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Written Testimony of
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Mr. Chairman and Members of the Committee:

Thank you for the invitation to testify today on federal rulemaking and the regulatory process. I am an economist and the Director for the Regulatory Studies Program and the Government Accountability Project at the Mercatus Center, a 501(c)(3) research, educational, and outreach organization affiliated with George Mason University.¹ For over three decades, I have been involved with the federal regulatory process at multiple levels. Previously, I worked as the Director of Social Sciences for the Center for Food Safety and Applied Nutrition in the Food and Drug Administration (FDA). In that capacity I worked on regulations for 27 years at FDA with the exception of a three month detail in the Office of Information and Regulatory Affairs (OIRA). I also served for three years in the Army and had a tour of duty in Vietnam.

My testimony focuses on the essential role that effective checks and balances play in the pursuit of high-quality, effective and economically efficient regulations. James Madison in Federalist No. 51 said, "If men were angels, no government would be necessary... you must first

enable the government to control the governed; and in the next place oblige it to control itself.” Absent regulators being angels, it is imperative that we apply effective checks and balances to regulatory agencies.

U.S. government agencies implemented the first federal regulations nearly 140 years ago. Since then, regulations have become a large part of how the federal government functions. Today, according to Regulations.gov, we are implementing nearly 8,000 regulations per year at a cost that may exceed \$1 trillion.² With so many regulations under development or being implemented, who is exercising oversight to assess their quality and effectiveness? With the courts giving deference to agencies in their interpretations of federal statutes and Congress virtually never exercising its authority to review and overturn rules, that leaves the small Office of Information and Regulatory Affairs (OIRA) as the sole bulwark for independent regulatory oversight. Yet, OIRA’s recent record indicates that it may not be fulfilling its critical duties. OIRA’s website shows that they are spending much less time reviewing very expensive rules and, under the current administration, the office has not returned a single proposed rule to its authorizing agency.

So why should we be concerned about regulatory checks and balances? We should be concerned primarily because they have a direct impact on our nation’s economy and international competitiveness. Current news stories report that businesses are afraid to invest in new enterprises in the United States because of uncertainty about new taxes and regulations, including regulations related to greenhouse gas emissions, health care, and financial markets.³ Adding to the uncertainty is OIRA’s apparently weak role in ensuring that the agencies thoroughly analyze regulatory policies and pay proper attention to benefits, costs, and unintended

consequences. This uncertainty forces people to reconsider investment decisions, including whether they should invest in the United States or move their capital abroad.

Our research at the Mercatus Center shows why weak checks and balances lead to dangerous trends in regulation that deter economic efficiency and growth. We find that agencies do an uneven and overall mediocre job in preparing regulatory impact analyses (RIAs), which are vital to understanding the likely economic effects of rules. Agencies clearly need to improve the quality and consistent use of these analyses.

In terms of regulatory reform, the Obama Administration has announced its intent to improve analysis and procedures by: (a) humanizing analysis, (b) using rigorous science, and (c) advancing open and transparent government, particularly “democratizing data.” My testimony examines how the following key factors will affect the potential success of these proposals:

- The value of benefit-cost analysis and analysis of values;
- Using behavioral economics in the development of regulations;
- Ensuring OIRA’s role in the use of rigorous science by federal agencies; and
- Using transparency to try to solve the knowledge problem.

Finally, I outline how OIRA can assist federal agencies in improving the quality, effectiveness, and efficiency of their regulatory regimes.

1. The Value of Benefit-Cost Analysis and Analysis of Values

The two types of analysis that agencies use the most extensively in evaluating regulations, particularly those that affect health, safety, the environment and security, are regulatory impact analyses and risk assessments. Regulatory impact analyses are comprehensive analyses of proposed and final rules that contain: (a) statements of the need for rule, *i.e.*, what systemic problem the rule intends to solve; (b) a review of multiple options to solve the problem;

and (c) an assessment of the benefits and costs of each option. For health, safety, and environmental rules, benefits are based on intended reductions in risk. Estimates of risk are taken from risk assessments that examine both the exposure to and the potency of (dose-response) of risky compounds and practices. Risk assessments come in two forms: (a) safety assessments, which define “safe” doses, and (b) actual risk assessments, which estimate levels of risk at various exposures. Only the latter is useful in a benefit-cost analysis. Both types of analysis assemble facts in a useful manner for decision makers and neither is, or at least neither is supposed to act as, a substitute for decisions.⁴

I would like to focus attention on why regulatory impact analyses, in particular, the benefit-cost analysis component in RIAs, continue to be important in the regulatory process. The key value of an RIA is often the result of asking questions that otherwise would not be asked during the development of regulations, such as:

- What systemic problem/risk does this rule attempt to address?
- What are all of the relevant ways in which it might be solved (including a determination of whether people are likely to solve the problem without regulation in the near future)?
- For each potential solution, what is the actual mechanism for solving the problem and what is the proof it will be effective?
- How are people and institutions likely to respond to various legal regulatory options?
- What is the cost of each option?
- What might happen that is not part of the rule but is an unintended effect, *i.e.*, a risk/risk issue?

