



**WRITTEN TESTIMONY OF
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Committee on the Judiciary
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Mr. Chairman and Members of the Committee:

Thank you for inviting me to testify today. My name is Richard Williams. I am an economist and the Director of Policy Studies at the Mercatus Center, a 501(c)(3) research, educational, and outreach organization affiliated with George Mason University.¹ For more than three decades, I have worked on rulemaking and regulatory analysis, first as an analyst at the Food and Drug Administration (FDA), then as a supervisor of all social science analyses at FDA's Center for Food Safety and Applied Nutrition. I also worked for a short time at the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB) reviewing rules from other agencies.

CONTROLLING THE EXECUTIVE BRANCH

For nearly 70 years, presidents have recognized the difficulty of managing regulatory agencies. Harry Truman complained: "I thought I was the president, but when it comes to these bureaucrats, I can't do a damn thing."² During the last year of his presidency, Jimmy Carter commented that, although he knew from the beginning that "dealing with the federal bureaucracy would be one of the worst problems [he] would have to face," the reality had been even "worse than [he] had anticipated."³

So why is it so difficult for a president to manage federal agencies? After all, the economic executive orders have the force and effect of law on federal employees and instruct agency heads on the major components of analysis they should use for decision-making. Moreover, agency heads are

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

²Elena Kagan, "Presidential Administration," *Harvard Law Review* 114 (2000-2001):2272-73.

³Ibid.

⁴Williams, Richard A., "The Influence of Regulatory Economists in Federal Health and Safety Agencies," Mercatus

appointed by, and presumably accountable to, the president. On the other hand, there are about 277,000 employees in 26 executive branch agencies, most of whom are career staff who see presidents come and go. Extensive research on the behavior of regulatory agencies shows how federal employees focus more on the welfare of their agency and less on the president's agenda. Other than career economists, few working on federal regulations pay attention to benefit-cost analysis or other aspects of regulatory analysis unless it is absolutely necessary.⁴ In fact, agencies have a lackluster record in the analysis of either benefit-cost trade-offs or risk-risk trade-offs.⁵

With these factors in mind, every president since Ronald Reagan has relied on OIRA as a regulatory gatekeeper. OIRA's primary duty is to enforce the presidential economic executive orders, which have barely changed since Reagan's Executive Order 12291. In doing so, OIRA labors in relative obscurity and, over the years, has produced a record of mixed results.

PRESIDENTIAL PROMISES

Like his predecessors, President Barack Obama has defined the quality standard for rulemaking by executive order. In January 2011, the president said, "Sometimes, those rules have gotten out of balance, placing unreasonable burdens on business—burdens that have stifled innovation and have had a chilling effect on growth and jobs."⁶ In that same month, the president issued Executive Order 13563, which states –

Our regulatory system must ... take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in

⁴Williams, Richard A., "The Influence of Regulatory Economists in Federal Health and Safety Agencies," Mercatus Working Paper, July 2008.

⁵ Worse, despite the decade-old requirement of the Government Performance and Results Act, agencies rarely are able to articulate the progress they are making at solving the problems under their purview.

⁶ Barack Obama, "Toward a 21st Century Regulatory System," *Wall Street Journal*, January 18, 2011.

plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements.⁷

OIRA Administrator Cass Sunstein, charged with overseeing this order, likewise has stated –

Since I was confirmed in September, OIRA has devoted special attention to working with agencies in three areas: promoting open government, improving regulatory analysis, and improving disclosure policies and increasing simplification. The unifying goal is to ensure that regulation is evidence based and data driven and that it is rooted in the best available work in science (including social science).⁸

So what does the record say about these efforts? As past presidents and administrators have discovered, setting standards for transparency and quality analysis is one thing—achieving agency compliance with those standards is another.

THE RECORD

As a measure of regulatory quality, many point to OMB's annual report to Congress on the benefits and costs of federal regulations and unfunded mandates. The first report issued in 1997 estimated annual benefits at or greater than \$298 billion and costs at \$279 billion.⁹ OMB's reports have consistently shown benefits exceeding costs for the last 15 years.¹⁰ Because of this, some regulatory scholars have argued that no institutional regulatory reforms are necessary. For example, one prominent scholar argues -

...all indications are that the rules being developed by Executive Branch agencies generally meet the “benefits justify costs” standard of the Executive Order. For

⁷ Executive Order 13563, *Improving Regulation and Regulatory Review*, January 18, 2011.

⁸ Cass Sunstein, Testimony before the Committee on the Judiciary, Courts, Commercial and Administrative Law Subcommittee, U.S. House of Representatives, July 27, 2010, <http://judiciary.house.gov/hearings/pdf/Sunstein100727.pdf/>.

⁹ OMB, *Report to Congress on the Costs and Benefits of Federal Regulation*, September 30, 1997, http://www.whitehouse.gov/omb/inforeg_chap2#taop/.

¹⁰ The latest report is *2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities*, found at http://www.whitehouse.gov/sites/default/files/omb/inforeg/2011_cb/2011_cba_report.pdf/.

example, in OMB's 2010 Report to Congress, OMB included data on the cost (\$43–\$55 billion) and the benefits (\$128–616 billion) of major rules issued by Executive Branch agencies over the most recent ten-year period (FY 1999–2009). Even if one uses the highest estimate of costs and the lowest estimate of benefits, the regulations issued over the past ten years have produced net benefits of \$73 billion to our society.¹¹

This argument, however, does not address the question of whether or not these reports are accurate and reliable. There are several reasons to suspect they are not.

1. The agencies have a monopoly on analysis.

The estimates used in OMB's report are prepared by the agencies themselves, which means that the agencies are analyzing their own decisions. Research shows that agencies often make decisions early in the regulatory process and agency economists are pressured to make their analyses support those decisions.¹² In fact, agencies do an overall poor job of preparing economic analysis for new rules. Since 2008, the Mercatus Center at George Mason University has conducted a project known as the Mercatus Regulatory Report Card (Report Card) that evaluates federal agencies' economic analyses, called Regulatory Impact Analyses (RIAs), for economically significant rulemakings. Rulemakings evaluated by the Report Card receive a score ranging from 0 (no useful content) to 5 (comprehensive analysis content with potential best practices) on questions based on requirements imposed under Executive Order 12866, as well as RIA guidelines laid out in the OMB's Circular A-4.

Unfortunately, the Report Card findings have not been reassuring. Agencies consistently do a poor job on economic analysis. The average Report Card score was 28 out of a total of 60 points for the

¹¹ Sally Katzen, Testimony before the Committee on the Judiciary, Courts, Commercial and Administrative Law Subcommittee, U.S. House of Representatives, May 4, 2011.

¹² Williams, Richard A., "The Influence of Regulatory Economists in Federal Health and Safety Agencies," Mercatus Working Paper, July 2008.

period 2008 to 2010.¹³ That's an F. In 2011, the average score is a disappointing 29. Analysis by other researchers in the past confirms the poor quality of federal regulatory impact analyses.¹⁴

Research indicates there are no significant differences in the quality of economic analysis across administrations, suggesting the problem is institutional, rather than just a case of a few bad apples. Some of the most problematic areas the Report Card data identify are a failure to define the systemic problem or market failure the agency sought to solve through regulation, a lack of consideration of serious alternatives to the regulation being proposed, and a failure to set forth procedures to track results of the regulation once it has been implemented.¹⁵

Another area of concern is the underlying science supporting the economic arguments. For example, one way to support decisions is to find new benefits. For rulemakings proposed in the last few years, many of the benefits are either co-benefits (primarily reductions in PM 2.5 included in clean air rules targeted at other pollutants), or benefits based on assumptions that individual preferences are incorrect (people are not buying energy-efficient cars or appliances to the extent that the government believes they should).¹⁶

Another way to generate excessive benefits is by using conservative assumptions in risk assessments. A recent report by the National Research Council (NRC) of the National Academy of Science raises the point that there may be systemic problems with some risk assessments -

¹³Ellig, Jerry and John Morrall, "Assessing the Quality of Regulatory Analysis," Mercatus Working Paper, December 15, 2010.

¹⁴ See, for example, Winston Harrington, "Grading Estimates of the Benefits and Costs of Federal Regulation: A Review of Reviews," (Discussion Paper 06-39, Resources for the Future) and Robert W. Hahn and Paul C. Tetlock, "Has Economic Analysis Improved Regulatory Decisions?" *Journal of Economic Perspectives*, 22 no.1 (Winter): 67-84.

¹⁵ See, for example, James Broughel and Jerry Ellig, "Regulatory Alternatives: Best and Worst Practices," *Mercatus on Policy*, February 21, 2012.

¹⁶Susan Dudley, cited in "The Rule of More," *The Economist*, February 18, 2012. See also, Michael L. Marlow and Sherzod Abdukadirov, "Fat Chance: An Analysis of Anti-Obesity Efforts," Mercatus Working Paper, March 1, 2012.

Overall, the committee noted some recurring methodologic problems in the draft IRIS assessment of formaldehyde. Many of the problems are similar to those that have been reported over the last decade by other NRC committees tasked with reviewing EPA's IRIS assessments for other chemicals. Problems with clarity and transparency of the methods appear to be a repeating theme over the years, even though the documents appear to have grown considerably in length... .

...The committee found that EPA's draft assessment was not prepared in a logically consistent fashion, lacks clear links to an underlying conceptual framework, and does not sufficiently document methods and criteria used to identify evidence for selecting and evaluating studies.¹⁷

A recent examination of United States Department of Agriculture's catfish inspection rule also found issues with the science behind the benefits analysis. In 1991, ten cases of *Salmonella* Hadar had been possibly associated with catfish consumption. However, the risk assessment multiplied that evidence into a finding that there were approximately 2,500 cases per year.¹⁸

Early on, the Government Accountability Office noted the problems with the OMB reports -

...the experts said that OMB's 1998 upper-bound estimate of total regulatory benefits was questionable or implausible and they were particularly critical of OMB's unadjusted use of EPA's Clean Air Act benefit estimate; (8) they also said that OMB should not have simply accepted agencies' cost and benefit estimates for the major and economically significant rules, and should have provided new regulatory reform recommendations; (9) however, the experts said they understood why OMB could do little to discuss the other statutory requirement regarding the indirect regulatory effects on particular sectors; (10) overall, they said OMB should have been more than a clerk, transcribing the agencies' and others' estimates of costs and benefits;... .¹⁹

2. OMB's reports to Congress are not representative of all rules.

The estimates presented in OMB's reports are a tiny fraction of all final rules issued in any given year. For example, in 2010 agencies issued 3,083 final rules but only 16 had quantified

¹⁷ National Research Council of the National Academy of Sciences, "Review of the Environmental Protection Agency's Draft IRIS Assessment of Formaldehyde," May 2011, p. 4, http://books.nap.edu/catalog.php?record_id=13142#toc/.

¹⁸ Richard A. Williams and Sherzod Abdulkadirov, "Regulatory Monsters," *Regulation Magazine*, 34 no. 3 (Fall 2011).

¹⁹ Government Accountability Office, "Analysis of OMB's Reports on the Costs and Benefits of Federal Regulation" (GGD-99-59) April 20, 1999, p.5. <http://www.gao.gov/products/GGD-99-59/>.

OMB REPORTS TO CONGRESS

| Report Year | # of Major Rules | # of Major Rules that have Monetized Costs and benefits | % of Major Rules that have Monetized Costs and benefits |
|-------------|------------------|---|---|
| 2001 | 31 | 6 | 19 |
| 2002 | 87 | 12 | 14 |
| 2003 | 31 | 3 | 10 |
| 2004 | 37 | 6 | 16 |
| 2005 | 45 | 11 | 24 |
| 2006 | 45 | 13 | 29 |
| 2008 | 40 | 12 | 30 |
| 2009 | 42 | 13 | 31 |
| 2010 | 66 | 16 | 24 |
| 2011 | 66 | 18 | 27 |

benefits and costs (or about ½ of 1 percent). OMB reported the sum of benefits and costs for those 16 rules as the total costs and benefits for all final rules issued that year. As in 2010 when there were 66 major rules, in the best of cases, OMB does not receive quantified benefits and costs for seven out of every 10 of the major rules they review (see chart below).

Drawing any conclusion from such a skewed data set is highly questionable at best.

3. Oversight by OIRA is insufficient.

At the inception of OIRA in 1981, the executive branch regulatory agencies had total staffing of 115,047. In 2012, it is 248,965 for social regulation alone, and about 277,000 in the executive branch overall.²⁰ This is an increase of 240 percent. At the same time, the OIRA professional staff declined from about 77 at its inception to 50, a decline of 38 percent. In addition, only about 30

²⁰Susan Dudley and Melinda Warren, "Fiscal Stalemate Reflected in Regulators' Budget: An Analysis of the U.S. Budget for Fiscal Years 2011 and 2012," *Regulator's Budget Report* (Weidenbaum Center on the Economy, Government, and Public Policy Washington University St. Louis, and Regulatory Studies Center Trachtenberg School of Public Policy and Public Administration, The George Washington University Washington, DC), 33 (May 2011).

OIRA staff members work on regulations at any one time. In 1981, there were about 63,554 pages in the Federal Register; in 2011, there were 82,419 pages in the Federal Register, an increase of almost 30 percent.²¹ So right now, 30 OIRA staff members are charged with examining the work of more than 270,000 people in the regulatory agencies.

OIRA staff members today review about 90 major (proposed and final) rules per year, about 600 non-major rules, and about 3,000 Paperwork Reduction Act requests each year.²² These rules take time to review as many are quite large. The Mercatus Regulatory Studies Program looked at OIRA review times in the first three years of the George W. Bush administration and compared this data to the first three years of the Obama administration. We found that the average review time in both periods for economically significant regulations was 44 days. However, this number is misleading because the average is skewed upwards by a small number of rules with very long review times. In general, most regulations are reviewed in much shorter periods. For example, in the six-year period reviewed, nearly 15 percent of economically significant rules had OIRA review times under five days, 25 percent were reviewed in under 10 days, and nearly 38 percent were reviewed in under 20 days. In comparison, agencies may take five years or longer preparing rules before they publish a proposal.

Recent Mercatus research suggests that short review times may be related to lower quality analysis. In a new study by Jerry Ellig of the Mercatus Center and Chris Conover of Duke University, the authors found that eight interim final rules associated with the Patient Protection and Affordable Care Act issued by the Department of Health and Human Services (HHS) in 2010 had considerably

²¹Office of the Federal Register, www.llsdc.org/attachments/wysiwyg/544/fed-reg-pages.pdf.

²²Curtis W. Copeland, "Federal Rulemaking: the Role of the Office of Information and Regulatory Affairs," Congressional Research Service Report for Congress RL32397, June 9, 2009.

lower quality analysis than previous rules issued by HHS. This may be related to the fact that these rules had an average review time of just five days.²³

A FEW SOLUTIONS

Based on the evidence, continuing the status quo cannot change the incentives that cause agencies to place a low priority on quality economic analysis. There are options, however, that could get us better regulatory analysis and better regulations.

1. Increase Government Oversight

As agency staffs have more than doubled, one could argue that OIRA's staff should be doubled from its original capacity, from 77 to 160. More important, OIRA urgently needs more trained risk assessors so that it has sufficient capacity to critically review every aspect of benefits analyses, including risk assessments. To be useful, risk assessments must be compatible with benefit assessments, but too often they are either the wrong form, such as safety assessments (for example, reference doses, reference concentrations, or acceptable daily intakes), or they are conservative estimates of risk.²⁴ As with all analysis, risk assessments must be, to the extent possible, objective. In fact, they are expected to comply with the Data Quality Act, which says that agencies must ensure and maximize the "quality, objectivity, utility and integrity of information." Objectivity

²³Conover, Chris and Jerry Ellig, "Rushed Regulation Reform," *Mercatus on Policy*, January 9, 2012, <http://mercatus.org/publication/rushed-regulation-reform> ; Conover and Ellig, "The Poor Quality of Affordable Care Act Regulations," *Mercatus on Policy*, January 9, 2012, <http://mercatus.org/publication/poor-quality-affordable-care-act-regulations> ; Chris Conover and Jerry Ellig, "Beware the Rush to Presumption, Part A," *Mercatus Working Paper*, January 9, 2012, <http://mercatus.org/publication/beware-rush-presumption-part> ; Conover and Ellig, "Beware the Rush to Presumption, Part B," *Mercatus Working Paper*, January 9, 2012), <http://mercatus.org/publication/beware-rush-presumption-part-b>.

²⁴Richard A. Williams and Kim Thompson, "Combining Risk and Economic Assessments While Preserving the Separation of Powers," *Risk Analysis*, 24 no. 6 (2004).

refers to the fact that independent observers using the same procedures will come to consensus and that personal opinions, values, and biases will not change the outcome. OIRA must be in a position to evaluate the suitability and objectivity of risk assessments to determine their effect on the benefit side of the equation.

If staffing is to be increased, OIRA's scope should also be increased to cover the increasingly active independent agencies whose economic analysis is either absent or has been repeatedly found to be poor (for example, the Securities and Exchange Commission).²⁵

In addition to needing more staff, OIRA needs to adjust its review time as some rules appear to be rushed through the process. A minimum review time should be placed on economically significant rules so that OIRA has sufficient time and resources to review economically significant regulations. A minimum of at least 60 days should be required to review those rules that have an impact of \$100 million dollars or more on the economy. This reform should help ensure that regulations are well informed by quality economic analysis before agencies move forward with a final regulation.

Finally, an alternative to giving OIRA more staff is to create an independent office to either prepare analyses for the Executive Branch or to act as a second set of reviewers after OIRA.

2. Open the Process Earlier

OIRA has tried for many years to get agencies to come to OIRA early in the process to discuss proposals. The reason, as is well known, is that by the time agencies have produced a proposal, an enormous amount of work has gone into it and the decision is normally on a conveyor belt to final

²⁵Sarah N. Lynch and Christopher Doering, "Analysis: Bruised regulators brace for Dodd-Frank Court Fights," *Reuters*, August 4, 2011, <http://www.reuters.com/article/2011/08/04/us-financial-regulation-courts-idUSTRE7730K220110804/>.

rule. The game that some agencies play with OIRA is to throw some things in their proposals that they don't care about. This allows OIRA to have some small victories in eliminating costly or ineffective provisions while the agencies keep their true proposals largely intact. As mentioned above, there is very little time for OIRA to review these rules, and agencies will typically dig in their heels to prevent significant changes to their rules. Besides giving OIRA more time and staff to review rules, give OIRA advanced notices for economically significant rules.

This kind of advanced notice would include the definition and evidence of the systemic problem the agency intends to address, along with some possible ways of solving the problem and a preliminary estimate of the benefits and costs of those alternatives. This would give both stakeholders and OIRA analysts a chance to weigh in early before agencies have cemented their position.

3. Increase Oversight by Stakeholders

One way to increase oversight would be to allow for “crowd sourcing.” Crowd sourcing refers to groups of people who, for any given issue, have significant information that should be factored into the decision. Currently, the only option open to people with this kind of information is to submit comments to the agencies. However, they cannot challenge the agency if the agency simply disagrees with them. Relying only on OIRA is not likely to work as OIRA faces the challenges of being too small and not being able to comment on politically sensitive rules. If the analyses were judicially reviewable, then stakeholders with knowledge of benefits and costs could challenge the agencies in court.²⁶

²⁶Williams, Richard A. and Sherzod Abdukadirov, “Blueprint for Regulatory Reform” Mercatus Working Paper, February, 2012, http://mercatus.org/sites/default/files/publication/Blueprint_For_regulatory_Reform.pdf /.

