran its model using our estimates

of costs, which were somewhat higher than OSM's. This run showed that in the Midwest, one region was expected to lose about 1 million tons to another, while in the West, three regions were projected to lose a combined total of roughly 800,000 tons to another region by 1990.

Although we assumed that regulatory costs would be fully passed on to consumers in the form of higher prices, we recognized that coal companies might not always choose to or be able to increase their prices. We therefore talked to a number of coal industry officials to find out generally how production cost increases of the magnitude that we projected might affect the industry. Although no one welcomed additional costs, they said that the increase would be a burden primarily to small operators, who often cannot pass through cost increases to their customers. However, as I noted earlier, this could be mitigated by some continued level of support for small operators.

STATE AND INTEREST GROUP COMMENTS

Despite our finding of a general absence of impact resulting from cost recovery, we nevertheless recognize that the effects of our recommendations could be far-reaching. As is our usual procedure, we asked for comments on our draft report from the Interior Department. We also invited comments on the report from the governors of 27 coal mining states, coal industry associations, and citizen and environmental groups. In addition to Interior, 19 of the 27 states replied, as did about half of the other groups.

All of the states who commented, along with the coal groups, objected strongly to our recommendations, in particular to the elimination of state grants. Six states told us that they might relinquish mining regulation to the federal government because they could not or would not replace grant funds with other revenues or fees assessed against coal operators.

Many of those who raised objections were against cost recovery in principle, arguing that since the public benefits from surface mining regulation, coal operators should not have to assume the costs. A number of states were also opposed to our proposals because they feared the adverse effects of increased costs on coal operators, especially small operators.

As we noted in responding to these comments in our report, we recognize that full cost recovery could lead some states to give up their regulatory programs. We also recognize that some coal companies, especially small ones, might find any production cost increase, no matter how small, a significant burden. However, surface mining regulation will still continue under federal auspices if state programs end. And if OSM wishes to, it may continue to provide support to cover the costs of small operators who cannot afford to pay their full share.

We do not disagree with those who argue that the Surface Mining Act's intent is to protect the public. Indeed, all federal regulation is meant to serve the public interest. The question is whether the public at large or coal mine operators and their customers should bear the costs. We believe that there is

sufficient policy and legal precedent to justify the full recovery of OSM's regulatory costs.

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Mr. Chairman, this concludes my remarks. I would be pleased to respond to any questions.