An example of a risk/risk trade-off might be a decision to regulate the manufacture of infant formula, often the sole source of nutrition for infants. Such a regulation would increase the price of infant formula causing a substitution effect. In this instance, surveys have shown that when the price of powdered infant formula increases, less wealthy consumers try to extend it by adding more water. The risk from watering down infant formula (decreased nutrient intake) may exceed any reduced risk from improved manufacturing practices. An RIA should identify

effects like these so that decision makers have a much better understanding of the consequences of their decisions.

By identifying the problem accurately, finding the least restrictive and least costly way to solve the problem, and ensuring the identification of all unintended consequences, thorough economic analysis can help decision makers make better informed decisions. However, all of that begins with agency economists who prepare these analyses, and OIRA plays an extremely important role in whether or not these analyses are done well and are used to inform the rulemaking process.

Benefit-cost analysis, the primary component of RIAs, has its foundations in microeconomics and has been used in by federal government agencies since the 1960's. The general acceptability of the principles and use of benefit-cost analysis can be seen by the fact that the last six administrations have adopted it for general use by federal agencies via executive order. In fact, President Clinton's Executive Order 12866 did not significantly alter the requirements of President Reagan's Executive Order 12291. One of the modifications made to Executive Order 12291 by the Clinton Administration was to add more focus on identifying distributional effects. The Obama Administration has proposed to humanize analysis by incorporating the findings of psychology and behavioral economics into analysis and focusing on distributional fairness and intergenerational concerns.

While these concerns are indeed important, it is critical that policymakers refrain from treating these issues as components of benefit-cost analysis. Distributional fairness and intergenerational concerns can be highly subjective issues. Subjective weights should not be used to calculate what is fair or equitable in benefit-cost analysis as it would be theoretically improper and would result in arbitrary values that would be misleading to decision makers.

For example, there are different definitions of fairness. Some people believe it is fair if every firm has to comply with all regulatory requirements equally, often referred to as a “level playing field.” The Regulatory Flexibility Act and its amendment, the Small Business Regulatory Enforcement and Fairness Act, define fairness differently. It may be *unfair* to make a small business purchase the same type of capital equipment, whose costs must be covered by a smaller sales base, as that required for a larger competitor. The smaller sales base means that the small business has to raise its prices much higher than the large business to cover the cost of the equipment. That puts the small business at a competitive disadvantage, which seems unfair. Using this theory, a regulation that requires every firm, no matter what size, to purchase the same equipment to level the playing field is not fair.

While it is important in many instances to consider what is fair or equitable, these considerations fall largely outside of benefit-cost analysis. Certainly, as required by Executive Order 12866, analysts are supposed to identify who will bear the costs and who will enjoy the benefits. In many cases, this is critical information decision makers will want to know, and I would argue that regulatory analysis should always provide this information in case decision makers might find it useful. In some cases, such as regulations that outline how federal agencies will spend money, the agency uses tax dollars to produce an outcome that benefits a specific target population. Benefit-cost analysis can help us understand how cost-effectively the regulation helps the intended beneficiaries.

That is different, however, than counting a transfer from one person to another as a net social “benefit” in a benefit-cost calculation. There is no generally accepted economic theory that could, for example, assign a quantitative benefit to a regulatory option that is more “fair” or more equitable. Fairness is not included in the microeconomic foundations of benefit-cost

analysis because it is purely a value judgment. A judgment about whether a transfer of benefits from one group to another is “fair” is simply a judgment based on the decision maker’s values, not economic analysis. Different decision makers may make different value judgments about whether a regulation is fair based on their own political and ethical philosophies.

Beyond identification of who gains and who loses, there is nothing more that analysts can (or should) add. Economists serve their most useful role advising decision makers as to which regulatory option has the greatest difference between benefits and costs, *i.e.*, “maximizing net benefits” or, in colloquial terms, “the biggest bang for the buck.”

Given that there are so many different regulations, sooner or later, everyone will receive benefits from some regulations. Given that, agency decision makers should explain the reasons for their decisions; why, for example, they chose an option that did not maximize net benefits or a decision that favored certain groups at the expense of others. These explanations would be consistent with the goal of transparency.