CONCLUSION

Every president has struggled to improve his management of agency regulatory authority. For 30 years, OIRA has served as a gatekeeper with limited authority. Six administrations have supported the use of quality economic analysis to inform regulatory decision-making. Simply restating this principle in executive orders and public statements has not and will not achieve the objective, all good intentions notwithstanding. Without definitive action, we risk doing the same thing over and over again expecting different results, an approach that Albert Einstein logically concluded to be the definition of insanity.

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**ASSESSING THE QUALITY OF REGULATORY ANALYSIS:
A New Evaluation and Data Set for Policy Research**

By Jerry Ellig and John Morrall



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**Assessing the Quality of Regulatory Analysis:
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Assessing the Quality of Regulatory Analysis: A New Evaluation and Data Set for Policy Research

Abstract

Congress and the executive branch have attempted to improve the quality of regulatory decisions by adopting laws and executive orders that require agencies to analyze benefits and costs of their decision options. This paper assesses the quality and use of regulatory analysis accompanying every economically significant regulation proposed by executive-branch regulatory agencies in 2008 and 2009. It considers all analysis relevant to the topics covered by Executive Order 12866 that appears in the Regulatory Impact Analysis document or elsewhere in the *Federal Register* notice that proposes the rule.

Our research team used a six-point qualitative scale to evaluate each regulation on 12 criteria grouped into three categories: (1) Openness: How easily can a reasonably intelligent, interested citizen find the analysis, understand it, and verify the underlying assumptions and data? (2) Analysis: How well does the analysis define and measure the outcomes the regulation seeks to accomplish, define the systemic problem the regulation seeks to solve, identify and assess alternatives, and evaluate costs and benefits?; and (3) Use: How much did the analysis affect decisions in the proposed rule, and what provisions did the agency make for tracking the rule's effectiveness in the future?

We find that the quality of regulatory analysis is generally low, varies widely, and did not change much with the change of administrations between 2008 and 2009. The principal improvements across all regulations occurred on the Openness criteria. Budget or "transfer" regulations, which define how the federal government will spend money or collect revenues, have much lower-quality analysis than other regulations. Use of analysis is correlated with its quality, and use of analysis fell in 2009 after controlling for the quality of the analysis. Regulations implementing Recovery Act spending programs have better provisions for retrospective analysis than other transfer regulations.

Keywords: regulatory impact analysis, benefit-cost analysis, regulatory review, regulation

JEL categories: D61, D73, D78, H11, H83, K23, L51, P16

Introduction

For nearly four decades, presidential administrations have required executive-branch agencies to conduct some type of economic impact analysis when they issue major regulations. Since 1993, President Clinton's Executive Order 12866 has laid out the fundamental analytical steps agencies must take. The very first section of the executive order states that agencies must identify the problem they are trying to address and assess its significance, examine a wide range of alternatives to solve the problem, assess the costs and benefits of the alternatives, and choose to regulate only when the benefits justify the costs. Analytical requirements are especially rigorous for "economically significant" regulations, defined as regulations that "have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local or tribal government or communities" (EO 12866, Sec. 2(f)(1)). Office of Management and Budget (OMB) Circular A-4, issued in September 2003, offered more detailed guidance on "best practices" in regulatory analysis (OMB 2003).

Despite executive orders and detailed guidance, the quality of agencies' regulatory analysis has been inconsistent at best:

- Several studies compared agencies' ex-ante predictions of regulatory benefits and costs with ex-post estimate of actual benefits and costs (Harrington et. al. 2000, OMB 2005, Harrington 2006). These studies found that, in the past, ex-ante estimates tended to overestimate both benefits and costs.
- In a series of papers, Robert Hahn developed and applied a yes/no checklist to evaluate whether agencies' Regulatory Impact Analyses have included a series of major elements that OMB expects them to include. The evaluations focused on final regulations issued by health, safety, and environmental agencies (Hahn and Dudley 2007, Hahn et. al. 1990, Hahn and Litan 2005, Hahn, Lutter, and Viscusi 2000). Surveying the evidence, Hahn and Tetlock (2008, 82–83) conclude that economic analysis has not had much impact, and the general quality of regulatory analysis is low. "Nonetheless," they note, "in a world where regulatory impacts are frequently measured in the billions of dollars, margins matter. Thus, economists should pay more attention to how economic analysis can contribute to improving benefits and costs on the margin."
- Belcore and Ellig (2008) employed a qualitative scoring approach to assess the quality of regulatory analysis at the Department of Homeland Security during its first five years: they conclude these analyses have been seriously incomplete but improved over time.

Most recently, Ellig and McLaughlin (2010) developed a 12-point qualitative framework to assess both the quality and use of regulatory analysis in federal agencies. They evaluated the quality and use of regulatory analyses of "economically significant" rules that were reviewed by OMB's Office of Information and Regulatory Affairs (OIRA) in 2008 and proposed in the

Federal Register.¹ The evaluation criteria are drawn from Executive Order 12866, OMB Circular A-4, and pre-existing scholarship on regulatory scorecards.² Ellig and McLaughlin found that the average quality of the 2008 regulatory analyses is low, both the quality and use of regulatory analysis vary widely, and there are significant opportunities for improvement through the diffusion of best practices. They also found that better analyses are more likely to be used in agency decisions, but only one-fifth of the regulatory analyses in 2008 appeared to have any effect on regulatory decisions (based on information agencies supplied in the preamble).

This study utilizes the Ellig and McLaughlin method to evaluate the quality and use of regulatory analysis for economically significant regulations proposed by executive-branch agencies in 2009. This is of interest for several reasons. First, a comparison of 2008 and 2009 would help identify whether the change of presidential administrations had any effect on the quality or use of regulatory analysis. Second, the Obama administration proposed in February 2009 to revise Executive Order 12866 (OMB 2009a); evaluating the quality and use of regulatory analysis in the Obama administration prior to the revision establishes a baseline to gauge the effects of any changes. Third, extending the evaluation to 2009 and subsequent years builds a larger data set, which may allow us to draw more reliable general inferences about the relative quality of analysis at different agencies or for different types of regulations.

Our principal findings include:

Quality is mostly unchanged in 2009. The average score for regulations proposed in 2008 and 2009 was virtually the same—27 points out of a possible 60. The most significant improvements occurred on Openness criteria, such as online accessibility of regulatory analyses and clarity. On average, explanations of how regulatory costs affect prices of goods and services also improved. Very modest improvements occurred in evidence of regulatory benefits and analysis of the distribution of benefits.

Analysis is less-widely used in 2009. Higher-quality analysis is more likely to be used in regulatory decisions. But for any given level of quality, regulatory agencies were less likely to use the analysis in 2009 than in 2008. This change is disturbing, because one of the most important reasons for doing regulatory analysis is so that decision makers can somehow use it to make better decisions. Of course, good regulatory analysis is also important for reviewers (like OMB) and stakeholders.

Quality is generally low. In both years, the average score is less than half of the possible 60 points. The highest-scoring regulation in 2008 earned 43 out of 60 possible points, equivalent to a grade of C. The highest-scoring regulation in 2009 earned 48 out of 60 possible points, equivalent to a B–.

¹ Economically significant regulations require an extensive Regulatory Impact Analysis (RIA) that assesses the need, effectiveness, benefits, costs, and alternatives for the proposed regulation. (EO 12866 Sec. 6(a)(3)(C))

² The qualitative evaluation method is based on the Mercatus Center's *Performance Report Scorecard*, a 10-year project that assessed the quality of federal agencies' annual performance reports required under the Government Performance and Results Act of 1996. For the most recent results, see McTigue et. al. (2009).

Diffusion of best practices could generate substantial improvement. In 2009, scores ranged from a high of 48 points to a low of just 3 points. In 2008, scores ranged from a high of 43 points to a low of 7 points. For each of our 12 criteria, at least one regulation earned the highest possible score of 5. But for 11 of our 12 criteria, less than a handful of regulations receive a 5. The fact that the highest-scoring regulation in 2009 resulted from collaboration between two agencies also suggests wider sharing of best practices can improve regulatory analysis.

Transfer regulations have worse analysis. Budget or “transfer” regulations, which determine how the federal government will spend or collect money, receive much lower scores. On average, transfer regulations received only 17 points in 2008 and 20 points in 2009, compared to an average of 32–34 points for non-transfer regulations.

Greatest strength: Accessibility on the Internet. Scores on this criterion averaged 4.06 out of 5 possible points in 2009 and 3.53 out of 5 possible points in 2008. These far exceeded average scores on any other evaluation criterion.

Greatest weaknesses: Retrospective analysis and identification of systemic problem. Few regulations or analyses set goals, establish measures, or provide for data gathering to assess the effects of the regulation after it is implemented. Few analyses provide a coherent theory and empirical evidence of a market failure, government failure, or other systemic problem the regulation is supposed to solve.

1. Evaluation Protocol

We evaluated the quality and use of regulatory analysis using 12 criteria grouped into three categories—Openness, Analysis, and Use:

1. Openness: How easily can a reasonably intelligent, interested citizen find the analysis, understand it, and verify the underlying assumptions and data?
2. Analysis: How well does the analysis define and measure the outcomes or benefits the regulation seeks to accomplish, define the systemic problem the regulation seeks to solve, identify and assess alternatives, and evaluate costs and benefits?
3. Use: How much did the analysis affect decisions in the proposed rule, and what provisions did the agency make for tracking the rule's effectiveness in the future?

Figure 1 lists the 12 criteria. Appendix 1 provides additional detail on the kinds of questions considered under each criterion. For a more extensive explanation and justification of this evaluation method, see Ellig and McLaughlin (2010). Individual "Report Cards" showing all scores and scoring notes for each regulation are available at www.mercatus.org/reportcard.

Ten of the 12 evaluation criteria closely parallel the Regulatory Impact Analysis checklist released by the Obama administration on November 3, 2010 (OMB 2010). This is not surprising, since both the administration's checklist and the Mercatus evaluation criteria are based on Executive Order 12866 and OMB Circular A-4. Appendix 2 presents a crosswalk chart comparing the OMB checklist with the 12 criteria used in this paper.

The principal Mercatus evaluation criteria not mentioned in the Obama administration's checklist are two criteria that assess whether the agency provided for retrospective analysis of the regulations' actual effects after it is adopted: criterion 11 (Measures and Goals) and criterion 12 (Retrospective Data). Although ex post, retrospective analysis has not received as much attention as ex ante analysis of proposed regulations; section 5 of Executive Order 12866 states that agencies should conduct retrospective analysis. OMB (2005) has recommended it repeatedly; most recently, OMB (2009b, 45) stated, "[W]e recommend that serious consideration be given to finding ways to employ retrospective analysis more regularly, in order to ensure that rules are appropriate, and to expand, reduce, or repeal them in accordance with what has been learned." The Government Performance and Results Act arguably requires retrospective analysis of regulations (Brito and Ellig 2009). It is a major area of regulatory analysis where the United States lags other industrialized nations (OECD 2009, 92).

Figure 1: Regulatory Analysis Assessment Criteria

Openness

1. **Accessibility:** How easily were the Regulatory Impact Analysis, the proposed rule, and any supplementary materials found online?
2. **Data Documentation:** How verifiable are the data used in the analysis?
3. **Model Documentation:** How verifiable are the models and assumptions used in the analysis?
4. **Clarity:** Was the analysis comprehensible to an informed layperson?

Analysis

5. **Outcomes:** How well does the analysis identify the desired benefits or other outcomes and demonstrate that the regulation will achieve them?
6. **Systemic Problem:** How well does the analysis identify and demonstrate the existence of a market failure or other systemic problem the regulation is supposed to solve?
7. **Alternatives:** How well does the analysis assess the effectiveness of alternative approaches?
8. **Benefit-Cost Analysis:** How well does the analysis assess costs and compare them with benefits?

Use

9. **Some Use of Analysis:** Does the preamble to the proposed rule or the Regulatory Impact Analysis present evidence that the agency used the analysis?
10. **Cognizance of Net Benefits:** Did the agency maximize net benefits or explain why it chose another option?
11. **Measures and Goals:** Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future?
12. **Retrospective Data:** Did the agency indicate what data it will use to assess the regulation's performance in the future and establish provisions for doing so?

Scoring Standards

For each criterion, the evaluators assigned a score ranging from 0 (no useful content) to 5 (comprehensive analysis with potential best practices). Thus, each analysis has the opportunity to earn between 0 and 60 points. In general, the research team used the guidelines in table 1 for scoring. Because the Analysis criteria involve so many discrete aspects of regulatory analysis, we developed a series of sub-questions for each of the four Analysis criteria and awarded a 0–5 score for each sub-question. These scores were then averaged to calculate the score for the individual criterion.

Table 1: What Do the Scores Mean?

| | |
|---|--|
| 5 | Complete analysis of all or almost all aspects, with one or more "best practices" |
| 4 | Reasonably thorough analysis of most aspects and/or shows at least one "best practice" |
| 3 | Reasonably thorough analysis of some aspects |
| 2 | Some relevant discussion with some documentation of analysis |
| 1 | Perfunctory statement with little explanation or documentation |
| 0 | Little or no relevant content |

Caveats and Qualifications

At the outset of this project, we had to address a seemingly simple question: What counts as a "regulatory analysis"? Most previous research focuses on the document required by OMB that is explicitly named the "Regulatory Impact Analysis" (Hahn and Dudley 2007, Hahn et. al. 1990, Hahn and Litan 2005, Hahn, Lutter, and Viscusi 2000). We adopted a broader definition that includes the entire preamble to the proposed rule, the freestanding document or section of the preamble labeled Regulatory Impact Analysis, and additional "technical support documents" that sometimes accompany a Regulatory Impact Analysis. Since different agencies organize their material in different ways, this approach helped ensure that we were fair to all agencies and included all material relevant to the topics a good regulatory analysis is supposed to address. We also needed to read the entire preamble to assess whether the agency used the results of the regulatory analysis or made provisions to conduct retrospective analysis in the future.

Given resource constraints, any evaluation project like this faces a fundamental choice between breadth and depth of the assessment. We assess whether the Regulatory Impact Analysis and preamble to the proposed rule make a reasonable effort at covering the major elements of regulatory analysis. Commenters on earlier versions of this paper who have detailed knowledge of particular regulations have usually told us that our evaluations seem too lenient. Others with more specialized knowledge will likely have additional important critiques of individual regulations, especially related to the quality, completeness or use of the underlying science. We have opted for less depth in favor of greater breadth. To the best of our knowledge, this is the

most-detailed assessment of the quality of regulatory analysis for all economically significant regulations proposed in a two-year period.

Finally, we caution the reader about drawing direct policy conclusions about particular regulations based on our analysis. Criteria 1–8 only evaluate the quality of regulatory analysis. We do not evaluate whether the proposed rule is economically efficient, fair, or otherwise good public policy.

The same caveat applies to the Use criteria. Criteria 9 and 10 assess the extent to which analysis of the regulation's outcomes or benefits, the systemic problem, the alternatives, and costs informed the agency's decisions about the regulation. On these criteria, we took great pains to avoid imposing the value judgment economists often make: that the agency should choose the most economically efficient alternative, as determined by a comparison of quantified benefits and costs. If an agency used some analysis of a regulation's benefits to make decisions, even if it did not consider costs or efficiency, it could receive some points on criterion 9. Similarly, if an agency demonstrated that it was fully cognizant of the net benefits of alternatives, but explicitly rejected the alternative with the greatest net benefits in favor of some other alternative for clearly articulated reasons, it could receive points on criterion 10. As a result, an agency can earn points on these two criteria even in cases where it is prohibited by law from considering costs, such as the EPA's national ambient air quality standards. We believe this approach is consistent with the spirit of Executive Order 12866 (sec. 1), which identifies multiple factors in addition to efficiency that are supposed to guide agency decisions: "[I]n choosing among regulatory approaches, agencies should select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity), unless a statute requires another regulatory approach."

Criteria 11 and 12 assess the extent to which the agency demonstrated its willingness to evaluate the regulation's actual effects in the future. Ideally, agencies would articulate goals, measures, and data that they could use to assess both realized benefits and costs, thus assessing the regulation's economic efficiency. In practice, so few regulations include any provisions for retrospective analysis that the handful of high scores occur in cases where agencies have at least identified goals, measures, and data that could be used to assess the regulation's effectiveness.

Improving the transparency of regulatory documents and the quality of regulatory analysis are necessary but not sufficient to improve public policy. Nevertheless, stakeholders or the agencies themselves may find these analyses useful as a starting point for identifying weaknesses in agency analyses. For example, if an agency has identified only one or two closely related regulatory alternatives, stakeholders may be able to identify additional alternatives that may accomplish the goal at a lower cost.

2. Results for 2009

2.1 Best and Worst Analyses

Table 2 lists all 42 economically significant proposed regulations for 2009. The best analysis was for the combined Environmental Protection Agency–Department of Transportation regulation on greenhouse gases from light-duty vehicles and Corporate Average Fuel Economy (CAFE) standards. This regulation received the highest total score (48 points) as well as the highest Analysis score (18 points). The two agencies collaborated on developing the regulation and the analysis. The regulatory analysis discusses the “conundrum” associated with the identified market failure. The agencies recognize that their estimates of the private benefits of increased fuel efficiency outweigh private costs, yet consumers do not voluntarily purchase as many fuel-efficient cars as economic rationality would suggest. This sort of disclosure should prove invaluable to stakeholders who wish to comment more extensively on the merits of the rule that requires increases in fuel efficiency. The result suggests that more extensive sharing of best practices could improve the quality of regulatory analysis. This regulation received a score six points higher than the next-best regulation in 2009 and five points higher than DOT’s CAFE regulation in 2008.

Capturing second place in 2009 are three energy-efficiency regulations from the Department of Energy and the Department of Homeland Security’s regulation limiting concentrations of live organisms permitted in discharged ballast water from ships.

The three worst analyses came from the Department of Education (General and Non-Loan Programmatic Issues, 14 points) and the Department of Energy (Weatherization Assistance, 10 points; Loan Guarantees for Projects that Employ Innovative Technologies, 5 points). Like most of the low-ranking regulations, all three of these are budget or “transfer” regulations. Transfer regulations, italicized in table 2, outline how the federal government will spend money, set fees, or administer spending programs. Most of these regulations score poorly, continuing a trend observed in 2008 (Ellig and McLaughlin 2010, 14–15).

The best analysis in 2009 received 48 points, or 80 percent of the maximum possible score. The worst received just five points (8 percent). The range of scores widened compared to 2008. In 2008, scores ranged from seven points to 43 points. If these were student papers, the best one in 2009 would have received a B-, and the best one in 2008 would have received a C.

2.2 Summary Statistics

Table 3 summarizes average total scores and scores on the three categories of criteria for 2008 and 2009. The average score in 2009 was 27.02 points out of a possible 60, or 45 percent. The average for 2008 was 27.31, virtually the same. The very low t-statistic indicates that the difference is not statistically significant; for all practical purposes, the averages are the same.³

³ In plain English, that means the total scores for 2008 and 2009 are like two sets of ping pong balls pulled at random out of the same bucket; any difference in the averages is random chance. There is likely no difference at all between the total scores for the two years.