Regulatory decisions that have a time component to them often have benefits that occur much later than costs and are addressed in benefit-cost analysis by what is known as the social rate of time preference, or the discount rate. A discount rate enables the economist to present to decision maker information that makes all benefits and costs comparable at the same moment, usually today. Choice of the social discount rate has a huge impact on how benefits or costs are valued in the future. A low discount rate says that society places more value on future events; a high one means we value immediate things more. People make their own time trade-offs constantly on such things as a decision to buy a car now versus saving the money for the future or choosing to enjoy tasty yet unhealthy food versus a stricter diet that preserves health for the future. Economists try and measure these trade-offs, the rate at which people discount the future

in favor of present consumption, and use these rates in their analysis. These calculated values can be used to advise decision makers. While the values employed in the analysis should be based on theoretical and empirical data, the decisions that implicitly value future versus current consumption belongs to decision makers, who need to make those decisions transparent. Again, the distinction should be made between economic valuation data that goes into economic analysis and actual decisions that reflect multiple considerations beyond the analysis. In no case should decision makers characterize a value-based decision as an economic analysis; rather they should provide a clear rationale for their decisions.

2. Using Behavioral Economics in the Development of Regulations

Cass Sunstein, the current administrator of OIRA, has offered a number of provocative ways of applying behavioral economics to solve significant regulatory problems in the book Nudge, which he coauthored with economist Richard Thaler.⁵ The basic theory Sunstein and Thaler advance is that the government can help people make better choices by fashioning the decision “architecture” to nudge them in the right direction, what they called, “libertarian paternalism.” They argue that, instead of intrusive command and control types of regulation, less intrusive means of regulation, such as information provision, can be used to nudge people into making the right decisions.

Suggestions to use less intrusive means to accomplish regulatory goals go back at least 35 years to OIRA’s predecessor, the Council on Wage and Price Stability (CWPS). The guidance to choose less restrictive options has not changed much from CWPS to OIRA but it has been routinely ignored. In our comments submitted to OIRA concerning a new Executive Order on RIA standards (which has not been issued), several colleagues and I pointed out that agency regulators seem to suffer from “the status quo bias,” the tendency to continue to do things the

same way you always have done them. In an interview paper I conducted with senior regulatory economists prior to leaving government, one economist described the problem this way: “*We do what we always do, just trotting out the same old thing. That’s why we don’t come up with better regulations; we just come up with the same regulations in different areas.*”⁶ In our comments to OIRA, we suggested that one way to cure this problem was to “nudge” the agencies to do a better job by requiring more analysis when they were choosing more restrictive options.

The nudge theory seeks to formulate regulatory policy based on human decision errors that have been identified in the psychological and behavioral economic literature over the last several decades. This literature addresses how people use shortcuts to make decisions, some of which are to their advantage while others appear not to be in their best interests. Applying this knowledge would prove valuable to structuring regulatory remedies that are less intrusive than command and control remedies.

However, in order to gain insight into human decision errors, researchers have used experimental studies that ask people what choices they would make under certain conditions. The researchers then compare those choices to “rational choices.” But as a recent Nobel Prize winner in economics Vernon Smith pointed out, the verbal behavior that individuals exhibit “strongly contradicts what their actual behavior achieves.”⁷ That is, in order to predict what individuals will do, as opposed to what they say, you would need to replicate the market experience, which is very difficult to do. This is why you cannot assume people will make mistakes in markets just because they give the “wrong” answers to survey questions. By interacting with others, rational outcomes are achieved in markets much more readily than experimental tests based on questions alone.

Market outcomes are adversely affected, however, by an excessive number of rules. OIRA could explore how people and organizations react to excessive rules by focusing on rule multiplicity as well as rule prioritization to see what effect they have on achieving the intended benefits. Findings from behavioral economics and psychology may help to uncover problems in this area. The examples provided below that are not intended to be conclusive. They simply suggest that having too many rules and not knowing which ones are important can defeat the original congressional intent of regulations.

For example, the availability heuristic (salience) might imply that regulated entities will spend most of their time complying with the most recent rules or rules that have recently been brought to their attention. The problem with this behavior is that the rule-du-jour may not be as important as rules passed 30, 60, or 100 months or even years ago. Generally, agencies do not prioritize rules, and they rarely take rules off the books even if they are no longer beneficial. All are treated, at least theoretically, equally. The very first OMB Report to Congress identified the problem: “Some regulations are critically important (such as safety criteria for airlines or nuclear power plants); some are relatively trivial (such as setting the times that a draw bridge may be raised or lowered). But each has the force and effect of law and each must be taken seriously.”⁸ As benefits and costs are directly related to the distribution and emphasis of compliance with rules, this only adds to the uncertainty of their effect. OIRA should encourage agencies to prioritize existing rules and remove those that are no longer relevant.

In addition to the problem of a lack of rule priority, there is the problem of too many rules. Is it really possible for an individual company to maintain focus on thousands of rules that it? Studies in numerous fields document the adverse effects from having too many rules. One author notes, “While generally there is an understanding that rules are useful guides for safe

behavior, there is also an increasing concern that an incremental build-up of too many rules will not create a good system to help human actors do the right thing, especially in states of abnormal operation where they would need strong but flexible guidance.”⁹ It may be that too many rules are a special case of too much information. Hwang and Lin report that “if information load keeps increasing and finally exceeds the capacity of decision makers, information processing will cease being increased. Instead, decision makers will decrease information processing as they experience a phenomenon termed ‘information overload.’”¹⁰

Hale examines the general approach of adding more and more rules:

“The second line of defense in many systems, if the human could not be eliminated, has been to try to turn the human into a robot by specifying rules and imposing them rigidly. The railway industry has been one of the main protagonists of this approach, alongside the nuclear, and to lesser extent, the chemical industries. Accidents were then analyzed up to the point where it became clear that someone had broken a rule (at which point discipline was appropriate) or that there was no rule for this eventuality (in which case a new one was made). In this way rulebooks continually grew and never diminished. This rules-fix is also a hankering after certainty. Ultimately we get a rule for everything and safety is seen as something which [sic] requires no thinking any longer, but simply good training, a prodigious memory, a large safety manual or computer to refer to, and an iron discipline. Management does not need to do any more thinking or planning, because it is all fixed in the rule system. Reason (1990, 1997), among others has shown clearly how this approach ossifies an organization and forces its staff into being habitual and professional violators of rules, just to get their work done.”¹¹

Another author identified a problem with additional rules in the nuclear power industry identified: “Regulators and industry officials come to view conformity or compliance with the rules rather than actual performance indicators as the measure of safety. So much time and attention are devoted to these surrogate measures of safety (‘complying with the regulations’) that the larger goal of such regulation is frequently neglected.”¹²

Academics who have studied classroom rules come to a related conclusion: “Too many rules result in rules that are not enforced. The ones that are not enforced become targets of abuse

that erode the effectiveness of the others.”¹³ For accounting, Nelson finds that adding rules to increase precision “can increase the complexity of the standard, thereby creating communication problems that offset the communication benefits provided by increased precision.”¹⁴ One conclusion of this study is that “a key to accurate communication is striking the right balance between providing enough rules to communicate clearly and not so many rules that practitioners are overwhelmed.”¹⁵

Knowing how excessive rules affect firm behavior is essential information that Congress and the public should have before policy makers commit to adding more rules to the complex web of current regulations. In fact, one crucial question that never seems to be asked is “when are there enough rules?”

3. Ensuring OIRA’s Role in the Use of Rigorous Science by Federal Agencies

The Obama administration, to its credit, has placed a high value on creating and using rigorous science in the regulatory process. OIRA plays several roles in this regard. First, OIRA is supposed to be the arbiter for science disputes between agencies, and this Administration has emphasized that role. An on-going dispute between EPA and FDA on the risks associated with methyl mercury suggests that such emphasis is long overdue. In this case, EPA has written a 60-page public letter describing the failures of a draft risk assessment done by FDA on the risks of methyl mercury.¹⁶ FDA has suggested a much more holistic, risk-benefit approach than that taken by EPA. This issue has been left open for over a year while FDA considers how to deal with these and other comments. When two agencies publicly disagree about whether or not a compound is risky at current levels of exposure, OIRA’s job is to resolve that dispute and, in this case, it should be done sooner rather than later as the current joint advisory between FDA and EPA may be misleading women of childbearing years.

On another front, the current administration has embraced the Data Quality Act, which is an excellent start to ensure that the science used to make decisions is of the highest quality.¹⁷ However, it is not clear yet whether the objective of using the best science will be achieved, given the limited appeals, both legally and administratively, in the Act.

The quality of RIAs in the federal government has long been a concern to many economists in the regulatory field, yet RIAs are only tangentially addressed in the Data Quality Act. A new project underway at the Mercatus Center at George Mason University seeks to address this concern by conducting an on-going evaluation of RIAs for all economically significant rules published since 2008. First, although we are not officially giving letter grades, when we analyzed all economically significant rules published in 2008, no RIA would receive above a “C” grade on a typical grading scale. Second, in many RIAs we found fundamental errors, such as the inability to articulate a systemic problem that the rule addressed. In the future, we hope that, by making these evaluations of proposed rules early and within the comment period, we will help stakeholders to comment more effectively and agencies to improve their analyses.

As I mentioned earlier, I conducted a qualitative survey of senior agency economists to get their thoughts on why their analyses might not be as effective as they believed they should be. There were several themes that came out of that survey. One was that economists are often managed by non-economists who place a big premium on getting the analysis done and done on time, often at the expense of quality. Another, perhaps more important, problem was simply a lack of appreciation by decision makers for the analysis. Some economists said that decision makers were not interested in their results or thought that economics was not a science, only “common sense.” My own experience at FDA was similar to the sentiments expressed in the

survey. I found that the tendency for most decision makers is to identify a solution and then request science, including and particularly economics, to support that decision. In some cases, it is clear that RIAs are completed well after decisions have been made.