Table 2: Scores for 2009 Proposed Regulations

| Proposed Rule | RIN | Department | Total | Openness | Analysis | Use |
|---|------------------|-------------------|--------------|-----------------|-----------------|------------|
| Greenhouse Gases from Light-Duty Vehicles | 2060-AP58 | DOT/EPA | 48 | 15 | 18 | 15 |
| Energy Conservation: Small Electric Motors | 1904-AB70 | DOE | 42 | 16 | 14 | 12 |
| Energy Efficiency Standards for Commercial Clothes Washers | 1904-AB93 | DOE | 40 | 14 | 14 | 12 |
| Energy Efficiency Standards for Pool Heaters etc. | 1904-AA90 | DOE | 40 | 14 | 14 | 12 |
| Living Organisms in Ships' Ballast Water Discharged in U.S. Waters | 1625-AA32 | DHS | 40 | 15 | 15 | 10 |
| Nutrition Labeling of Single-Ingredient Products | 0583-AC60 | USDA | 38 | 14 | 16 | 8 |
| Title V Greenhouse Gas Tailoring Rule | 2060-AP86 | EPA | 38 | 15 | 11 | 12 |
| Emissions From New Marine Compression-Ignition Engines | 2060-AO38 | EPA | 37 | 15 | 16 | 6 |
| Portland Cement NESHAP | 2060-AO15 | EPA | 35 | 17 | 11 | 7 |
| Greenhouse Gas Mandatory Reporting Rule | 2060-AO79 | EPA | 34 | 12 | 10 | 12 |
| Migratory Bird Hunting | 1018-AW31 | Interior | 34 | 13 | 12 | 9 |
| Emission Standards, Reciprocating Internal Combustion Engines | 2060-AP36 | EPA | 33 | 14 | 11 | 8 |
| <i>End Stage Renal Disease Prospective Payment System</i> | <i>0938-AP57</i> | <i>HHS</i> | <i>32</i> | <i>13</i> | <i>9</i> | <i>10</i> |
| Lead; Opt-out and Recordkeeping Provisions | 2070-AJ55 | EPA | 32 | 16 | 13 | 3 |
| Primary National Ambient Air Quality Standard for Nitrogen Dioxide | 2060-AO19 | EPA | 32 | 11 | 14 | 7 |
| Motor Vehicle Safety Standards, Ejection Mitigation | 2127-AK23 | DOT | 31 | 12 | 11 | 8 |
| <i>School Improvement Grants</i> | <i>1810-AB06</i> | <i>ED</i> | <i>31</i> | <i>11</i> | <i>7</i> | <i>13</i> |
| Primary National Ambient Air Quality Standard for Sulfur Dioxide | 2060-AO48 | EPA | 30 | 12 | 12 | 6 |
| Medical Examination of Aliens | 0920-AA26 | HHS | 28 | 14 | 12 | 2 |
| Positive Train Control | 2130-AC03 | DOT | 26 | 10 | 7 | 9 |
| <i>Prospective Payment Skilled Nursing Facilities</i> | <i>0938-AP46</i> | <i>HHS</i> | <i>26</i> | <i>11</i> | <i>8</i> | <i>7</i> |
| <i>Electronic Health Record Incentive Program</i> | <i>0938-AP78</i> | <i>HHS</i> | <i>25</i> | <i>13</i> | <i>7</i> | <i>5</i> |
| <i>Home Health Prospective Payment System</i> | <i>0938-AP55</i> | <i>HHS</i> | <i>25</i> | <i>11</i> | <i>8</i> | <i>6</i> |
| <i>Prospective Payment System for Inpatient Rehabilitation Facilities</i> | <i>0938-AP56</i> | <i>HHS</i> | <i>25</i> | <i>15</i> | <i>5</i> | <i>5</i> |
| <i>Hospital Inpatient and Long-Term Care Prospective Payment System</i> | <i>0938-AP39</i> | <i>HHS</i> | <i>24</i> | <i>14</i> | <i>5</i> | <i>5</i> |
| Hazard Communications Standard | 1218-AC20 | DOL | 24 | 13 | 7 | 4 |
| <i>Outpatient Prospective Payment</i> | <i>0938-AP41</i> | <i>HHS</i> | <i>24</i> | <i>13</i> | <i>6</i> | <i>5</i> |
| <i>Race to the Top Fund</i> | <i>1810-AB07</i> | <i>ED</i> | <i>23</i> | <i>9</i> | <i>5</i> | <i>9</i> |
| <i>Revisions to Payment Policies Under the Physician Fee Schedule</i> | <i>0938-AP40</i> | <i>HHS</i> | <i>23</i> | <i>11</i> | <i>6</i> | <i>6</i> |
| <i>State Fiscal Stabilization Fund Program</i> | <i>1810-AB04</i> | <i>ED</i> | <i>23</i> | <i>13</i> | <i>5</i> | <i>5</i> |
| Renewable Fuels Program | 2060-AO81 | EPA | 21 | 11 | 6 | 4 |
| <i>Special Community Disaster Loans Program</i> | <i>1660-AA44</i> | <i>DHS</i> | <i>20</i> | <i>11</i> | <i>6</i> | <i>3</i> |
| <i>Investing in Innovation</i> | <i>1855-AA06</i> | <i>ED</i> | <i>19</i> | <i>11</i> | <i>4</i> | <i>4</i> |
| <i>Hospice Wage Index for FY 2010</i> | <i>0938-AP45</i> | <i>HHS</i> | <i>18</i> | <i>9</i> | <i>4</i> | <i>5</i> |
| <i>Housing Trust Fund Program</i> | <i>2506-AC23</i> | <i>HUD</i> | <i>18</i> | <i>10</i> | <i>3</i> | <i>5</i> |
| <i>Revisions to the Medicare Advantage Program</i> | <i>0938-AP77</i> | <i>HHS</i> | <i>18</i> | <i>9</i> | <i>4</i> | <i>5</i> |
| <i>Credit Assistance for Surface Transportation Projects</i> | <i>2105-AD70</i> | <i>DOT</i> | <i>17</i> | <i>11</i> | <i>5</i> | <i>1</i> |
| <i>Expansion of Enrollment in the VA Health Care System</i> | <i>2900-AN23</i> | <i>VA</i> | <i>17</i> | <i>11</i> | <i>3</i> | <i>3</i> |
| <i>Children's Health Insurance Program (CHIP)</i> | <i>0938-AP53</i> | <i>HHS</i> | <i>15</i> | <i>8</i> | <i>1</i> | <i>6</i> |
| <i>General and Non-Loan Programmatic Issues</i> | <i>1840-AC99</i> | <i>ED</i> | <i>14</i> | <i>8</i> | <i>2</i> | <i>4</i> |
| <i>Weatherization Assistance Program</i> | <i>1904-AB97</i> | <i>DOE</i> | <i>10</i> | <i>6</i> | <i>3</i> | <i>1</i> |
| <i>Loan Guarantees for Projects that Employ innovative Technologies</i> | <i>1901-AB27</i> | <i>DOE</i> | <i>5</i> | <i>3</i> | <i>2</i> | <i>0</i> |
| Averages | | | 27.02 | 12.00 | 8.38 | 6.64 |

Note: Regulations in red italics are budget or "transfer" regulations.

Some slight shifts in scores may have occurred in two of the categories between 2008 and 2009. The average Analysis score was largely unchanged. The average Openness score increased by about one point—from 11.04 in 2008 to 12 in 2009. The average Use score fell by about a point, from 7.73 in 2008 to 6.64 in 2009. These differences are statistically significant at the 85 percent confidence level. This is suggestive, but not nearly as strong an indicator as the 95 percent confidence level economists normally use as the standard to infer a likely relationship. Based on this comparison of averages for all kinds of regulations, perhaps the transparency of regulatory analysis increased in 2009, and actual use to make decisions may have decreased, but the difference is not clear enough to tell for sure.

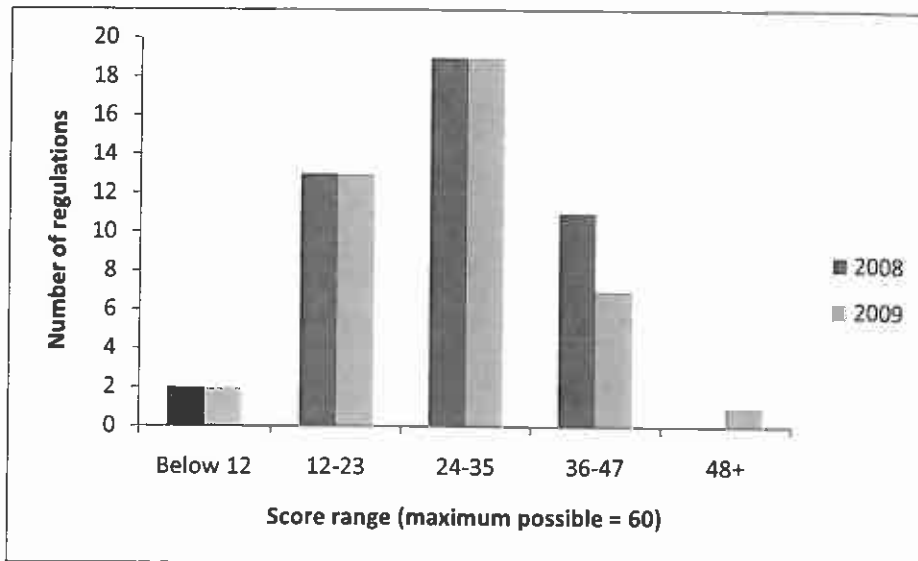
Figure 2 shows that the distribution of scores was roughly the same in both years. The only differences are that the joint DOT/EPA regulation received a score of 48 in 2009, and several more regulations in 2008 received scores in the 36–47 range.

Table 3: Average Scores, 2008 vs. 2009

| | 2008 (n=45) | 2009 (n=42) | Change | T-stat. |
|--------------------|----------------|----------------|--------|---------|
| Total Score | 27.31 | 27.02 | -0.29 | 0.14 |
| Openness | 11.04 | 12.00 | 0.96 | 1.46 |
| Analysis | 8.53 | 8.38 | -0.15 | 0.16 |
| Use | 7.73 | 6.64 | -1.09 | 1.48 |

Maximum possible total score = 60. Maximum possible score on each category = 20.

Figure 2: Distribution of Scores



2.3 Average Scores by Criterion

Table 4 shows the average score for each criterion in 2008 and 2009. For each criterion, at least one regulation earned the highest possible score of 5 in most cases. Best practices, however, are not widely shared. The “# Earning Highest Score” column demonstrates that, except for Availability, very few regulations earn a score of 5 on any individual criterion. The “Theoretical Highest Score” is the score a hypothetical regulation could have earned if it had incorporated all of the best practices identified that year. For 2009, the highest-scoring regulation is much closer to the theoretical highest score than in 2008.

Table 4: Scores by Criterion

| Criterion | 2008 Average Score | 2008 Highest Score | 2008 # Earning Highest Score | 2009 Average Score | 2009 Highest Score | 2009 # Earning Highest Score |
|-----------------------------|--------------------|--------------------|------------------------------|--------------------|--------------------|------------------------------|
| 1. Accessibility | 3.53 | 5 | 12 | 4.06 | 5 | 14 |
| 2. Data Documentation | 2.24 | 5 | 1 | 2.50 | 5 | 5 |
| 3. Model Documentation | 2.33 | 5 | 3 | 2.62 | 5 | 1 |
| 4. Clarity | 2.93 | 5 | 3 | 2.83 | 4 | 10 |
| 5. Outcome Definition | 2.36 | 5 | 2 | 2.38 | 5 | 1 |
| 6. Systemic Problem | 1.80 | 5 | 1 | 1.60 | 4 | 4 |
| 7. Alternatives | 2.29 | 5 | 1 | 2.21 | 5 | 1 |
| 8. Benefit-Cost Analysis | 2.09 | 4 | 3 | 2.19 | 5 | 1 |
| 9. Some Use of Analysis | 2.44 | 5 | 2 | 2.24 | 5 | 1 |
| 10. Considered Net Benefits | 2.20 | 5 | 2 | 1.62 | 5 | 4 |
| 11. Measures and Goals | 1.36 | 5 | 1 | 1.29 | 4 | 1 |
| 12. Retrospective Data | 1.73 | 5 | 1 | 1.50 | 4 | 2 |
| Total | 27.31 | 43 | | 27.02 | 48 | |
| Theoretical Highest Score* | | 59 | | | 56 | |

Very few of the score changes between 2008 and 2009 are statistically significant.⁴ Moreover, changes in averages for some criteria appear to be driven by the changing mix of regulations rather than an actual change in the quality of agencies’ analysis. An accurate assessment of changes, therefore, requires separate consideration of transfer and non-transfer regulations.⁵

⁴ Summary statistics for all criteria, and the sub-questions for criteria 5–8, are in appendix 3.

⁵ Statistically significant changes in averages for the entire set of regulations, without distinguishing between transfer and non-transfer regulations, are in appendix 4.

2.4 Transfer vs. Non-Transfer Regulations

Several previous studies using 2008 data, as well as table 2, demonstrate that the quality and use of analysis for transfer regulations is well below the quality and use of analysis for non-transfer regulations (Ellig and McLaughlin 2010, McLaughlin and Ellig 2010). Indeed, OMB (2008, 12–17) observes that although transfer regulations generate social costs via mandates, prohibitions, and price distortions, agencies do not usually estimate the social benefits and costs of transfer regulations.

Table 5 confirms that the quality and use of analysis for transfer regulations is much lower in both 2008 and 2009. In 2008, for example, the average total score for transfer regulations (17 points) is 47 percent below the average score for non-transfer regulations (32 points). Similarly, in 2009 the average total score for transfer regulations (21 points) is 40 percent below the average total score for non-transfer regulations (34 points). These differences occur for Openness, Analysis, and Use. Openness has the smallest gap, but even there, transfer regulations score 20–30 percent below non-transfer regulations.

Table 5: Transfer vs. Non-Transfer Regulations, Average Scores

| | Transfer 2008 (n=15) | Non-Transfer 2008 (n=30) | Difference | T-stat. |
|--------------------|--------------------------------|------------------------------------|-------------------|----------------|
| Total Score | 17.07 | 32.43 | 15.37 | 8.03 |
| Openness | 8.6 | 12.27 | 3.67 | 4.16 |
| Analysis | 3.53 | 11.03 | 8.53 | 8.71 |
| Use | 4.93 | 9.13 | 4.20 | 4.99 |
| | Transfer 2009 (n=22) | Non-Transfer 2009 (n=20) | Difference | T-stat. |
| Total Score | 20.54 | 34.15 | 13.65 | 6.84 |
| Openness | 10.5 | 13.65 | 3.15 | 4.32 |
| Analysis | 4.91 | 12.20 | 7.29 | 8.9 |
| Use | 5.14 | 8.3 | 3.16 | 3.18 |

All differences are statistically significant at greater than the 99 percent level of confidence. Maximum possible total score = 60. Maximum possible score on each category = 20.

Because transfer regulations generally receive lower scores, a shift in the mix of transfer vs. non-transfer regulations could affect changes in average scores from one year to the next. In 2008, there were 15 proposed economically significant transfer regulations, accounting for 33 percent of proposed economically significant regulations. In 2009, there were 22 proposed economically significant transfer regulations, accounting for 52 percent of proposed economically significant regulations. The increase mostly reflects five regulations proposed in 2009 that implemented provisions of the American Recovery and Reinvestment Act. Thus, one might expect that the average quality and use of regulatory analysis would be lower in 2009 than in 2008 simply because more transfer regulations were proposed in 2009.

Table 6: Score Changes on Individual Criteria and Questions, Transfer vs. Non-Transfer Regulations

| | 2008 (n=30) | 2009 (n=20) | Change | T-stat. |
|---|----------------|----------------|--------|---------|
| Non-Transfer Regulations | | | | |
| Total Score | 32.43 | 34.15 | 1.72 | 0.94 |
| Openness | | | | |
| Criterion 1 – Availability | 12.27 | 13.65 | 1.38 | 1.91* |
| Criterion 2 – Data Documentation | 3.30 | 3.95 | 0.65 | 1.69* |
| Criterion 3 – Theory and Model Documentation | 2.63 | 3.15 | 0.52 | 1.66* |
| Criterion 3 – Theory and Model Documentation | 2.83 | 3.30 | 0.47 | 1.49 |
| Analysis | | | | |
| Criterion 5 – Outcomes | 11.03 | 12.20 | 1.17 | 0.20 |
| Criterion 5 – Outcomes | 3.10 | 3.55 | 0.45 | 1.63 |
| Question 5D – Evidence Regulation Will Affect Outcome | 2.40 | 3.15 | 0.75 | 1.88* |
| Criterion 8 – Cost-Benefit Analysis | 2.60 | 3.10 | 0.5 | 2.15** |
| Question 8C – Effects on Prices of Goods and Services | 1.70 | 3.30 | 1.60 | 3.91*** |
| Question 8G – Calculates Cost-Effectiveness | 1.43 | 2.35 | 0.92 | 2.35** |
| Question 8I – Incidence of Benefits | 2.07 | 2.95 | 0.88 | 2.33** |
| Use | | | | |
| Use | 9.13 | 8.3 | -0.83 | 0.35 |
| Transfer Regulations | | | | |
| Total Score | 17.07 | 20.55 | 3.48 | 1.70* |
| Openness | | | | |
| Criterion 3 – Theory and Model Documentation | 8.60 | 10.50 | 1.90 | 2.11** |
| Criterion 3 – Theory and Model Documentation | 1.33 | 2.00 | .67 | 1.88* |
| Criterion 4 – Clarity | 1.80 | 2.45 | .65 | 2.37** |
| Analysis | | | | |
| Criterion 5 – Outcomes | 0.87 | 1.31 | 0.45 | 1.61 |
| Question 5A – Articulate Desired Outcome | 1.80 | 2.45 | 0.65 | 1.52 |
| Question 5D – Evidence Regulation Will Affect Outcome | 0.20 | 1.00 | 0.80 | 2.86*** |
| Criterion 6 – Systemic Problem | 0.60 | 1.00 | 0.40 | 1.79* |
| Question 6B – Coherent Theory of Systemic Problem | 0.47 | 0.86 | 0.40 | 1.64 |
| Question 7A – List Alternatives | 1.07 | 1.91 | 0.84 | 2.18** |
| Criterion 8 – Cost-Benefit Analysis | 1.07 | 1.36 | 0.30 | 1.51 |
| Use | | | | |
| Use | 4.93 | 5.14 | 0.20 | 0.83 |

Statistical significance: *90 percent ** 95 percent

Maximum possible score on individual criteria or questions = 5.

Table 6 shows changes in mean scores calculated separately for transfer and non-transfer regulations. We report statistics for individual criteria or questions only when the differences approach statistical significance.

For non-transfer regulations, there are very few improvements. Average Openness scores improved from 12.27 points to 13.65 points. The difference is almost statistically significant at the 95 percent level. Within the Analysis category, there is weak evidence of improvement on criterion 5 (Outcomes), largely because agencies provided more evidence that the regulation will accomplish the intended outcomes. Criterion 8 (Cost-Benefit Analysis) also saw improvement due to better scores on three questions: question 8C (Effects on Prices of Goods and Services), question 8G (Evaluation of Cost-Effectiveness) and question 8I (Incidence of Benefits). These changes are consistent with the administration's goals of improving the transparency of the regulatory process, identifying benefits of regulation, and expanding the focus on distributional issues. We caution, however, that the changes are quite small, and the improvements under the Analysis category mostly just move the average scores closer to 3.