As one economist put it, *“Everyone knows that life will be easier...if you just go along with the program office.”* This pressure does not just cause discomfort; it can affect the careers of staff economists.¹⁸ I once was told on a Friday that if I did not lower the costs estimates in an RIA that I should not return to work on Monday, *i.e.*, I would be fired. I did lower the costs and subsequent investigation by academic economists showed that our original (higher) estimates were correct. I cannot make this point too strongly: often jobs of agency economists are to analyze their bosses’ decisions. Those are unenviable tasks in any circumstance, but federal agencies make those jobs harder, and civil servants probably get fewer honest analyses when they treat economists (and other scientists) as hired-gun consultants who are supposed to gin up support for decisions that have already been made for other reasons. In this instance, decision makers will certainly not get what the President has requested, “a dispassionate and analytical ‘second opinion’ on agency actions.” Beyond the solution offered below, it would be helpful to locate economists as far away organizationally from program office decision makers as possible.

You might ask what OIRA has to do with all of this as it does not see the RIAs until the agencies have completed these analyses. The answer is a lot if OIRA is doing its job correctly. There are two ways that OIRA can do its job. One is working collaboratively with agencies - what I call the “caring and sharing” model. The other is acting as the president’s quality control officer to ensure that RIAs are done correctly and used appropriately. OIRA has historically been perceived as a “black box” to both those outside of government and even for many within the regulatory agencies. When I asked a branch chief at OIRA to describe what the agency does,

he told me that 90% of the job is to make sure that RIAs are done correctly and 10% is passing along decisions from the White House to the agencies. (This did not include all of the other assigned work like reports and special jobs for the White House). That focus on ensuring that RIAs are done correctly can go a long way toward solving the problem that plagues agency economists. If agency decision makers are either not interested in using analyses, or are instructing economists on what the analyses should conclude, it is unlikely that a collaborative relationship between OIRA and the regulatory agencies will correct this problem. OIRA's ability to return a rule based on bad analysis can help protect the integrity of the analysis and the related rulemaking process.

One example of this may be illustrative. At one point during the Clinton administration, I was asked to do a benefit analysis on a rule that addressed botulism in smoked fish. There had not been a botulism problem in this industry for 30 years as the industry had made substantive changes in their processing after problems arose in the 1960's. I told the program office that I really could not come up with any quantified benefits that would help the rule to get through OMB. I said this despite the fact that OIRA had not yet returned any rules to agencies in that administration. The rule went to OIRA anyway. My understanding was that the smoked fish rule ended up being the first one that then Administrator Sally Katzen returned to any agency.

The Obama administration has said that it is interested in using rigorous economic analysis as one way to make the impact of regulations transparent to the public. Quoting from the 2009 Report to Congress:

“Regulation should be data-driven and evidence-based, and benefit-cost analysis can help to ensure a careful focus on evidence and a thorough consideration of alternative approaches. Properly understood, such analysis should be seen as a pragmatic tool for helping agencies assess the consequences of regulations and thus to identify approaches that best promote human welfare.”

I would suggest that the way to accomplish that is to enforce the requirements on the agencies to do high quality analysis by returning rules accompanied by RIAs that do not measure up to standards articulated by the Executive Order 12866 and Circular A-4. While collaboration may also be useful in instances, given the nature of regulatory agencies to focus almost exclusively on their primary missions, a strong quality control role is a must for OIRA to be a truly effective oversight agency.

It is also important that that OIRA analysts be given sufficient time to do their job correctly. DATA.GOV shows the amount of time OIRA analysts take to review rules going back to 1981. The chart below shows the review times for OIRA staff.

OIRA Review Days

| | 2007 | 2008 (until Jan. 20, 2009) | 2009 |
|---|------|-------------------------------|------|
| Economically Significant | 50 | 52 | 33 |
| Not Economically Significant | 64 | 62 | 41 |

From the chart, it appears that OIRA staff has spent 35% less time reviewing rules in 2009 than in the previous two years. Some rules were cleared very quickly. For example, the proposal to control green houses gases for light duty vehicles was cleared in just 20 days and a proposal for energy efficiency standards for general service fluorescent and incandescent lamps was cleared in four days. This may understate the true problem if in fact the current administration has also eliminated OIRA’s informal reviews. Is there an implied goal that the Administration has set for OIRA analysts to reduce review time? If the goal is to minimize

review time, that is likely to conflict with a goal of conducting high quality reviews in order to achieve better RIAs and better rules.

Having said that, I recognize the difficulties that confront this small agency as there are only about 40 analysts charged with reviewing about 500 significant regulations each year. My experience suggests however that most of the analysts in OIRA fulfill the requirements that President Kennedy requested when he called for the “best and the brightest” to join the government. Focusing this small number of talented people on thorough rule review and returns when necessary should be a goal for this Administration.

Finally, I will point out that there is another mechanism in government that can help with the quality of RIAs - the Interagency Economic Peer Review Group. This is a group of federal economists within different agencies who have agreed to provide peer reviews of RIAs from other agencies at the request of the originating agency. OIRA support for this function may help the agency to do its job better. In the interest of full disclosure, I started this group prior to leaving government service.

4. Advancing Open and Transparent Government, Particularly “Democratizing Data”

Certainly one of the commendable hallmarks of the Obama administration is its keen focus on transparency with respect to the regulatory process. This continues an uneven trend started in the previous administration, and unfortunately, it continues to be uneven.

Nevertheless, the President’s call for a “presumption in favor of disclosure” is a welcome sentiment and it is hoped that the Administration will continue to try and meet this challenge. In fact, the Mercatus Center had a project for the last ten years in which we evaluated the transparency efforts of the Executive Branch agencies in their performance and budget requests. Over that time, we saw agencies improve in their transparency. We emphasized in our

evaluations that agencies should publicize outcome-based goals, as opposed to input-based goals. An example might be a reading program where the goal was measured by the quantity or quality of increased reading skills, not by the number of books that students received. Those are goals that people care about. Those are also the goals for which agencies should be held accountable, another goal of the current administration.

However, achieving these results is necessarily difficult. In his book, Governments End, Jonathan Rausch details at great length how each government program builds a constituency that fights any decreases in funding for that program with great tenacity.¹⁹ As the costs of the program are widely distributed among taxpayers, those that want the program continued usually win. The result is that the ineffective programs remain and the government grows.

The same thing is true for regulations as for government programs. Often industries and activists want certain regulations to further their own ends. They then support the regulatory decisions of agencies that are regulating for their own purposes.²⁰ Those who do not want the particular regulations end up outgunned as agencies tend to give much more deference to those who agree with them. As the government seeks a more open and transparent process, agencies must find a way to give equal weight to those who argue the regulation will harm them.

Besides transparency and accountability, there are two other core values that the current administration has adopted for which they should be commended: participation (government actively soliciting expertise from outside Washington) and collaboration (working together with other government officials and citizens to solve national problems). One way these are being implemented is by “democratizing data,” *i.e.*, by sharing more government datasets and information about government operations than has been done previously. A reason given for doing this goes back to the words of Justice Louis Brandeis, “sunlight is the best disinfectant.”

This kind of activity is certainly likely to help provide sunlight, and the IT Dashboard and DATA.GOV are two excellent examples. A key goal for each is to lower the cost of participation and collaboration and to reach out for innovative ideas. The themes that the current administration has embraced include:

- a. Promoting accountability,
- b. Providing information people can “readily find and use,” and
- c. Taking advantage of dispersed information.²¹

While these activities and themes are certainly likely to help, it is important not to over claim what they can accomplish. The current administration asserts that seeking “dispersed information” through both putting information out for comment and by actively seeking citizen participation, can solve the problem identified by Nobel Prize winning economist Friedrich Hayek over fifty years ago. The “knowledge problem,” identified by Hayek is that no central authority can ever gather sufficient information to replace dispersed private decision-making. As Hayek put it, “[K]nowledge . . . never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess.”²² The claim that outreach techniques that use sophisticated computers and the internet solves this problem misunderstands both what the knowledge problem is and the fact that it can never be solved. As most technology and management professionals will readily acknowledge, “Data is not knowledge.” If the knowledge problem is not properly understood, the limitations of government are improperly understood and that can lead to decisions that will adversely affect citizens.

Let me review some of the issues associated with the knowledge problem that cannot be solved by these initiatives.

a. The Nature of Knowledge. While some knowledge is explicit, Hayek identified a category of knowledge that cannot be shared with anyone, including government. This is the knowledge that every individual has, but generally cannot easily articulate to others. It is knowledge that is “local” to them, knowledge of time and place, and it cannot be aggregated. Such knowledge drives the decisions people make and the actions they take every day. For example, while you know what kind of car you drive and perhaps have some idea of the gas mileage your car gets, you are probably not aware of why you choose one product over another. Even if you try to explain this to someone else, it is sometimes very difficult to put into words. Furthermore, each time you make a decision, the context changes, which changes the trade-off. It is impossible for people to convey continually to government or anyone else the highly individualized contexts for each type of decision they make every time they make one. Some people may decide whether to order a dessert in a restaurant based on whether they plan to work out the next day while others may focus on caloric content, price, or whether the restaurant smells bad. They may or may not be able to articulate what caused them to make that decision but that context most likely would only be valid for that particular decision at that time. That is not information that the government can obtain through a survey.

What’s more, in a survey government must aggregate information and doing so causes it to lose all context. Context is not just important; it is crucial. For example, even after the election of Scott Brown in Massachusetts it is impossible to understand all of the trade-offs that people made when voting for him. What’s more, it seemed to be very difficult to know at the time what was happening in a timely manner and it is likely that,

as perceptions changed, people were changing their minds. Finally, even after the fact there seemed to be no general agreement on what people were thinking when voting. This example illustrates why surveys will always be an imperfect tool for gathering information and contingent valuation surveys will be just as problematical.