Transfer regulations show slightly more improvement than non-transfer regulations. The average Openness score improved, largely due to increases in scores on criterion 3 (Theory and Model Documentation) and criterion 4 (Clarity). The improvement on criterion 4 is actually significant at the 98 percent level. All four Analysis criteria saw higher average scores in 2009 than in 2008. However, all of these scores remained well below 2 in 2009. This indicates only that more analyses presented a small amount of discussion or evidence relevant to these criteria instead of saying nothing. While these improvements are certainly welcome, the low levels of the scores indicate that analysis of transfer regulations has a long way to go before it is as good as the analysis of non-transfer regulations.

We draw the following conclusions from this breakdown between transfer and non-transfer regulations:

- The only category of criteria that appears to have improved for both transfer and non-transfer regulations is Openness.
- The few improvements in the Analysis criteria for non-transfer regulations seem consistent with the Obama administration's regulatory priorities.
- Improvements in some of the Analysis criteria for transfer regulations largely reflect the presence of some content or assertions where previously there were none.
- Regulators made little commitment to retrospective analysis of regulations proposed in either year.

2.5 Total Scores by Agency

Another way to control for factors that might affect the average quality or use of regulatory analysis is to break scores down by agency. Some agencies may do a better job of

analysis than others. Some may tackle analytical problems that are inherently more difficult. Yet others may have different mixes of transfer regulations and non-transfer regulations. Table 7 presents average scores by agency for 2008 and 2009, with and without transfer regulations.

When all regulations are included, five agencies increased their average total scores in 2009, and five agencies reduced their average total scores. When transfer regulations are excluded, four agencies increased their average total scores in 2009, and four agencies reduced their average total scores. Given that most agencies proposed small numbers of economically significant regulations, few agencies proposed comparable numbers of economically significant regulations in both years, and six agencies proposed economically significant regulations only in 2008, it is difficult to infer any general pattern of improvement or deterioration from these results.

However, it is clear that the presence or absence of transfer regulations in a given year has a big effect on some agencies' scores. Scores for the Departments of Energy, Homeland Security, Transportation, and Health and Human Services climb noticeably in one or both years when transfer regulations are excluded. Omitting transfer regulations, Energy and Homeland Security leapfrog Agriculture, EPA, and Interior in the 2009 rankings, and HHS edges past Labor.

Table 7: Average Total Scores by Agency

| All Regulations | 2009 Average Score | # of Regulations | 2008 Average Score | # of Regulations | 2008-09 Change |
|-----------------------------|--------------------------|---------------------|--------------------------|---------------------|-------------------|
| Joint DOT/EPA | 48.0 | 1 | NA | 0 | NA |
| USDA | 38.0 | 1 | 28.0 | 1 | +10.0 |
| Interior | 34.0 | 1 | 27.3 | 4 | +6.7 |
| EPA | 32.5 | 9 | 39.5 | 2 | -7.0 |
| DHS | 30.0 | 2 | 38.0 | 2 | -8.0 |
| Energy | 27.4 | 5 | 27.0 | 1 | +0.4 |
| DOT | 24.7 | 3 | 32.3 | 6 | -7.6 |
| Labor | 24.0 | 1 | 34.1 | 6 | -10.1 |
| HHS | 23.6 | 12 | 20.7 | 11 | +2.9 |
| Education | 22.0 | 5 | 22.0 | 2 | 0 |
| HUD | 18.0 | 1 | 41.0 | 1 | -23.0 |
| Veterans | 17.0 | 1 | 10.0 | 1 | +7.0 |
| Justice | | 0 | 35.0 | 3 | NA |
| Treasury | | 0 | 27.0 | 1 | NA |
| Fed Acquisition | | 0 | 24.0 | 1 | NA |
| State | | 0 | 13.0 | 1 | NA |
| Defense | | 0 | 12.0 | 1 | NA |
| SSA | | 0 | 7.0 | 1 | NA |
| | | | | | |
| Non-Transfer Regulations | 2009 Score | # of Regulations | 2008 Score | # of Regulations | 2008-09 Change |
| Joint DOT/EPA | 48.0 | 1 | NA | 0 | NA |
| Energy | 40.7 | 3 | 27.0 | 1 | +13.7 |
| DHS | 40.0 | 1 | 38.0 | 1 | +2.0 |
| USDA | 38.0 | 1 | 28.0 | 1 | +10.0 |
| EPA | 32.5 | 9 | 39.5 | 2 | -7.0 |
| Interior | 34.0 | 1 | 27.3 | 4 | +6.7 |
| DOT | 29.0 | 2 | 32.3 | 6 | -3.3 |
| HHS | 28.0 | 1 | 29.0 | 2 | -1.0 |
| Labor | 24.0 | 1 | 34.1 | 6 | -10.1 |
| HUD | | 0 | 41.0 | 1 | NA |
| Justice | | 0 | 35.0 | 3 | NA |
| Treasury | | 0 | 27.0 | 1 | NA |
| Federal Acquisition | | 0 | 24.0 | 1 | NA |

Maximum possible average total score = 60.

5. Use of Analysis

Previous research found that use of the analysis was positively correlated with the quality of the analysis in 2008. Scores on criteria 9–12, which evaluate use of analysis, are positively correlated with the Analysis score and overall quality, defined as the sum of the Openness and Analysis scores, criteria 1–8 (Ellig and McLaughlin 2010). An additional year gives us a larger data set to test whether this relationship still held and whether it changed in 2009.

5.1 Total Use Score

Table 8 shows the results from regressing the Use score on the Quality score, along with several control variables. A one point increase in the Quality score is associated with a 0.25–0.31 point increase in the Use score, and this correlation is highly statistically significant. The result also seems quantitatively significant. The standard deviation of Quality is 6.86; a one-standard-deviation change in Quality implies about a two-point change in Use. Given that the mean Use score is 7.21, variation in Quality seems to explain a great deal of the variation in Use.⁶

The Year 2008 dummy tests whether Use scores tend to be different in 2008 and 2009. It shows that Use is about 1.3 points higher in 2008, after controlling for Quality. This result indicates a 1.3-point shift in the intercept of the regression equation. One might also speculate that the slope of the line might be different in the two years. When we run the same regressions using Quality \times Year as an explanatory variable instead of the year dummy, we get roughly the same results with a bit worse statistical fit.⁷

The year appears to make a big difference, considering that the mean Use score is only 7.21 and its standard deviation is 3.45. However, it would be a mistake to portray the first year of the Obama administration as a retreat from stellar use of analysis in the Bush administration. Figure 3 shows the distribution of Use scores in 2008 and 2009. Neither year shows more than middling use of analysis. The principal difference is that the middle class shrinks in 2009, with more regulations that either fail to use the analysis or make only a passing reference to it.

Models 3 and 4 in table 8 include control variables for transfer regulations, to see if tendencies to use analysis differ for this type of regulation. In general, the relationship between Use and Quality seems no different for transfer regulations than for non-transfer regulations. However, the transfer regulations that implement provisions of the American Recovery and Reinvestment Act appear to be marginally more likely to use the analysis. The Use score for these five regulations averages 7 points, compared to an average of 5 points for other transfer regulations in 2009. The difference in averages stems from relatively high Use scores for two Education Department regulations that provide grants to states for education reform: the School Improvement Grants (13 points) and the Race to the Top Fund (9 points). School Improvement Grants earned a relatively high Use score because the regulations focus the grants on education reforms that have research demonstrating their effectiveness, and because the regulation includes

⁶ Using only the four Analysis criteria 5–8 as the independent variable produces roughly the same results with a bit worse statistical fit.

⁷ Results are in appendix 5.

provisions to gather data and evaluate the effectiveness of the reforms funded by the spending. The Race to the Top fund did not make much use of analysis to create the regulation, but it did establish goals and require states to submit data to evaluate the effectiveness of the reforms funded by the regulation.

5.2 Ex-Ante Use vs. Retrospective Analysis

The total Use score consists of scores for two types of criteria that might be affected differently by the quality of analysis. Criteria 9 and 10 assess the extent to which the agency used the analysis to make decisions in the proposed regulation. Criteria 11 and 12 assess the extent to which the agency provided for retrospective analysis in either the preamble to the regulation or the Regulatory Impact Analysis. To see whether Quality has different effects on these variables, table 9 replicates the regressions in table 8 using criteria 9–10 as a dependent variable and using criteria 11–12 as a dependent variable.

The quality of analysis clearly has a positive, statistically significant correlation with both the use of analysis to craft the regulation and on provisions for retrospective analysis. The effect is about twice as large for the former as for the latter.

The Year dummy variable, however, shows that Quality has a differential effect in 2008 only for use of analysis to craft the regulation. Agencies were no more likely to make provisions for retrospective analysis in 2008 than in 2009. This is perhaps unsurprising, given that Executive Order 12866 and Circular A-4 place little emphasis on retrospective analysis.

Finally, the Transfer dummy variable indicates that agencies were neither more nor less likely to use analysis in crafting transfer regulations or provide for retrospective analysis. The Recovery Act dummy shows that these regulations tend to have better retrospective analysis provisions—again largely because of the higher scores of the two education reform regulations.

These regressions identify some significant correlations, but we are not sure if they imply causation. Perhaps decision makers choose to use analysis when they are confident it is higher quality. Or perhaps analysts prepare better analysis when they are confident the decision makers will use it. Similarly, the higher Use scores in 2008 might reflect a stronger commitment to using regulatory analysis in the Bush administration, but other hypotheses might also explain the difference. To the extent that regulations proposed in 2009 were already in process in 2008, perhaps the Bush administration simply pushed out the regulations that were better-supported by analysis in 2008 and left the rest for the Obama administration to deal with. Alternatively, the difference could just reflect the fact that 2009 was a transition year (perhaps because new members of an administration have to “learn” how to use economic analysis). Forthcoming data on the quality and use of regulatory analysis in 2010 may allow us to test these and other hypotheses. Systematic interviews of federal regulatory personnel, such as those conducted by Williams (2008), could provide additional (and perhaps even better) insights.

Table 8: Quality of Analysis vs. Use of Analysis

| Explanatory Variables | Dependent Variable: Use of Analysis Score (Criteria 9–12) | | | |
|-------------------------|---|-------------------|-------------------|-------------------|
| | (1) | (2) | (3) | (4) |
| Quality (Criteria 1–8) | 0.30 [6.98***] | 0.31 [7.28***] | 0.27 [3.99***] | 0.25 [3.83***] |
| Year 2008 Dummy | | 1.34 [2.31***] | 1.15 [1.85*] | 1.33 [2.14**] |
| Transfer Regulation | | | -0.80 [-0.85] | -1.19 [-1.25] |
| Recovery Act Regulation | | | | 2.25 [1.70*] |
| Constant | 1.14 [1.24] | .33 [0.34] | 1.64 [0.91] | 1.82 [1.02] |
| N | 87 | 87 | 87 | 87 |
| Adjusted R ² | 0.36 | 0.39 | 0.39 | 0.40 |

Ordinary least squares regressions: t-statistics in parentheses.
 Statistical significance: ***1 percent **5 percent *10 percent

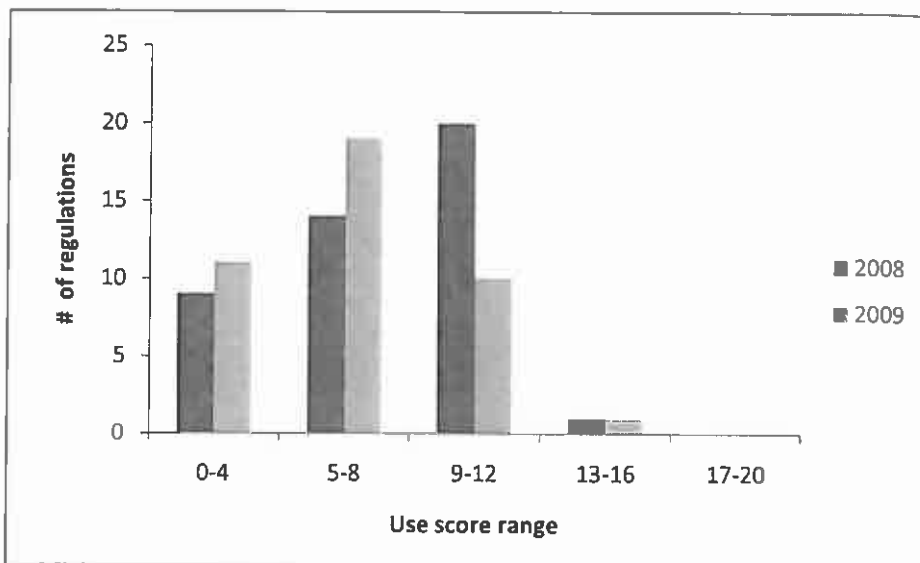
Figure 3: Use of Analysis Scores by Quintile

Table 9: Quality of Analysis vs. Separate Scores for Ex-Ante and Retrospective Analysis

| Explanatory Variables | Dependent Variable: Ex Ante Use of Analysis (Criteria 9–10) | | | |
|-------------------------|---|-------------------|-------------------|-------------------|
| | (1) | (2) | (3) | (4) |
| Quality (Criteria 1–8) | 0.20 [6.05***] | 0.20 [6.30***] | 0.17 [3.46***] | 0.17 [3.37***] |
| Year 2008 Dummy | | 0.94 [2.18**] | 0.83 [1.78*] | 0.87 [1.82*] |
| Transfer Regulation | | | -0.51 [-0.72] | -0.58 [-0.80] |
| Recovery Act Regulation | | | | 0.45 [0.45] |
| Constant | 0.34 [0.50] | -0.22 [-0.32] | 0.60 [0.44] | 0.64 [0.47] |
| N | 87 | 87 | 87 | 87 |
| Adjusted R ² | 0.29 | 0.32 | 0.32 | 0.31 |

| Explanatory Variables | Dependent Variable: Provisions for Retrospective Analysis (Criteria 11–12) | | | |
|-------------------------|--|-------------------|------------------|------------------|
| | (1) | (2) | (3) | (4) |
| Quality (Criteria 1–8) | 0.11 [3.98***] | 0.11 [4.04***] | 0.09 [2.19**] | 0.08 [2.00**] |
| Year 2008 Dummy | | 0.39 [1.06] | 0.32 [0.81] | 0.47 [1.29] |
| Transfer Regulation | | | -0.29 [-0.49] | -0.61 [-1.01] |
| Recovery Act Regulation | | | | 1.80 [2.15**] |
| Constant | 0.79 [1.39] | 0.56 [0.91] | 1.04 [0.90] | 1.18 [1.04] |
| N | 87 | 87 | 87 | 87 |
| Adjusted R ² | 0.15 | 0.15 | 0.14 | 0.18 |

Ordinary least squares regressions; t-statistics in parentheses.
 Statistical significance: ***1 percent **5 percent *10 percent

5.3 Use by Individual Agencies

Is the reduction in Use scores widespread, or concentrated in a few agencies? Table 10 sheds light on this question by calculating changes in average Use scores for individual agencies, including and excluding transfer regulations.

Including all regulations, four agencies improved their average Use scores between 2008 and 2009: Interior, Agriculture, Health and Human Services, and Veterans Affairs. Except for Agriculture, all of these improvements were less than one point. Seven agencies saw their average Use scores fall, and all of these reductions exceeded two points. Thus, improvements are small, and reductions are widespread.

Some of these changes were driven by the increased proportion of transfer regulations in 2009. Excluding transfer regulations, four agencies increased their Use scores: Interior, Agriculture, Health and Human Services, and Energy. Interior's score increased by just 0.7 point; all the others increased by at least two points. Four agencies saw their Use scores fall when transfer regulations are excluded: Homeland Security, Transportation, EPA, and Labor. Each of these four reductions was two points or greater. Excluding transfer regulations thus suggests that some agencies had noticeable improvements in their Use scores, while about the same number saw noticeable reductions.

The changing mix of transfer vs. non-transfer agencies had a big effect on results for four agencies: Energy, Homeland Security, Transportation, and Health and Human Services. Excluding transfer regulations actually increases Energy's Use score; with transfer regulations, Energy's Use score falls. Excluding transfer regulations leads to a much bigger increase in Health and Human Services' Use score: a 5.5 point increase instead of a 0.7 point increase. Finally, excluding transfer regulations cuts the reduction in Homeland Security's and Transportation's Use scores by more than half.

The regression equations in tables 8 and 9 show that use of analysis to make decisions about regulations is lower in 2009, even after controlling for transfer regulations. Tabulations in table 10 suggest that the primary reason for the statistically significant decline in Use scores in 2009 appears to be the reductions in Use scores at Transportation and EPA. Of all the agencies whose average Use scores fell, Transportation proposed two regulations in 2009 and EPA proposed nine. No other agency whose Use score for non-transfer regulations fell in 2009 proposed more than one non-transfer regulation in 2009.

In fairness, we should also note that the combined DOT/EPA CAFÉ/greenhouse gas emissions regulation earned the highest Use score in 2009: 15 points. In addition, the caveat we applied to table 7 applies to table 10 as well. Because the number of regulations is so small, it is hard to make reliable generalizations about particular agencies. For that, more years of data are needed.

Table 10: Use by Individual Agencies

| All Regulations | 2009 Average Score | # of Regulations | 2008 Average Score | # of Regulations | 2008-09 Change |
|-----------------------------|--------------------------|---------------------|--------------------------|---------------------|-------------------|
| Joint DOT/EPA | 15.0 | 1 | NA | 0 | NA |
| Interior | 9.0 | 1 | 8.3 | 4 | +0.7 |
| USDA | 8.0 | 1 | 5.0 | 1 | +3.0 |
| Energy | 7.4 | 5 | 10.0 | 1 | -2.6 |
| EPA | 7.2 | 9 | 10.5 | 2 | -3.3 |
| Education | 7.0 | 5 | 9.0 | 2 | -2.0 |
| DHS | 6.5 | 2 | 12.0 | 2 | -5.5 |
| HHS | 5.6 | 12 | 5.5 | 11 | +0.1 |
| HUD | 5.0 | 1 | 10.0 | 1 | -5.0 |
| DOT | 4.5 | 3 | 10.0 | 6 | -5.5 |
| Labor | 4.0 | 1 | 8.7 | 6 | -4.7 |
| Veterans | 3.0 | 1 | 2.0 | 1 | +1.0 |
| Justice | | 0 | 11.7 | 3 | NA |
| Treasury | | 0 | 9.0 | 1 | NA |
| Fed Acquisition | | 0 | 4.0 | 1 | NA |
| SSA | | 0 | 3.0 | 1 | NA |
| State | | 0 | 2.0 | 1 | NA |
| Defense | | 0 | 1.0 | 1 | NA |
| | | | | | |
| Non-Transfer Regulations | 2009 Score | # of Regulations | 2008 Score | # of Regulations | 2008-09 Change |
| Joint DOT/EPA | 15.0 | 1 | NA | 0 | NA |
| Energy | 12.0 | 3 | 10.0 | 1 | +2.0 |
| DHS | 10.0 | 1 | 12.0 | 1 | -2.0 |
| Interior | 9.0 | 1 | 8.3 | 4 | +0.7 |
| DOT | 8.5 | 2 | 10.0 | 6 | -2.5 |
| USDA | 8.0 | 1 | 5.0 | 1 | +3.0 |
| EPA | 7.2 | 9 | 10.5 | 2 | -3.3 |
| HHS | 7.0 | 1 | 2.0 | 2 | +5.0 |
| Labor | 4.0 | 1 | 8.7 | 6 | -4.7 |
| HUD | | 0 | 10.0 | 1 | NA |
| Justice | | 0 | 11.7 | 3 | NA |
| Treasury | | 0 | 9.0 | 1 | NA |
| Federal Acquisition | | 0 | 4.0 | 1 | NA |

Maximum possible Use score = 20.