- b. Gathering Information. There are a number of reasons why this is a much bigger problem than just actively soliciting input. First, many people may find that the costs of supplying government with information exceeds the benefits. (Think of the number of people who simply hang up when a survey firm phones them because they don't want to spend 10 minutes answering questions.) In fact, many will probably find that they do not want to share information with the government, out of mistrust of how their information will be used or because they just consider it too private. Some may want to share information with government but will frame the information in a misleading way to try and affect some government policy in a way that suits them. (It could be argued that giving government information in a directed way to accomplish a specific end is what lobbyists do.) Some may just lie to government. Finally, government officials may seek actively some types of information, particularly information that supports their preferences. For whatever reason, it will always be difficult to sort out the different sources of information. At a minimum, being a passive recipient of unrepresentative data is not going to give a statistically representative sample.
- c. Using Information. A large literature on bureaucratic incentives and agency capture (by firms or activists) details the gap between what might be considered the "right" thing to do for society and what is actually done. To date, while there are many suggestions to overcome these problems, there have been no effective solutions.

Certainly the use of benefit-cost analysis is one type of solution, as it does not favor any particular group. But when decisions on value-laden concepts like fairness and equity – and benefit-cost analysis is ignored, it will be more difficult to prevent rules that serve to benefit favored groups.

Much of government regulation is a one-size-applies-to-all solution. Even many benefit-cost analyses focus on total or average costs or benefits, which may obscure important effects that vary with the diversity of the population. To the extent that preferences are different, even if you could gather the right information in a timely manner to know everything (and it's not possible), regulations often contain policies that satisfy a few people's preferences at the expense of many. The more diverse people's preferences for different policies, the fewer people will be satisfied with the option policymakers choose. In general, this means that more people will be less satisfied with how the government directs resources and would prefer alternative uses.

Finally, one of the biggest problems with the government's use of information in regulations is its inability to adapt quickly to changes in new information. For example, the Food and Drug Administration's definition for the use of the term "healthy" applied to food labeling is over 15 years old. Nutrition science has changed during that time.²³ For example, the rule still includes a definition for total fat that fails to distinguish between more beneficial fats like mono and polyunsaturated fats.

Rulemaking is a slow, deliberate process, as it should be. But that also means that it is difficult if not impossible to employ rulemaking effectively to solve problems in situations where science is changing rapidly. Imagine, for example, if the government had tried to establish performance standards for personal computers. By the time a proposal would be written it would be out of date.

Why should it matter that a 50 year-old hypothesis (the Hayek knowledge problem) is still essentially correct and that governments will always be woefully short of the knowledge necessary to make intelligent decisions? It is important because the presumption must always be on the government to show, as best it can with extremely imperfect tools such as benefit-cost analysis and risk assessments, that there is some reasonable probability that it can improve the lives of citizens by the action it takes. It matters because we must set the bar for such interventions as high as possible so that, at a minimum, we follow the guiding principle for physicians, “*primum nil nocere*,” first, do no harm. Any intervention should be accompanied by a great deal of humility with respect to this principle, as every attempt is fraught with uncertainty. When the government redirects resources by mandate, we will always be uncertain as to whether those resources are going to a use that is of most value to society.

In short, while the transparency and outreach initiatives are laudable, there are some problems that can never be overcome (tacit knowledge, timeliness, motivation and aggregation) and others that have yet to be solved (incentives and capture). There is a great deal of evidence of government failing to overcome these problems. The burden of proof should always fall on those who believe they can solve the knowledge problem to show that it can be done. The same problem arises when governments have tried to institute industrial policies by picking winners and losers: there is never enough knowledge to do so and the odds of success are no better than a coin toss.

Even the goal of providing the public with information should be approached with great care. The question that should be asked when information is to be provided is “what is the goal of providing that information?” In risk communication, for example, the goal is to provide people with information to help inform their decisions. So if people get and understand the

information, the goal is satisfied, even if people decide the risk is acceptable after they have been fully informed about the consequences. However, regulatory agencies may not be satisfied with that outcome. The Administration points out as a successful program the Toxic Release Inventory Program, requiring firms to report release of toxic chemicals.²⁴ The success that is cited is the “large reductions in toxic releases throughout the United States.” But what if there had been no reductions? What if, based on the actual risks as opposed to the presence of the hazards, people were satisfied with the levels of release and there were no reductions? Would it still be considered a success? Under normal standards for evaluating the effectiveness of risk communication, it would still be a success.

Another success story cited by OMB in its “2009 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State Local and Tribal Entities” is the release of fatality data by the Occupational Health and Safety Administration (OSHA) to “promote accountability and promote safer workplaces.”²⁵ The OMB Report does not cite whether this data was tested before it was released, or the actual goal of releasing this data. For instance, there are a number of ways the information could have been framed. It could have been framed as deaths per number of workers per year by firm or by industry. It could also have been framed as deaths per firm as a percentage of industry deaths. Another way it could be framed is as deaths that resulted in a successful claim of firm negligence versus worker errors. One can imagine a number of ways this information could be released and each one is likely to elicit a different response and perhaps, satisfy a different goal.