6. Conclusions

This study expands on existing research by applying a consistent set of standards to assess the quality and use of regulatory analysis for all economically significant regulations proposed in two different years. We find that the average quality of analysis is not high. The quality and use of regulatory analysis is especially poor for transfer regulations that define how the federal government will spend or collect money. But Regulatory Impact Analyses and *Federal Register* preambles present many examples of best practices that could improve the quality and use of analysis significantly if they were diffused more widely.

Our comparison of regulations in 2008 and 2009 generates several insights relevant to contemporary regulatory policy discussions. We find very little evidence that the quality of regulatory analysis changed between 2008 and 2009. The most significant improvement occurred in accessibility of regulatory analyses on the Internet. While this is a welcome improvement that is consistent with the Obama administration's focus on government transparency, improvements on a few other criteria were generally small and, at best, usually improved average scores from poor in 2008 to middling in 2009. In addition, we find substantial evidence that agencies were less likely to use the analysis to make decisions about proposed regulations in 2009 than in 2008.

This research also raises numerous questions that deserve further inquiry. We have not, by and large, identified why the quality and use of regulatory analysis exhibits the patterns revealed in this paper. For example, it is not obvious why some non-transfer regulations receive better analysis than others. Subject matter, deadlines, differing statutory mandates, explicit policy preferences, or department-specific factors may be part of the explanation.

It is also not clear why the quality of regulatory analysis changed very little between 2008 and 2009. Does this mean career staffers at agencies and/or OIRA consciously promote continuity between administrations? Another factor that may have played a role is that it is likely that the Bush administration focused greater effort on improving the quality of its "midnight" final regulations in 2008 relative to its proposed regulations, while the Obama administration is likely to have placed a greater focus on its own newly proposed regulations. This would suggest that the quality of analysis for proposed rules should have improved in 2009—unless most of the regulations proposed in 2009 were already in the pipeline in 2008. Research on what happened to the quality and use of analysis for final rules might shed further light on this issue.

Our data also indicate a statistically significant reduction in OIRA review time for non-transfer regulations in 2009 (from 66 to 40 days), but not for transfer regulations, which averaged about 35 days in both years. McLaughlin (2010) finds that midnight regulations receive shorter review times at OIRA. Whether OIRA review time impacts quality and use is an area ripe for further research.

Finally, we do not know why the use of regulatory analysis to make regulatory decisions declined in 2009. Indeed, we are not even sure if good analysis leads to use in decisions, or if decision makers' openness to analysis promotes good analysis, or if some third set of factors

causes both of these. Creating consistent data on the quality and use of regulatory analysis is the first step toward answering these questions.

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Appendix 1

Major Factors Considered When Evaluating Each Criterion

Note: Regardless of how they are worded, all questions involve qualitative analysis of how well the RIA and the *Federal Register* notice address the issue, rather than “yes/no” answers.

Openness

1. How easily were the RIA, the proposed rule, and any supplementary materials found online?

How easily can the proposed rule and RIA be found on the agency’s website?

How easily can the proposed rule and RIA be found on Regulations.gov?

Can the proposed rule and RIA be found without contacting the agency for assistance?

2. How verifiable are the data used in the analysis?

Is there evidence that the analysis used data?

Does the analysis provide sufficient information for the reader to verify the data?

How much of the data are sourced?

Does the analysis provide direct access to the data via links, URLs, or provision of data in appendices?

If data are confidential, how well does the analysis assure the reader that the data are valid?

3. How verifiable are the models and assumptions used in the analysis?

Are models and assumptions stated clearly?

How well does the analysis justify any models or assumptions used?

How easily can the reader verify the accuracy of models and assumptions?

Does the analysis provide citations to sources that justify the models or assumptions?

Does the analysis demonstrate that its models and assumptions are widely accepted by relevant experts?

How reliable are the sources? Are the sources peer-reviewed?

4. Was the agency’s analysis comprehensible to an informed layperson?

How well can a non-specialist reader understand the results or conclusions?

How well can a non-specialist reader understand how the analysis reached the results?

How well can a specialist reader understand how the analysis reached the results?

Are the RIA and relevant portions of the *Federal Register* notice written in “plain English”?

(Light on technical jargon and acronyms, well-organized, grammatically correct, direct language used.)

Analysis

For each Analysis criterion, the lettered sub-questions each receive a score of 0–5, and these are averaged and rounded to produce the score on the criterion.

5. How well does the analysis identify the desired outcomes and demonstrate that the regulation will achieve them?
 - A. How well does the analysis clearly identify ultimate outcomes that affect citizens' quality of life?
 - B. How well does the analysis identify how these outcomes are to be measured?
 - C. Does the analysis provide a coherent and testable theory showing how the regulation will produce the desired outcomes?
 - D. Does the analysis present credible empirical support for the theory?
 - E. Does the analysis adequately assess uncertainty about the outcomes?

6. How well does the analysis identify and demonstrate the existence of a market failure or other systemic problem the regulation is supposed to solve?
 - A. Does the analysis identify a market failure or other systemic problem?
 - B. Does the analysis outline a coherent and testable theory that explains why the problem (associated with the outcome above) is systemic rather than anecdotal?
 - C. Does the analysis present credible empirical support for the theory?
 - D. Does the analysis adequately assess uncertainty about the existence and size of the problem?

7. How well does the analysis assess the effectiveness of alternative approaches?
 - A. Does the analysis enumerate other alternatives to address the problem?
 - B. Is the range of alternatives considered narrow or broad?
 - C. Does the analysis evaluate how alternative approaches would affect the amount of the outcome achieved?
 - D. Does the analysis adequately address the baseline—what the state of the world is likely to be in the absence of further federal action?

8. How well does the analysis assess costs and benefits?
 - A. Does the analysis identify and quantify incremental costs of all alternatives considered?
 - B. Does the analysis identify all expenditures likely to arise as a result of the regulation?
 - C. Does the analysis identify how the regulation would likely affect the prices of goods and services?
 - D. Does the analysis examine costs that stem from changes in human behavior as consumers and producers respond to the regulation?
 - E. Does the analysis adequately address uncertainty about costs?
 - F. Does the analysis identify the approach that maximizes net benefits?

- G. Does the analysis identify the cost-effectiveness of each alternative considered?
- H. Does the analysis identify all parties who would bear costs and assess the incidence of costs?
- I. Does the analysis identify all parties who would receive benefits and assess the incidence of benefits?

Use

9. Does the proposed rule or the RIA present evidence that the agency used the Regulatory Impact Analysis?

Does the proposed rule or the RIA assert that the analysis of outcomes, benefits, the systemic problem, alternatives, or costs affected any decisions?

How many aspects of the proposed rule did the analysis affect?

How significant are the decisions the analysis affected?

10. Did the agency maximize net benefits or explain why it chose another option?

Did the analysis calculate net benefits of one or more options so that they could be compared?

Did the analysis calculate net benefits of all options considered?

Did the agency either choose the option that maximized net benefits or explain why it chose another option?

How broad a range of alternatives did the agency consider?

11. Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future?

Does the RIA or *Federal Register* notice contain analysis or results that could be used to establish goals and measures to assess the results of the regulation in the future?

In the RIA or the *Federal Register* notice, does the agency commit to performing some type of retrospective analysis of the regulation's effects?

Does the agency explicitly articulate goals for at major outcomes the rule is supposed to affect?

Does the agency establish measures for major outcomes the rule is supposed to affect?

Does the agency set targets for measures of major outcomes the rule is supposed to affect?

12. Did the agency indicate what data it will use to assess the regulation's performance in the future and establish provisions for doing so?

Does the RIA or *Federal Register* notice demonstrate that the agency has access to data that could be used to assess some aspects of the regulation's performance in the future?

Would comparing actual outcomes to outcomes predicted in the analysis generate a reasonably complete understanding of the regulation's effects?

Does the agency suggest it will evaluate future effects of the regulation using data it has access to or commits to gathering?

Does the agency explicitly enumerate data it will use to evaluate major outcomes the regulation is supposed to accomplish in the future?

Does the analysis demonstrate that the agency understands how to control for other factors that may affect outcomes in the future?

Appendix 2: Crosswalk of 2010 OMB Regulatory Impact Analysis Checklist with Mercatus Regulatory Report Card evaluation criteria

| OMB Checklist | Mercatus Evaluation Criteria |
|---|--|
| Does the RIA include a reasonably detailed description of the need for the regulatory action? | Criterion 6: How well does the analysis demonstrate the existence of a market failure or other systemic problem the regulation is supposed to solve? |
| Does the RIA include an explanation of how the regulatory action will meet that need? | Criterion 5: How well does the analysis identify the desired outcomes and demonstrate that the regulation will achieve them? |
| Does the RIA use an appropriate baseline (i.e., best assessment of how the world would look in the absence of the proposed action)? | Criterion 7, question D: Does the analysis adequately assess the baseline—what the state of the world is likely to be in the absence of further federal action? |
| Is the information in the RIA based on the best reasonably obtainable scientific, technical, and economic information and is it presented in an accurate, clear, complete, and unbiased manner? | <p>Criterion 2: How verifiable are the data used in the analysis?</p> <p>Criterion 3: How verifiable are the models or assumptions used in the analysis?</p> <p>Criterion 4: Was the analysis comprehensible to an informed layperson?</p> <p><i>Criterion 3 includes an assessment of whether the models and assumptions are based on peer-reviewed or otherwise reliable publications. However, the Mercatus evaluation does not assess the quality of the underlying science.</i></p> |
| Are the data, sources, and methods used in the RIA provided to the public on the Internet so that a qualified person can reproduce the analysis? | <p>Criterion 1 takes the first step by assessing how easily the RIA itself can be found on the Internet.</p> <p>Criteria 3 and 4 include an assessment of how easily the reader could find the underlying data, sources, and methods from information or links provided in the RIA or the <i>Federal Register</i> notice.</p> |
| To the extent feasible, does the RIA quantify and monetize the anticipated benefits from the regulatory action? | Criterion 5, question 2: How well does the analysis identify how the outcomes are to be measured? |

| | |
|---|---|
| To the extent feasible, does the RIA quantify and monetize the anticipated costs? | Multiple questions under criterion 8 (Benefits and Costs) assess how well the analysis identifies, quantifies, and monetizes costs. |
| Does the RIA explain and support a reasoned determination that the benefits of the intended regulation justify its costs (recognizing that some benefits and costs are difficult to quantify)? | Criterion 8, question F: Does the analysis identify the approach that maximizes net benefits? Criterion 8, question G: Does the analysis identify the cost-effectiveness of each alternative considered? |
| Does the RIA assess the potentially effective and reasonably feasible alternatives? | Criterion 7: How well does the analysis assess the effectiveness of alternative approaches? |
| Does the preferred option have the highest net benefits (including potential economic, public health and safety, and other advantages; distributive impacts; and equity), unless a statute requires a different approach? | Criterion 10: Did the agency maximize net benefits or explain why it chose another option? |
| Does the RIA include an explanation of why the planned regulatory action is preferable to the identified potential alternatives? | Criterion 9: Does the proposed rule or RIA present evidence that the agency used the Regulatory Impact Analysis? Criterion 10: Did the agency maximize net benefits or explain why it chose another option? |
| Does the RIA use appropriate discount rates for the benefits and costs that are expected to occur in the future? | Considered under criterion 5, question 2: How well does the analysis identify how the outcomes are to be measured?, as well as several questions about measurement and comparison of benefits and costs under criterion 8 (Benefits and Costs). |
| Does the RIA include, if and where relevant, an appropriate uncertainty analysis? | Criterion 5, question E: Does the analysis adequately assess uncertainty about the outcomes? Criterion 6, question D: Does the analysis adequately assess uncertainty about the existence and size of the problem? Criterion 8, question E: Does the analysis adequately address uncertainty about costs? |

| | |
|--|--|
| Does the RIA include, if and where relevant, a separate description of the distributive impacts and equity (including transfer payments and effects on disadvantages or vulnerable populations)? | <p>Criterion 8, question H: Does the analysis identify all parties who would bear costs and assess the incidence of costs?</p> <p>Criterion 8, question I: Does the analysis identify all parties who would receive benefits and assess the incidence of benefits?</p> |
| Does the analysis include a clear, plain-language executive summary, including an accounting statement that summarizes the benefit and cost estimates for the regulatory action under consideration, including the qualitative and non-monetized benefits and costs? | Criterion 4: Was the analysis comprehensible to an informed layperson? |
| Does the analysis include a clear and transparent table presenting (to the extent feasible) anticipated benefits and costs (qualitative and quantitative)? | Criterion 4: Was the analysis comprehensible to an informed layperson? |
| <i>Goals and measures to assess results of the regulation in the future – No content.</i> | Criterion 11: Does the proposed rule establish measures and goals that can be used to track the regulation's results in the future? |
| <i>Provisions for gathering data to assess results of the regulation in the future – No content.</i> | Criterion 12: Did the agency indicate what data it will use to assess the regulation's performance in the future and establish provisions for doing so? |

Appendix 3: Summary Statistics on All Criteria and Sub-Questions

2008

| Variable | N | Mean | Std. Dev. | Min | Max |
|--------------|----|-------|-----------|-----|-----|
| Total | 45 | 27.30 | 9.46 | 7 | 43 |
| Openness | 45 | 11.04 | 3.26 | 4 | 18 |
| Analysis | 45 | 8.53 | 4.48 | 0 | 16 |
| Use | 45 | 7.73 | 3.31 | 1 | 14 |
| Criterion 1 | 45 | 3.53 | 1.36 | 0 | 5 |
| Criterion 2 | 45 | 2.24 | 1.19 | 0 | 5 |
| Criterion 3 | 45 | 2.33 | 1.30 | 0 | 5 |
| Criterion 4 | 45 | 2.93 | 1.21 | 0 | 5 |
| Criterion 5 | 45 | 2.36 | 1.40 | 0 | 5 |
| 5A | 45 | 3.31 | 1.52 | 0 | 5 |
| 5B | 45 | 2.71 | 1.74 | 0 | 5 |
| 5C | 45 | 2.22 | 1.59 | 0 | 5 |
| 5D | 45 | 1.67 | 1.60 | 0 | 5 |
| 5E | 45 | 2.00 | 1.86 | 0 | 5 |
| Criterion 6 | 45 | 1.80 | 1.47 | 0 | 5 |
| 6A | 45 | 2.31 | 1.68 | 0 | 5 |
| 6B | 45 | 2.00 | 1.75 | 0 | 5 |
| 6C | 45 | 1.71 | 1.59 | 0 | 5 |
| 6D | 45 | 0.82 | 1.28 | 0 | 5 |
| Criterion 7 | 45 | 2.29 | 1.36 | 0 | 4 |
| 7A | 45 | 2.78 | 1.86 | 0 | 5 |
| 7B | 45 | 1.96 | 1.45 | 0 | 5 |
| 7C | 45 | 1.98 | 1.64 | 0 | 5 |
| 7D | 45 | 2.04 | 1.30 | 0 | 5 |
| Criterion 8 | 45 | 2.09 | 0.996 | 0 | 4 |
| 8A | 45 | 2.93 | 1.16 | 0 | 5 |
| 8B | 45 | 3.18 | 1.01 | 1 | 5 |
| 8C | 45 | 1.38 | 1.34 | 0 | 5 |
| 8D | 45 | 1.56 | 1.47 | 0 | 5 |
| 8E | 45 | 1.78 | 1.80 | 0 | 5 |
| 8F | 45 | 1.91 | 1.66 | 0 | 5 |
| 8G | 45 | 1.04 | 1.17 | 0 | 5 |
| 8H | 45 | 2.82 | 1.13 | 1 | 5 |
| 8I | 45 | 1.60 | 1.34 | 0 | 5 |
| Criterion 9 | 45 | 2.44 | 1.32 | 0 | 5 |
| Criterion 10 | 45 | 2.20 | 1.46 | 0 | 5 |
| Criterion 11 | 45 | 1.36 | 1.03 | 0 | 5 |
| Criterion 12 | 45 | 1.73 | 1.10 | 0 | 5 |

2009

| Variable | N | Mean | Std. Dev. | Min | Max |
|--------------|----|-------|-----------|-----|-----|
| Total | 42 | 27.03 | 9.37 | 5 | 48 |
| Openness | 42 | 12.00 | 2.82 | 3 | 17 |
| Analysis | 42 | 8.38 | 4.52 | 1 | 18 |
| Use | 42 | 6.64 | 3.56 | 0 | 15 |
| Criterion 1 | 42 | 4.05 | 0.85 | 2 | 5 |
| Criterion 2 | 42 | 2.50 | 1.50 | 0 | 5 |
| Criterion 3 | 42 | 2.62 | 1.23 | 0 | 5 |
| Criterion 4 | 42 | 2.83 | 0.88 | 1 | 4 |
| Criterion 5 | 42 | 2.38 | 1.43 | 0 | 5 |
| 5A | 42 | 3.36 | 1.61 | 0 | 5 |
| 5B | 42 | 2.52 | 1.63 | 0 | 5 |
| 5C | 42 | 2.21 | 1.60 | 0 | 5 |
| 5D | 42 | 2.02 | 1.56 | 0 | 5 |
| 5E | 42 | 1.76 | 1.69 | 0 | 5 |
| Criterion 6 | 42 | 1.60 | 1.15 | 0 | 4 |
| 6A | 42 | 2.21 | 1.70 | 0 | 5 |
| 6B | 42 | 1.50 | 1.29 | 0 | 4 |
| 6C | 42 | 1.21 | 1.24 | 0 | 4 |
| 6D | 42 | 0.88 | 1.31 | 0 | 4 |
| Criterion 7 | 42 | 2.21 | 1.42 | 0 | 5 |
| 7A | 42 | 2.83 | 1.58 | 0 | 5 |
| 7B | 42 | 1.86 | 1.32 | 0 | 5 |
| 7C | 42 | 1.90 | 1.76 | 0 | 5 |
| 7D | 42 | 1.93 | 1.44 | 0 | 5 |
| Criterion 8 | 42 | 2.19 | 1.15 | 0 | 5 |
| 8A | 42 | 2.83 | 1.34 | 0 | 5 |
| 8B | 42 | 3.24 | 1.32 | 0 | 5 |
| 8C | 42 | 2.07 | 1.69 | 0 | 5 |
| 8D | 42 | 1.60 | 1.48 | 0 | 5 |
| 8E | 42 | 1.76 | 1.59 | 0 | 5 |
| 8F | 42 | 1.33 | 1.66 | 0 | 5 |
| 8G | 42 | 1.24 | 1.54 | 0 | 5 |
| 8H | 42 | 3.00 | 1.17 | 0 | 5 |
| 8I | 42 | 1.86 | 1.47 | 0 | 5 |
| Criterion 9 | 42 | 2.24 | 1.36 | 0 | 5 |
| Criterion 10 | 42 | 1.62 | 1.56 | 0 | 5 |
| Criterion 11 | 42 | 1.29 | 0.97 | 0 | 4 |
| Criterion 12 | 42 | 1.50 | 1.04 | 0 | 4 |

Appendix 4: Average changes without separating transfer and non-transfer regulations

The table below shows the change in average scores on individual criteria and on sub-questions for the Analysis criteria. We only report average scores whose differences are statistically significant at the 85 percent level or higher. Even for individual criteria or questions, there is very little evidence that average scores changed much between 2008 and 2009. As noted in the text, some of the changes identified below are driven by the increased proportion of transfer regulations in 2009.

Score Changes on Individual Criteria and Questions

| | 2008 (n=45) | 2009 (n=42) | Change | T-stat. |
|---|----------------|----------------|--------|---------|
| Openness | | | | |
| Criterion 1 – Accessibility | 3.53 | 4.05 | 0.51 | 2.10** |
| Analysis | | | | |
| Question 6B – Coherent Theory of Systemic Problem | 2.00 | 1.50 | -0.50 | 1.60 |
| Question 6C – Empirical Evidence of Systemic Problem | 1.71 | 1.21 | -0.50 | 1.62 |
| Question 8C – Effects on Prices of Goods and Services | 1.38 | 2.07 | 0.69 | 2.13** |
| Question 8F – Identifies approach that maximizes net benefits | 1.91 | 1.33 | -0.58 | 1.62 |
| Use | | | | |
| Criterion 10 – Decision Cognizant of Net Benefits | 2.20 | 1.62 | -0.58 | 1.80* |

Statistical significance: *90 percent **95 percent

Maximum possible score on any criterion or question = 5 points.

The increase on criterion 1 (Accessibility) indicates that agency regulatory analyses were somewhat easier to find online in 2009 than in 2008. This reflects the fact that regulatory analyses were easier to find on agency websites and *Federal Register* preambles provided clearer information about how to obtain a copy of the Regulatory Impact Analysis. Some of the improvement may also stem from the redesign of the regulations.gov web site, which may have made regulations and accompanying analysis easier to find.

The lower average scores on questions 6B (Coherent Theory of Systemic Problem) and 6C (Empirical Evidence of Systemic Problem) suggest that agencies may be somewhat less likely to demonstrate that proposed regulations actually address a market failure, government failure, or other systemic problem in 2009. Average scores were already quite low in 2008; this weakness may have gotten even weaker in 2009.

The higher average score on criterion 8C (Effects on Prices of Goods and Services) indicates that agencies were more likely in 2009 to discuss the effects of regulatory costs on the prices of goods and services. This is something that agencies usually do either reasonably well or pretty poorly; there are few mid-range scores. The increase from 1.38 to 2.07 implies that this improvement occurred only for a few regulations, or that agencies provided just a bit more discussion or evidence in place of unsupported assertions.

The lower scores on question 8F (Identifies Alternative that Maximizes Net Benefits) and criterion 10 (Decision Cognizant of Net Benefits) suggest that regulatory analyses in 2009 were less likely to assess the net benefits of alternatives, and decision makers were less likely to consider net benefits when choosing among alternatives. Agencies usually do these things either reasonably well or not at all, so this shift suggests that fewer regulations in 2009 identified or considered net benefits of alternatives.

Appendix 5: Use vs. Quality Employing Quality x Year Interaction Variable

| Explanatory Variables | Dependent Variable: Use of Analysis Score (Criteria 9-12) | | | |
|---------------------------|---|-------------------|-------------------|-------------------|
| | (1) | (2) | (3) | (4) |
| Quality (Criteria 1-8) | 0.30 [6.98***] | 0.28 [6.26***] | 0.23 [3.67***] | 0.22 [3.41***] |
| Year 2008 Dummy X Quality | | 0.06 [2.21***] | 0.05 [1.79*] | 0.06 [1.98**] |
| Transfer Regulation | | | -0.88 [-0.95] | -1.28 [-1.34] |
| Recovery Act Regulation | | | | 2.07 [1.57] |
| Constant | 1.14 [1.24] | 1.06 [1.18] | 1.64 [0.91] | 2.70 [1.63] |
| N | 87 | 87 | 87 | 87 |
| Adjusted R ² | 0.36 | 0.39 | 0.38 | 0.40 |

Ordinary least squares regressions: t-statistics in parentheses.
 Statistical significance: ***1 percent **5 percent *10 percent

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MERCATUS ON POLICY

THE POOR QUALITY OF AFFORDABLE CARE ACT REGULATIONS

By Christopher J. Conover
and Jerry Ellig



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WILL THE PATIENT Protection and Affordable Care Act (ACA) improve the performance of the U.S. health care system? The quality of the major interim final regulations issued under the ACA in 2010 gives three main reasons for pessimism on this score.

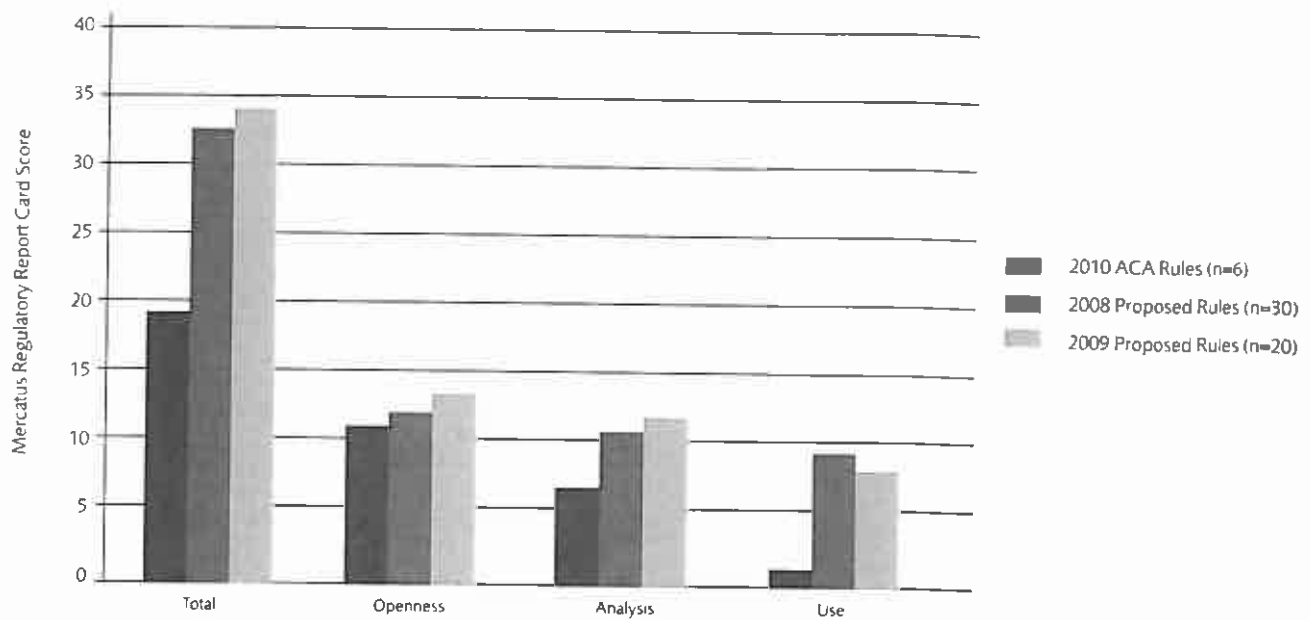
First, the quality of analysis for these regulations is measurably lower than for other major regulations proposed in 2008 and 2009. Second, the analyses supporting these regulations tended to overestimate the rules' benefits and underestimate their costs, in some cases by amounts exceeding billions of dollars. Third, the analyses often ignored more effective or less costly alternatives.

Had these regulations been accurately analyzed, it is likely that at least some would have failed a simple cost-benefit test. The challenge for Congress is to ensure that future ACA regulations yet to be issued do not repeat such flaws.

HOW THESE REGULATIONS WERE EVALUATED

WE USED THE Mercatus Center's Regulatory Report Card scoring system to compare the first eight major regulations issued under the ACA with all major proposed regulations issued in 2008 and 2009. Report Card criteria fall into three categories: Openness (how accessible, clear, and well-documented is the analysis?); Analysis (how well does the analysis identify the desired outcomes, systemic problem, alternatives,

FIGURE 1: REPORT CARD SCORES FOR PRESCRIPTIVE REGULATIONS



Source: Authors' calculations from data in Christopher J. Conover and Jerry Ellig, "Beware the Rush to Presumption, Part A: Material Omissions in Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012)

costs, and benefits?); and Use (to what extent did the agency claim to use the analysis or make provisions for retrospective analysis of the regulation?).¹

As Figure 1 shows, the quality and use of analysis for the ACA interim final regulations falls well below the standards set by other agencies and by the Department of Health and Human Services itself in conventional notice-and-comment rulemakings in previous years. However, the regulatory impact analyses for the eight ACA interim final rules is comparable to the analysis that accompanied a series of interim final homeland security regulations issued by the Bush administration following 9/11. This suggests that the institutions, not the people or party in power, explain the decline in quality of regulatory analysis when agencies implement significant presidential priorities on short deadlines.²

In general, the health regulations were less transparent than the major proposed rules issued by the Bush and Obama administrations in 2008 and 2009. This means it was difficult for the lay public or even experts to understand how the analysis calculated at least some of its estimates of benefits or costs. In some cases, the rules inadequately assessed the expected benefits or failed to demonstrate how the rule would achieve them. In other cases, the analysis failed to demonstrate that there was some market failure or other systematic problem that could be addressed only through federal government action. Some rules also failed to identify alternative, less expensive approaches to regulation or failed to adequately assess costs and compare these to benefits. In fact, not one of

these rules sought to monetize expected benefits, making it unclear why the agency concluded that the rule had benefits that exceeded its costs.

The lowest scores were for use of the analysis. Apparently, agencies used analysis as a post hoc justification of a regulatory approach already decided upon. The analyses did not always explain why the agency chose a particular option. Little thought was given to establishing measures, goals, or data sources that would permit the agency to evaluate the rule's future impact.

We examined in greater detail how well these regulations evaluated benefits, costs, equity, and regulatory alternatives. We found that the regulatory impact analyses were seriously incomplete or inaccurate, often omitting or mismeasuring significant benefits, costs, or regulatory alternatives. This resulted in a general pattern of exaggerated benefits and understated costs. Analysis of equity was cursory at best. In short, the regulatory analyses for these regulations were insufficient to guide decisions or inform the public.³

WHAT DIFFERENCE DOES IT MAKE?

ONE EXAMPLE ILLUSTRATES the kinds of problems we found in the ACA regulatory analyses. None of the eight rules mentions moral hazard, even though this is an inherent feature of health insurance. Moral hazard simply means that when someone else is paying the bill, people are less likely to avoid a

risk. In the context of health insurance, this means that people with insurance may be more likely to use medical care or less likely to care for their own health.

The size of this commonsense effect on behavior has been measured scientifically. The RAND Corporation performed a randomized, controlled trial of health insurance coverage. People randomly assigned to a plan that gave them completely free health care had medical expenses 50 percent higher than those randomly assigned to plans with modest cost sharing.⁴

Clearly, some of this additional care was of value to patients in the free care plan. But at least some of it was waste, meaning that the cost of the added care exceeded its worth to patients. RAND calculated that fully 30 percent of the total annual cost of medical spending for the free care group was wasted in this fashion. Yet for the average patient, this additional spending did not lead to any improvement in health status. The waste due to moral hazard ranges from 10 percent of spending for patients in plans with modest cost sharing to 28 percent for those on Medicare⁵ to 44 percent for the additional spending induced by the Medicare prescription drug plan.⁶ By ignoring an effect of this magnitude, the analyses understate the potential costs of various ACA regulations by double-digit percentages.

For at least three rules, the magnitude of such estimation errors is large enough that more accurate measurement of benefits and costs might well have reversed the presumption that benefits exceeded costs. These include the early retiree reinsurance program (where costs appear to have been understated by \$9–\$10 billion over four years), dependent coverage for children up to age 26 (where costs were underestimated by at least 20 percent) and the preexisting-condition insurance plan (where benefits appear to have been overestimated by at least \$1.5 billion and costs underestimated by at least \$6 billion).

This does not imply that these rules confer no benefits on the individuals whose health costs will be subsidized by taxpayers or policyholders. But reasonable people may conclude such transfers are not worthwhile if society bears an often hidden cost of \$1 or \$2 or \$3 for every dollar of health benefits delivered to patients.

KEY LESSONS

A COMBINATION OF top-down direction from the White House and tight deadlines imposed by Congress appears to have contributed to an abbreviated regulatory process that severely impaired the ability and willingness of agencies to produce high-quality regulatory impact analyses.

We have no way of determining whether the administration's process for developing these high-priority regulations was the sole reason for their poor quality or whether the tight dead-

lines imposed by Congress alone would have produced the same result. These rules spent much less time in the Office of Information and Regulatory Affairs (OIRA) review than rules typically do. But the involvement of both White House and high-ranking agency staff in the promulgation of these rules suggests that the administration likely got the rules it wanted written, in which case additional time for OIRA review would have made little or no difference in their quality.

POLICY RECOMMENDATIONS

THERE ARE SEVERAL steps Congress could take to help ensure that the final versions of these regulations—and subsequent regulations implementing other provisions of the ACA—reflect a more careful assessment of their consequences.

First, Congress could conduct more diligent oversight. This could be accomplished through oversight hearings or confirmation hearings for the heads of regulatory agencies; individual members of Congress also may meet with agency officials, write letters, or file public comments on rules.

Second, Congress could use the Congressional Review Act to overturn the final versions of these rules if it believes the analysis is insufficient. Senator Mike Enzi attempted this approach in the form of S.J. 39, introduced September 21, 2010, to disapprove the rule related to grandfathered health plans; the resolution was defeated by a vote of 40–59. This helps illustrate that such legislation is difficult to pass in a Congress divided along party lines. Moreover, since the president can veto the congressional resolution of disapproval, Congress is unlikely to overturn a rule issued by one of the president's own Cabinet departments. In the absence of more sweeping reforms—such as a requirement that Congress affirmatively approve major regulations—oversight is likely the more effective option.

Third, Congress can and often has used the text of appropriations bills either to direct or preclude the development of particular proposed rules, place restrictions on implementation or enforcement of certain provisions, or otherwise restrict certain types of regulatory activity. This same mechanism can be used to require the use of certain procedures before or after a rule is issued. Because of the urgency required in passing appropriations bills, such language can be used to steer the course of rulemaking even when the president is in the opposition party.⁷

CONCLUSION

POLICY MAKERS CANNOT eradicate politics from the regulatory process. But they can better ensure that politics does not trump good policy. This may require better congressional

checks and balances on the executive branch, a strategy the Founding Fathers would have understood well.

ENDNOTES

- 1 For a full explanation of the Report Card methodology and 2008 scoring results, see Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008." *Risk Analysis* (forthcoming 2012) A prepublication version of this article is available at <http://mercatus.org/publication/quality-and-use-regulatory-analysis-2008>
- 2 This section summarizes a much longer analysis in Christopher J Conover and Jerry Ellig, "Beware the Rush to Presumption. Part C: A Public Choice Analysis of the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012)
- 3 Christopher J. Conover and Jerry Ellig, "Beware the Rush to Presumption. Part A: Material Omissions in Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012)
- 4 Emmett B. Keeler, Joan L. Buchanan, John E. Rolph, Janet M. Hanley, and David M. Reboussin, *The Demand for Episodes of Medical Treatment in the Health Insurance Experiment* (Santa Monica, CA: RAND Corporation, 1988)
- 5 Amy Finkelstein and Robin McKnight, "What Did Medicare Do (and Was It Worth It)?" (National Bureau of Economic Research Working Paper no. 11609, Cambridge, MA, 2005)
- 6 Mark V. Pauly, "Medicare Drug Coverage and Moral Hazard." *Health Affairs* 23, no. 1 (2004): 113-22
- 7 Curtis W. Copeland, *Congressional Influence on Rulemaking and Regulation through Appropriations Restrictions* (Washington, DC: Congressional Research Service, 2008)

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MERCATUS ON POLICY

RUSHED REGULATION REFORM

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WHAT DO THE Obama administration's first few major health care regulations and the Bush administration's first few major homeland security regulations have in common? Both reflected a president's signature high-priority issue. Both took the form of "interim final rules" issued under tight legislative deadlines. Both exemplify "fire, ready, aim" rulemaking at its worst. And both were accompanied by low-quality regulatory analysis that reads more like an attempt to justify decisions than an attempt to *inform* decisions.

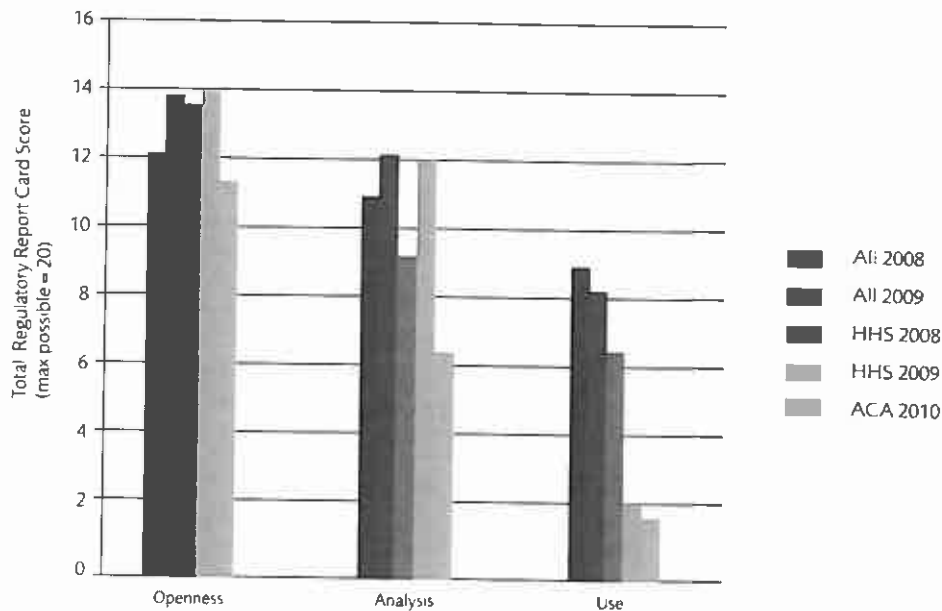
When the White House directs agencies in fast-tracked rulemakings, many of the usual checks that should ensure that good analysis informs decisions get short-circuited. Regulatory process reforms would prevent this problem.

THE SYSTEMIC PROBLEM

EXECUTIVE ORDER 12866 requires federal agencies to produce regulatory impact analyses (RIAs) when they propose regulations.¹ The analysis requirements are most comprehensive for the most important regulations: those termed "economically significant." When proposing a regulation, an agency must assess the systemic problem the regulation is supposed to solve, define the outcomes the regulation is supposed to produce for the public, examine a wide variety of alternative solutions, and assess the pros and cons (benefits and costs) of the alternatives. The agency must publish the RIA along with the proposed regulation for public comment, and the agency must consider the comments when they write the final version of the regulation.