Behavioral economics shows that it matters how information is released, how questions are framed, and what the context of those questions is. This means that release of data can be done in such a way that drives behavioral responses in a desired way. There should be a goal for

releasing information and the agency should test it to see if it accomplishes the goal. If there is more of a motive beyond informing people's decision, then that should also be made transparent.

Recommendations

OIRA can best serve the American people by ensuring that regulatory agencies perform and use high quality analysis in their decision-making processes. Congress should set high standards for regulation in view of the limited amount of knowledge government agencies will have available to them. OIRA can do this by:

1. Ensuring that all aspects of regulations are evidence based. In particular, regulations should contain:
 - a. Evidence of a systemic problem. This evidence should not be a recitation of an anecdote, the agency's legal authority, a potential problem, or a problem that is outside the agency's primary goals as articulated by its Government Performance Results Act (GPRA) annual goals. It also should not be based on individual failures, but on failures of the market or other institutions that might be corrected through changes in the "rules of the game."
 - b. Evidence, through baseline analysis, that individuals, organizations, or other levels of government will not fix the problem in the absence of federal intervention. Often, when government discovers a problem, firms or consumers discover the problem more or less at the same time and take steps to correct the problem. If the problem is expected to be corrected before or reasonably after the end of a regulatory process, which includes the time from final rule to the compliance date, no regulation is necessary. This may be a period of anywhere from two to five years. These alternative solutions may arise directly from

consumer demand or indirectly through either contractual changes or incentives resulting from judicial decisions.

- c. Analysis of the benefits and costs of a broad variety of options, including options that may require legislative changes. Decision makers should have available to them analysis of regulatory options that range from the least to the most restrictive. This means that the more restrictive the option ultimately chosen, such as an engineering standard like best available technology, the more analysis will be necessary to evaluate numerous less restrictive options.
- d. Include in every regulation a plan for follow-up or retrospective analysis to determine whether or not the regulation is accomplishing its goal.

Focus OIRA analysts on their role as quality control officers. As stated in the “OMB Report to Congress,” “To promote evidence-based regulation, those who produce the relevant numbers must respect scientific integrity.” This must apply to RIAs and OIRA must take the responsibility to ensure that this happens. This means a primary focus on the quality of RIAs and ensuring that the RIAs are used to inform decisions. Where a policy option has been chosen that ignores the RIAs analysis because of a focus on fairness or equity, ensure that there is a well-articulated rationale for the decision. Where these conditions have not been met, return rules to the agencies. This will empower staff economists and encourage agencies to produce and use the results of high-quality analysis. Also, OIRA must ensure that the analyses are done and done completely and they must have sufficient time to conduct thorough reviews of the regulations.

- 2. Examine the possibility that regulated entities have difficulty knowing which regulations are important and determine the extent to which too many regulations results in

organizational issues that adversely affect the underlying goals regulations are intended to address. Begin to think about the core regulatory functions of government as being rule destruction and simplification as well as rule creation.

¹ This testimony reflects only the views of its author and does not represent an official position of George Mason University.

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¹¹ Hale, Andrew, "Railway Safety Management: The Challenge of the New Millennium," Based on a keynote address to the Occupational Safety & Health Conference of the Union Internationale des Chemins de Fer (UIC), Paris September 1999 pp. 7-8.

¹² Barkenbus, Jack N. "Is Self Regulation Possible?" *Journal of Policy Analysis and Management* 2(4), Summer 1983, p. 578.

¹³ Malone, Bobby G. and Cheryl L Tietjens, "Re-Examination of Classroom Rules: The Need for Clarity and Specified Behavior," *Special Services in the Schools* 16(1/2) 2000 Haworth Press, Inc. p. 165.

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¹⁵ *Ibid*, p. 100.

¹⁶ <http://www.fda.gov/Food/FoodSafety/Product-SpecificInformation/Seafood/FoodbornePathogensContaminants/Methylmercury/ucm088758.htm>.

¹⁷ Section 515 of the Consolidated Appropriations Act, 2001 (Pub. L. 106-554), also known as the Data Quality Act or the Information Quality Act.

¹⁸ Williams, p. 12.

¹⁹ Rauch, Jonathan, *Governments End: Why Washington Stopped Working*, Public Affairs, New York, 1999.

²⁰ *See, e.g.*, Yandle, Bruce, "Bootleggers and Baptists in Retrospect," *Environment and Risk* at <http://www.id.iit.edu/externalID/documents/bootleggers.pdf>.

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²² Hayek, Friedrich A., "The Use of Knowledge in Society," American Economic Review, 1945, pp. 519-30.

²³ 21 CFR §101.65 (d) (i) (2) Implied nutrient content claims and related label statements.

²⁴ 2009 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local and Tribal Entities, Office of Management and Budget, Office of Information and Regulatory Affairs, 2009, p. 37.

²⁵ *Ibid*, p. 38.