Many of the first health care and homeland security regulations, however, were interim final rules. This means the agencies decided on, wrote, and published the rules without first publishing a proposal or RIA for public comment. The Department of Health and Human Services (HHS) and other agencies published eight economically significant interim

FIGURE 1: ACA INTERIM FINAL REGULATIONS HAVE WORSE ANALYSIS THAN OTHER REGULATIONS



Source: Jerry Ellig and Christopher J. Conover. "Beware the Rush to Presumption, Part B: Substandard Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012)

final rules implementing the Patient Protection and Affordable Care Act (ACA) in 2010. The Department of Homeland Security (DHS) published seven economically significant interim final rules between 2003 and 2007.

The RIAs accompanying both sets of regulations were seriously incomplete, and they fell far short of federal agencies' normal practice.

Incomplete Regulatory Analysis

THE HEALTH CARE RIAs presented no monetary estimates of benefits, often overestimated the number of people who would benefit, and usually underestimated costs, often by hundreds of millions or billions of dollars. Despite the importance of fairness and equity in the health care debate, analysis of equity was even more superficial—usually consisting of mere assertions that some result would improve "equity" without even defining the term.²

The Bush administration's early homeland security regulations tended to overestimate benefits and underestimate costs.³ They rarely identified the systemic problem the regulation was supposed to fix or evaluated alternatives to the proposed regulation. Nor did they explain why federal action was necessary to safeguard facilities and assets where the private sector had substantial investments at stake.⁴

Analysis Fails to Meet Normal Standards

THE MERCATUS REGULATORY Report Card evaluates the quality and use of regulatory analysis based on criteria derived from Executive Order 12866 and Office of Manage-

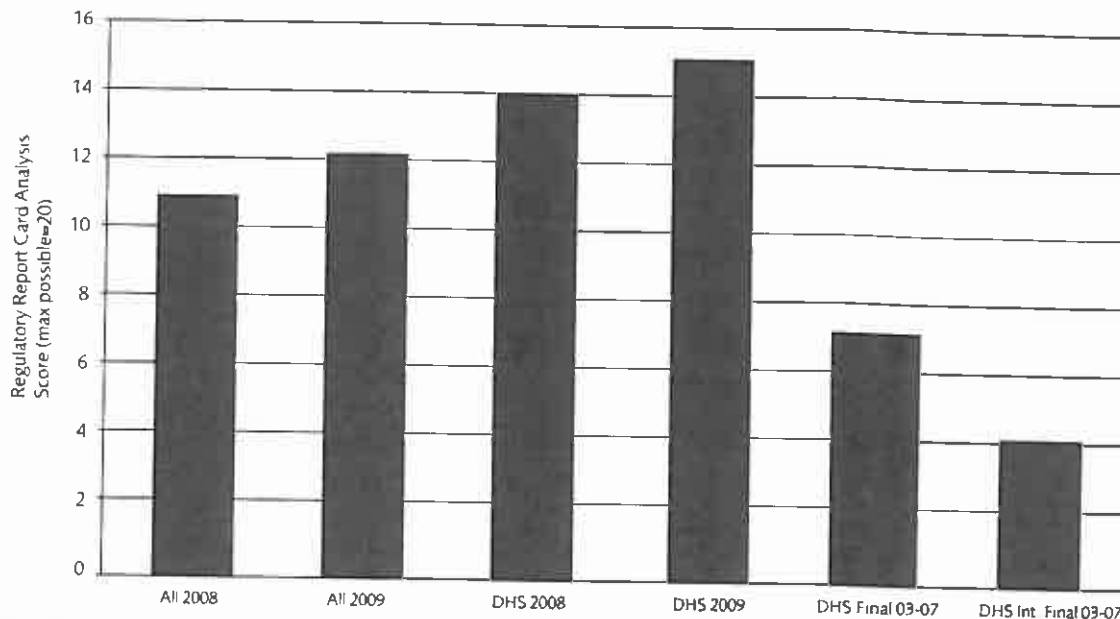
ment and Budget (OMB) guidance. Report Card criteria fall into three categories: Openness (how accessible, clear, and well documented is the analysis?); Analysis (how well does the analysis identify the desired outcomes, systemic problem, alternatives, costs, and benefits?); and Use (to what extent did the agency claim to use the analysis or make provisions for retrospective analysis of the regulation?). A regulation can earn a maximum of 20 points for each category.⁵

Figure 1 compares the quality and use of analysis for six prescriptive interim final ACA regulations with that for economically significant regulations proposed by all agencies and by HHS in 2008 and 2009:⁶

- The ACA regulations perform best on the openness criteria. These are the easiest criteria to do well on.
- The ACA regulations fare poorly on the analysis criteria, earning fewer than half the possible points.
- The ACA regulations score much worse than other regulations on the use criteria with virtually no evidence that the departments used the analysis to make decisions.

A pilot study that preceded the Regulatory Report Card assessed DHS regulations according to the four analysis criteria. Figure 2 compares the six prescriptive interim final rules issued by DHS during its first few years with other regulations. The interim final DHS regulations earned only one-quarter of the possible points for quality of analysis—well below the quality of other federal regulations, recent DHS

FIGURE 2: EARLY DHS INTERIM FINAL REGULATIONS HAVE WORSE ANALYSIS THAN OTHER REGULATIONS



Source: Jerry Ellig and Christopher J. Conover, "Beware the Rush to Presumption, Part B: Substandard Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012)

regulations, and regulations issued by DHS in its first five years that were not interim final regulations.

The ACA and DHS interim final regulations earned similar scores for quality of analysis. The analysis falls far short of the analyses normally conducted, which generally falls well below the standards outlined in Executive Order 12866 and OMB's Circular A-4.⁷

THE ROOT CAUSES⁸

THE ACA RULES analyzed encompassed nearly all the major components of the ACA scheduled to go into effect prior to 2014. Congress gave the agencies deadlines that ensured the regulations would be written before control of Congress changed hands after the 2010 elections and implemented before the 2012 elections. Similarly, Congress explicitly told DHS to issue five of the homeland security rules as soon as practicable as interim final rules.

Health care and homeland security are the signature initiatives of the Obama and Bush administrations, respectively. In her classic 2001 *Harvard Law Review* article on "Presidential Administration," Elena Kagan revealed how the Clinton White House proactively set the regulatory agenda for agencies and directed development of high-priority regulations.⁹ She predicted future presidents would continue this practice, and subsequent scholarship has proven her prediction accurate.¹⁰

At least for some presidential regulatory priorities, many key decisions are already made before the regulatory analysis is done. Thus, it is unlikely agency analysts will put much effort into the analysis, as it will have little effect on decisions. It is also unlikely that OMB's Office of Information and Regulatory Affairs (OIRA) could block the regulation, so OIRA has little leverage to prompt improvements in the analysis.

Consistent with this hypothesis, the interim final health care regulations received rapid review at OIRA, averaging just five days. The DHS rules received somewhat longer review, averaging 22 days. By comparison, OIRA took an average of 27 days to review proposed economically significant regulations in 2009 and 56 days in 2008.¹¹

The poor quality and use of analysis for these regulations is an institutional problem that requires an institutional solution. Both the Bush and the Obama administrations pledged to improve the quality of regulatory analysis. Both appointed noted regulatory scholars as OIRA administrators—John Graham and Susan Dudley in the Bush administration and Cass Sunstein in the Obama administration. The Bush administration published an updated, extensive, peer-reviewed guidance for regulatory analysis (Circular A-4) and sought to rein in "midnight regulations." The Obama administration issued a memorandum urging departments to respect scientific integrity, sought public comments on revising Executive Order 12866, and ultimately reaffirmed it with Executive Order 13563. Deficiencies in the quality and use of analysis occurred despite these good intentions.

REGULATORY REFORM SOLUTIONS

ALTERNATIVE CHECKS ARE needed to insulate analysis from presidential and congressional politics:

- Require agencies to publish an assessment of the systemic problem, its root cause, and the pros and cons of alternative solutions for public comment before writing a proposed rule. The public would have an opportunity to replicate, improve, or comment upon the agency's analysis before it is used to make decisions.
- Designate an independent authority to review RIAs produced by the executive branch. Such review could be competently performed in a nonpartisan manner by the Congressional Budget Office or Government Accountability Office, provided that they are clearly empowered and staffed to conduct an objective review.
- Mandate external peer review with systematic monitoring. Without systematic monitoring by OIRA or Congress (e.g., random audits of RIAs), there may be little incentive for agency staff to incorporate the suggestions of peer reviewers.
- Explicitly rein in the use of interim final rulemaking. In principle, an agency can amend an interim final rule based on public comments, but this happens less frequently than for rules issued under the normal process.¹² Interim final rules should be reserved for genuine emergencies or routine, uncontroversial administrative decisions.

ENDNOTES

- 1 Executive Order 12866, *Federal Register* 58, no. 190 (October 4, 1993): 51, 735–44.
- 2 Christopher J. Conover and Jerry Ellig, "Beware the Rush to Presumption, Part A. Material Omissions in Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012).
- 3 John Mueller and Mark G. Stewart, "Evaluating the Risks, Costs, and Benefits of Homeland Security Spending" (paper presented at the American Political Science Association, 2011 Annual Meeting, Seattle, WA, September 1–4, 2011).
- 4 Jamie Belcore and Jerry Ellig, "Homeland Security and Regulatory Analysis: Are We Safe Yet?" *Rutgers Law Journal* 40, no. 1 (2008): 1–96.
- 5 A full explanation of the Report Card methodology and 2008 scoring results are in Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008," *Risk Analysis* (forthcoming 2012). A prepublication version of this article is available at <http://mercatus.org/publication/quality-and-use-regulatory-analysis-2008>.
- 6 Prescriptive regulations do what most people think of when they think of regulation; they specify what individuals, firms, or other levels of government can and cannot do. Budget regulations implement spending or revenue collection programs. Some of the interim final ACA and DHS regulations were budget regulations and are not included in these charts.

7. If Regulatory Report Card scores were letter grades, the best analysis produced in 2008 or 2009 would receive a B–, and the average would be an F+. See Jerry Ellig and John Morrall, "Assessing the Quality of Regulatory Analysis: A New Evaluation and Data Set for Policy Research" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), <http://mercatus.org/sites/default/files/publication/wp1075-assessing-the-quality-of-regulatory-analysis.pdf>.
- 8 This section summarizes a much longer analysis in Christopher J. Conover and Jerry Ellig, "Beware the Rush to Presumption, Part C: A Public Choice Analysis of the Affordable Care Act's Interim Final Rules" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012).
- 9 Elena Kagan, "Presidential Administration," *Harvard Law Review* 114 (2001): 2,246–385.
- 10 For examples, see John D. Graham, "Saving Lives through Administrative Law and Economics," *University of Pennsylvania Law Review* 157 (2008): 395–540 and Sidney A. Shapiro and Ronald F. Wright, "The Future of the Administrative Presidency: Turning Administrative Law Inside-Out" (working paper no. 1738491, Wake Forest University Legal Studies, Winston-Salem, NC, 2011).
11. Review time data gathered from Office of Information and Regulatory Affairs (OIRA), "EO 12866 Regulatory Review," <http://www.reginfo.gov/public/do/eoPackageMain>.
- 12 Administrative Conference of the United States, "Recommendation 95-4, Procedures for Noncontroversial and Expedited Rulemaking," *Recommendations of the Administrative Conference of the United States, 1995*; and Curtis W. Copeland, "Initial Final Rules Implementing the Patient Protection and Affordable Care Act (P.L. 111-148)," Congressional Research Service Report, December 10, 2010, 11.

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WORKING PAPER

BLUEPRINT FOR REGULATORY REFORM

By Richard Williams and Sherzod Abdukadirov



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Blueprint for Regulatory Reform

By Richard Williams and Sherzod Abdukadirov

Regulations affect nearly every aspect of our daily lives. By the time you brush your teeth, eat breakfast, and drive to work, you will be subject to dozens of federal regulations. The Food and Drug Administration (FDA) sets standards for the jam on your toast,¹ and the U.S. Department of Agriculture inspects the plant that processes and packages your bacon.² The Federal Communications Commission issues the broadcast license for your morning news TV channel.³ And the Environmental Protection Agency, the Department of Energy, and the Department of Transportation all regulate your car and the roads on which you drive.⁴

Regulations are supposed to improve our lives by solving problems that otherwise would not be fixed. But even if a problem needs government to fix it, there may be multiple solutions. Federal agencies have to choose the regulatory alternative—the solution—that best meets society’s needs. How these agencies choose matters.

Think about how you choose options in your daily life. Say you were looking to buy a new PC. If you were to go online to find a PC tablet, you would find dozens of options that vary in price, technical specifications, and available software. In order to find the one that suits you best, first, you would have to decide what you would use it for. Next, you would analyze the options and qualities of each tablet relative to the cost. After doing that research, you would choose one that you would think comes the closest to meeting your computing needs for the best price.

Of course, there is a difference between choosing regulations and choosing PC tablets. With regulations, government agents choose for us. We hope they make the best choices, but there are no guarantees. Like online shopping, regulatory policy has many options, from establishing performance standards all the way to detailing prescriptive rules that tell people precisely what they must do to comply. Each option yields benefits, but each one also generates costs. So the decision to pursue a specific regulatory solution depends on judgment. There are always trade-offs between the benefits and costs of policy options.

Like careful shoppers, federal agencies need to do the following in order to make good decisions about regulations:

¹ Food and Drug Administration (FDA), “Fruit Preserves and Jams,” *Code of Federal Regulations*, title 21, sec. 155.160.

² U.S. Department of Agriculture, “Regulatory Requirements under the Federal Meat Inspection Act and the Poultry Products Inspection Act,” *Code of Federal Regulations*, title 9, parts 416–500.

³ Federal Communications Commission, “Rules Applicable to All Broadcast Stations,” *Code of Federal Regulations*, title 47, part 73, subpart H.

⁴ See, e.g., Environmental Protection Agency and Department of Transportation, “Light-Duty Vehicle Greenhouse Gas Emission Standards and Corporate Average Fuel Economy Standards,” *Federal Register* 75, no. 88 (May 7, 2010): 25,324–25,728; Department of Energy, “Advanced Technology Vehicles Manufacturing Incentive Program,” *Federal Register* 73, no. 219 (November 12, 2008).

- define the problem they are trying to solve;
- consider a suitable range of alternatives;
- estimate the costs and benefits of each alternative; and
- choose an option that gives the best value to consumers (benefits) for the resources to be used (costs).

In practice, most regulations fall substantially short of these guidelines.⁵ Unfortunately, Congress and the federal agencies have few incentives to push for better regulatory decisions. Lawmakers often use regulations as an alternative to earmarks in order to reward their supporters, and agencies' tunnel vision and incentives to expand their reach often lead them to overlook the broader impact of their regulations. As a result, a growing number of regulations fail to "identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends."⁶

The problem is not new. Over the last few decades, Congress and the executive branch have adopted several statutes and executive orders seeking to increase transparency in the rulemaking process and to improve the analytical quality of regulatory decisions. These efforts produced mixed results since they did not address the incentives that Congress and federal agencies face. The pattern of poor regulatory choices persists across administrations, indicating that the problem is institutional, not political.⁷ Institutional problems need legislative fixes to change the incentives in the institutions if we want better outcomes.

Faced with some of the toughest economic challenges in generations, Congress is taking a closer look at the balance between the burden and benefits of regulation and what reforms could embed the principles of good regulatory decision-making in agencies. To aid in that effort, this paper proposes a cornerstone of foundational reforms on which to build comprehensive regulatory reform.

Well-Designed Regulations

Regulations are specific standards and instructions guiding the actions of individuals, businesses, and other organizations. The executive branch produces them to implement legislation passed by Congress. Regulations cannot be passed without an authorizing statute from Congress. Congressional statutes may apply to all agencies (e.g., the Administrative Procedures Act) or to specific agencies (e.g., the Clean Air Act, implemented primarily by the Environmental Protection Agency). The president is charged by the

⁵ Jerry Ellig and John Morrall, "Assessing the Quality of Regulatory Analysis: A New Evaluation and Data Set for Policy Research" (working paper, Mercatus Center at George Mason University, Arlington, VA, December 2010), <http://mercatus.org/sites/default/files/publication/wp1075-assessing-the-quality-of-regulatory-analysis.pdf>; Robert W. Hahn and Paul C. Tetlock, "Has Economic Analysis Improved Regulatory Decisions?," *Journal of Economic Perspectives* 22, no. 1 (2008): 67–84; Richard Williams, "The Influence of Regulatory Economists in Federal Health and Safety Agencies" (working paper, Mercatus Center at George Mason University, Arlington, VA, July 2008), http://mercatus.org/sites/default/files/publication/WP0815_Regulatory%20Economists.pdf.

⁶ Executive Order no. 13,563 - Improving Regulation and Regulatory Review, *Federal Register* 76, no. 14 (January 18, 2011): 3,821.

⁷ Ellig and Morrall, "Assessing the Quality of Regulatory Analysis."

Constitution with implementing and enforcing laws passed by Congress and with appointing the individuals in charge of federal agencies.

Executive Order no. 12,866 expresses and Executive Order no. 13,563 reaffirms the principles of efficient and cost-effective regulation.⁸ Federal agencies are supposed to be governed by the regulatory philosophy and principles expressed in these executive orders when drafting new regulations. In particular, a federal regulation should have the following qualities:

1. *The rule should address a significant and systemic problem that has persisted over time and is appropriately addressed at the federal level.*

Systemic: The rule should address the failure of private markets or public institutions to solve social problems. The problem should be institutional, occurring over time, and expected to continue.

Significant: Government resources should not be spent on trivial issues. The FDA's trans-fat labeling requirement represents a use of resources that has significantly improved peoples' lives.⁹ However, the agency's painstaking description of what qualifies as a can of green beans (down to the shape, color, and cut of pods) hardly justifies the use of federal resources.¹⁰

Persistent: The rule is necessary only if the evidence indicates that there are no incentives in the marketplace to address the problem in the near future. Often, when the government discovers a problem, market actors do as well. Consequently, markets produce remedies even without government action. For example, corporations in some industries shifted from opposing environmental regulation to actively adopting environmental standards that exceed federal requirements.¹¹ In cases where market actors take initiative to solve significant and systemic problems, issuing new regulations that duplicate private market efforts wastes resources.

Federal: Federal regulations should address problems that involve interstate commerce or that states or localities cannot address on their own.¹²

Actual: The rule should address actual rather than potential problems. There are an infinite number of low-probability potential problems that may but are not likely to occur. Chasing after them diverts resources from more pressing needs. For example, the Net Neutrality rule proposed by the Federal Communications Commission would restrict the ability of Internet providers to prioritize the traffic over their networks. The commission justified its rule by

⁸ Executive Order no. 12,866 - Regulatory Planning and Review, *Federal Register* 58 no. 190 (October 4, 1993): 51,735; Executive Order no. 13,563.

⁹ FDA, "Food Labeling: Trans Fatty Acids in Nutrition Labeling, Nutrient Content Claims, and Health Claims," *Federal Register* 68, no. 133 (July 11, 2003): 41,433-41,506.

¹⁰ FDA, "Canned Green Beans and Canned Wax Beans," *Code of Federal Regulations*, title 21, sec. 155.120 (April 1, 2011). The FDA would certainly argue that it is required by statute (the 1938 Food, Drug and Cosmetic Act) to set these "identity" or recipe standards for foods. Nevertheless, about half of all foods are standardized and about half are not. For example, catsup is standardized, but salsa is not.

¹¹ Marc Allen Eisner, "Corporate Environmentalism, Regulatory Reform, and Industry Self-Regulation: Toward Genuine Regulatory Reinvention in the United States," *Governance* 17, no. 2 (April 1, 2004): 145-167.

¹² For example, to the extent that air pollution moves across multiple states, it would be difficult for individual states to negotiate air standards between their multiple jurisdictions.

claiming that Internet providers *might* discriminate against some types of content. Yet, it could show no evidence that such a problem exists.¹³

2. *There should be evidence that the rule will actually solve some significant part of the problem.*
Real Solutions: Agencies should have a theory of precisely how their proposed remedies will work. The causation links from rule to behavioral changes to solution should be clearly laid out and backed by evidence. The evidence should be grounded in high-quality scientific research (research that shows cause and effect for the proposed solution) or real-world examples from pilot, state, or international programs. Further, the rule should not rely on society to invent a solution that does not yet exist, as in the case of the technology-forcing environmental regulations.¹⁴ Evidence suggests that such regulations are less efficient than regulations relying on market incentives.¹⁵ If innovation is necessary, the government should consider funding research instead of promulgating regulation.
Focus on Outcomes: The rule should focus on outcomes instead of outputs. The result of regulation must be something that people value, such as reducing the level of food-borne illness. For example, a requirement that manufacturers produce more paperwork on their processes would generate outputs, but it would not necessarily reduce food-borne illness.
3. *The rule should not create more problems than it solves.*
Risk Tradeoffs: There should be a quantified analysis of a proposed rule's potential risk tradeoffs. Often, regulation reduces the risk of one hazard only to see another risk increase. For example, the inconvenience of baggage-screening procedures introduced after the 9/11 attacks prompted 6 percent of passengers nationwide to drive to their destinations instead of flying.¹⁶ Yet, because flying involves far fewer risks than driving, this regulation has likely led to more than 100 driving-related fatalities.¹⁷
4. *The rule should solve the problem at a reasonable cost.*
Measurement: In general, all costs and benefits should be quantified as much as possible. Measurement enables federal agencies and the general public to make better-informed decisions.
Net Benefits: At minimum, the combination of qualitative and quantitative benefits of each provision of the rule should be such that a reasonable person would conclude that benefits exceed costs.
Cost-effectiveness: If it is not possible to maximize net benefits, the rule should achieve the goal at the lowest possible cost.
Alternatives: The rule should choose the most efficient alternative. When that is not possible, or

¹³ Jerry Brito et al., "Net Neutrality Regulation: The Economic Evidence," *SSRN eLibrary* (April 12, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1587058.

¹⁴ A technology-forcing regulation is one where a standard for safety, such as an emission standard, is set to apply in the future, when there is no technology available to meet the standard at the time it is established. The idea is to force the market to create the new technology.

¹⁵ Adam B. Jaffe, Richard G. Newell, and Robert N. Stavins, "Environmental Policy and Technological Change," *Environmental and Resource Economics* 22, no. 1–2 (2002): 47–70.

¹⁶ Garrick Blalock, Vrinda Kadiyali, and Daniel H. Simon, "The Impact of Post-9/11 Airport Security Measures on the Demand for Air Travel," *Journal of Law and Economics* 50, no. 4 (November 1, 2007): 731–755.

¹⁷ *Ibid.*

when there is a compelling reason for doing so, the agencies should state clearly the reasons for choosing a less efficient alternative.¹⁸

These principles have existed for decades, yet regulations routinely violate them.¹⁹ Regulations that fail to achieve these principles should be considered "poor" regulations.

Reasons for Poor Regulations

Virtually all of the groups involved in regulations, including the regulated industries, activists, Congress, and federal agencies, have some perverse incentives that lead them to demand or create poor regulations. This section discusses some of those incentives.

Regulated Industries

Regulated firms or groups of firms tend to be the strongest advocates for economic regulation (although they frequently oppose social regulations relating to workplace safety or the environment when they do not stand to gain financially from those regulations). There are many reasons for companies to favor regulation. Increasing regulatory costs for competing firms both creates barriers to entry for new companies and drives smaller companies out of business.²⁰ For example, ARCO, the largest gasoline retailer in California, supported more stringent regulation for reformulated gasoline, which increased refining costs. Following the adoption of regulation, ARCO's market share increased by 34 percent, mostly at the expense of small refiners.²¹ Regulation may also create new markets for existing industries by mandating specific products. The Renewable Fuel Standard in the Energy Independence and Security Act of 2007 set a minimum share of fuel consumption that must come from biofuels.²² This standard drastically increased the demand for corn, which is used to produce ethanol, the main source of biofuels.

Firms push for regulation to put their rivals at a competitive disadvantage, to charge consumers higher prices, or to force consumers to buy products they may not want. While companies may benefit from such regulations, their profits come at the general public's expense.

¹⁸ Agencies often have statutes that require particular outcomes for rules that are not necessarily cost-beneficial. There are other reasons that agencies may pick regulatory options for which costs exceed benefits, such as where there is great uncertainty in either or both benefit and cost estimates or where there is a desire to protect a high-risk subpopulation.

¹⁹ Ellig and Morrill, "Assessing the Quality of Regulatory Analysis."

²⁰ Steven C. Salop and David T. Scheffman, "Raising Rivals' Costs," *American Economic Review* 73, no. 2 (May 1, 1983): 267–271.

²¹ Jennifer Lynn Brown, "Three Essays on Raising Rivals' Costs via California's Environmental Regulations" (dissertation, University of California, Santa Barbara, 2006).

²² Tom Capehart, *Ethanol: Economic and Policy Issues*, CRS Reports (Washington, DC: Congressional Research Service [CRS], April 2, 2009).

Activists

In pushing for favorable regulation, industries often receive inadvertent help from activists.²³ Since the impact of regulation tends to be broad, the interests of industries and activists occasionally overlap. In the previous example, both environmental activists and agricultural businesses supported the regulatory requirement for the ethanol content of fuels.²⁴ Environmentalists supported the regulation in the belief that it would reduce greenhouse gas emissions; agricultural businesses enjoyed windfall profits from the higher demand for corn. In this alliance, environmentalists provided the public face for the initiative, while the agricultural lobbies acted behind the scenes to push the legislation through Congress. The regulation persisted even after scientists and environmentalists started to question whether the regulation, as it is currently written, may actually lead to higher greenhouse gas emissions.²⁵

In contrast to regulated industries, activists push for regulation in pursuit of what they perceive as the public interest. But their mission's narrow focus often leads them to overlook the trade-offs and larger negative impacts of regulation, resulting in inefficient regulations. For example, in California, environmentalists strongly advocate against housing development along the coastline in order to preserve its pristine nature. Yet, according to recent evidence, houses in California's moderate coastal climate have some of the lowest carbon emissions in the nation due to low heating and cooling costs.²⁶ By trying to preserve the coastline, the environmental groups advocate regulatory policies that push construction inland into areas with considerably higher carbon emissions. The unintended consequence of such regulation is an increase in the carbon footprint of housing development. By focusing narrowly on preserving the coastline, environmental activists overlook the regulation's larger negative impact on the environment.

Congress

Congress often facilitates poor regulation in authorizing legislation. While recognizing the legitimacy of elected members of Congress to decide when government action is necessary and justified, there is a great deal of room for improvement by measures which might hold members more accountable for the end of the process following executive branch implementation. Legislators face a harder constraint on their spending than on regulatory legislation. Their spending is kept (somewhat) in check by the public's willingness to incur higher taxes. In contrast, while regulatory costs are borne by the public and in many

²³ Bruce Yandle, "Bootleggers and Baptists: The Education of a Regulatory Economist," *Regulation* 7, no. 3 (1983): 12–17.

²⁴ Bruce Yandle, "Bootleggers and Baptists in Retrospect," *Regulation* 22, no. 3 (1999): 5–7.

²⁵ Robert Bonnie, "Corn Ethanol: Importance of Performance Standards," *Environmental Defense Fund: Climate* 411, April 29, 2008, http://blogs.edf.org/climate411/2008/04/29/corn_ethanol_standards/; David Pimentel and Tad W. Patzek, "Ethanol Production Using Corn, Switchgrass, and Wood; Biodiesel Production Using Soybean and Sunflower," *Natural Resources Research* 14 (March 2005): 65–76; Timothy Searchinger et al., "Use of U.S. Croplands for Biofuels Increases Greenhouse Gases Through Emissions from Land-Use Change," *Science* 319, no. 5,867 (February 29, 2008): 1,238–1,240.

²⁶ Edward L. Glaeser, *Triumph of the City: How Our Greatest Invention Makes Us Richer, Smarter, Greener, Healthier, and Happier* (New York: Penguin, 2011).

ways act as a form of taxation,²⁷ they do not appear on the federal government's balance sheet. Consequently, legislators find it easier to appease their key constituents by imposing new regulations, especially when their spending ability is limited.²⁸ For example, much of the cost of regulation requiring the Transportation Security Administration to screen passengers in airports falls on passengers. The hassle of going through the security check pushes 6 percent of passengers to forgo flying altogether and drive instead.²⁹ For the remaining passengers, the value of the time lost to screening added up to \$2.76 billion in 2005 alone.³⁰ Yet, these numbers are not included in the cost estimates of regulation.

Congress is rarely held accountable for imposing regulatory costs on the public. Unlike budgets, regulatory costs remain hidden from the public view. The government seldom estimates the full costs of regulation, even for major regulations. Of the 66 major regulations passed in 2010, only 18 quantified and monetized both benefits and costs.³¹ Thus, legislators face few constraints in adopting statutes that authorize new regulation, and they have no incentive to look for more efficient or more cost-effective alternatives.

Agencies

The regulatory agencies themselves are another major source of inefficient regulations. Federal agencies face complex incentives, some of which lead them to produce poor regulations. For example, there are strong incentives for agencies to expand their reach, which in turn expands their budgets. Expanding their reach implies greater control over the economy and an expanding budget means that agency officials move up the promotional pyramid. Thus, federal agencies may pass regulations that add substantial costs without yielding commensurate benefits.³²

Also, like activists, agencies often suffer from tunnel vision. A narrow focus on the agency's mission leads regulators to overlook the broader impacts, tradeoffs, and burdens that regulations place on the economy. Examples of agency tunnel vision abound. In 1991, the Fifth Circuit Court struck down the EPA

²⁷ Richard A. Posner, "Taxation by Regulation," *Bell Journal of Economics and Management Science* 2, no. 1 (1971): 22–50.

²⁸ Noel D. Johnson, Matthew Mitchell, and Steven Yamarik, "Pick Your Poison: Do Politicians Regulate When They Can't Spend?" (working paper, Mercatus Center at George Mason University, Arlington, VA, June 2011), http://mercatus.org/sites/default/files/publication/Partisan_Policies_Johnson_Mitchell_Yamarik_WP1128_0.pdf.

²⁹ Blalock, Kadiyali, and Simon, "The Impact of Post-9/11 Airport Security Measures on the Demand for Air Travel."

³⁰ Jerry Ellig, Amos Guiora, and Kyle McKenzie, *A Framework for Evaluating Counterterrorism Regulations*, Mercatus Policy Series (Arlington, VA: Mercatus Center at George Mason University, 2006), http://mercatus.org/sites/default/files/publication/20060908_PS_terrorism_Complete.pdf.

³¹ U.S. Office of Management and Budget (OMB), *2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities* (Washington, DC: U.S. Government Printing Office [GPO], 2011),

http://www.whitehouse.gov/sites/default/files/omb/inforeg/2011_cb/2011_cba_report.pdf.

³² Supreme Court Justice Stephen Breyer calls situations where most risk can be eliminated at a reasonable cost but eliminating the last bit requires a prohibitively high expense in return for very little improvement "the last 10 percent." Stephen G. Breyer, *Breaking the Vicious Circle: Toward Effective Risk Regulation* (Cambridge, MA: Harvard University Press, 1993).

ban on products containing asbestos.³³ The ban would have saved seven or eight lives over 13 years at a cost of \$200–\$300 million. The Fifth Circuit Court noted in its opinion,

As the petitioners point out, the EPA regularly rejects, as unjustified, regulations that would save more lives at less cost. For example, over the next 13 years, we can expect more than a dozen deaths from ingested toothpicks--a death toll more than twice what the EPA predicts will flow from the quarter-billion-dollar bans of asbestos pipe, shingles, and roof coatings.³⁴

Similarly, in their drive to reduce risk in one area, agencies often increase risks elsewhere. For instance, as the FDA became increasingly concerned about the health risk posed by the mercury in commercial fish, it issued an advisory in 2001 instructing at-risk people (i.e., pregnant women, nursing mothers, and young children) to reduce their consumption of certain fish and shellfish.³⁵ While well intentioned, the rule may have had adverse effects on public health. Recent evidence indicates that at-risk consumers reduced their consumption of all fish, not only species with high mercury levels.³⁶ Yet, fish is a primary source of substances such as omega-3 fatty acids that have health benefits, particularly in infants and young children. By consuming less fish, at-risk consumers may have actually increased their health risks—the opposite of what the FDA intended. The FDA’s narrow focus on one risk led it to overlook the other risks its actions introduced.³⁷

In addition to tunnel vision, agencies suffer from risk aversion. In the case of risk tradeoffs, the public often holds agencies accountable for risks that are highly visible and easily identifiable, but largely ignores hidden risks. Thus, agencies have strong incentives to “regulate first, ask questions later.”³⁸ In the case of the FDA’s drug approval process, for instance, there are clear risk tradeoffs between approving a risky drug that may lead to fatalities and delaying a drug that could save lives. However, the risks associated with approving an unsafe drug are highly visible and embarrassing for the agency. For example, the FDA recall of Vioxx, a painkiller produced by Merck, led to a public outrage and congressional inquiries of the FDA.³⁹ On the other hand, the risks of delaying an experimental drug are

³³ *Corrosion Proof Fittings v. EPA*, 947 F.2d 1201 (5th Cir. 1991).

³⁴ *Ibid.*, 1223 n. 23.

³⁵ “F.D.A. Warns Women Not to Eat Some Fish,” *New York Times*, January 14, 2001, Health, <http://www.nytimes.com/2001/01/14/us/fda-warns-women-not-to-eat-some-fish.html>.

³⁶ Jay P. Shimshack and Michael B. Ward, “Mercury Advisories and Household Health Trade-Offs,” *Journal of Health Economics* 29, no. 5 (September 2010): 674–685.

³⁷ The FDA may be well on its way to remedying this problem based on its recent risk assessment, which looks at both risks and benefits. FDA, “Draft Risk & Benefit Assessment Report, Draft Summary of Published Research, Peer Review Report,” January 15, 2009, <http://www.fda.gov/Food/FoodSafety/Product-SpecificInformation/Seafood/FoodbornePathogensContaminants/Methylmercury/ucm088758.htm>.

³⁸ Hale, Borys, and Adams, *Regulatory Overload*; Russell S. Sobel and Peter T. Leeson, “Government’s Response to Hurricane Katrina: A Public Choice Analysis,” *Public Choice* 127 (April 2006): 55–73.

³⁹ Richard Horton, “Vioxx, the Implosion of Merck, and Aftershocks at the FDA,” *Lancet* 364, no. 9,450 (December 4, 2004): 1,995–1,996.

largely hidden. Given that the drug's effectiveness is uncertain, estimating the lives lost due to delays is always more challenging. Consequently, the FDA responds disproportionately to the visible risks.⁴⁰

In some cases, agencies become more responsive to the interests of the industries they regulate than to the interests of the general public, particularly for economic regulation (regulation that controls prices or output directly), and they target regulations narrowly so that specific sectors of industry benefit. For example, one of the earliest federal regulatory agencies, the Interstate Commerce Committee, set the maximum rates for rail freight under the influence of agricultural interests.⁴¹ Later, the same agency set the minimum rates under the influence of the rail industry, purportedly to prevent overproduction and "ruinous competition."⁴²

All the major participants in the regulatory process have incentives to produce both more and poorly crafted regulations. Some of these incentives are the result of individual behavior (e.g., firms' pursuit of favorable regulation). These incentives are likely to persist, as it is hardly probable that firms will stop lobbying for their interests. Activists favor regulation to advance narrow agendas without taking into account the risk and economic trade-offs involved. Congress and the federal agencies, rather than acting as checks on the private sector participants, are the largest source of inefficient regulations. Congress passes legislation without considering the economic merits of the regulations likely to be passed. Agencies fail to produce high-quality regulatory analysis or even to use analysis in their decision-making. The incentives leading Congress and federal agencies to push for poor regulations are institutional. Lack of accountability and check mechanisms lead both groups to disregard the broader public interest in favor of special interests or narrowly defined missions.

Previous Regulatory Reforms

To date, regulatory reform has focused on two key areas: (1) process, or how to make the regulatory process more transparent and inclusive, and (2) analysis, or how to improve the quality of regulatory analysis. The primary reforms to date are summarized below.

Procedural Reforms

- Administrative Procedures Act of 1946 (APA) – establishes minimum rulemaking standards that federal agencies must follow. It also establishes judicial review standards for agencies' actions. In addition, the APA requires federal agencies to offer the public a chance to comment on proposed rules.

⁴⁰ Michael D. Greenberg, "AIDS, Experimental Drug Approval, and the FDA New Drug Screening Process," *New York University Journal of Legislation and Public Policy* 3 (1999): 295–350.

⁴¹ Marc Allen Eisner, Jeffrey Worsham, and Evan J. Ringquist, *Contemporary Regulatory Policy* (Boulder: Lynne Rienner Publishers, 2006).

⁴² *Ibid.*

- Regulatory Flexibility Act (RFA) – requires agencies to perform an analysis that states the reasons for the proposed rule, to list the small entities affected by the rule, and to describe the steps the agency has taken to minimize the rule’s impact on small entities.
- Small Business Regulatory Enforcement Fairness Act (SBREFA) – amends the RFA to provide, among other things, for judicial review of the agencies’ compliance with the RFA.
- Congressional Review Act (CRA) – an SBREFA provision that provides Congress with a mechanism to review and disapprove new regulations proposed by federal agencies.
- Government Performance and Results Act (GPRA) – requires agencies to articulate goals and objectives, identify measures, and report annually on progress.
- GPRA Modernization Act of 2010 – requires agencies to identify high-priority goals, requires the Office of Management and Budget (OMB) to identify high-priority government-wide goals, requires quarterly reporting on progress toward those goals, and requires agencies and the OMB to identify every program, regulation, and tax expenditure that contributes to each high-priority goal.
- Freedom of Information Act – requires that agency records be published in the Federal Register, be made available for public inspection, or be provided upon written request, depending on the type of record.
- Federal Advisory Committee Act – limits committees to a strictly advisory role, requires a balanced representation of views, and requires that nearly all committee meetings be advertised in the Federal Register and be open to the public.
- Government in the Sunshine Act – requires that, with few exceptions, every agency meeting be open to the public. Agencies must give sufficient notice to the public regarding the proposed meetings.
- Negotiated Rulemaking Act – supplements the traditional rulemaking process. The negotiated rulemaking process allows agencies to collaborate with representatives of affected parties by establishing a committee to develop the text of proposed rules.

Regulatory Analysis Reform

- Paperwork Reduction Act (PRA) – requires agencies to justify the collection of any information from the public. The PRA established the Office of Information and Regulatory Affairs (OIRA) within the OMB and entrusted the OIRA with leading the effort to reduce the unnecessary paperwork burden related to the federal government’s information-gathering activities.
- Regulatory Flexibility Act (RFA) – Although this act is a procedural act, it also requires agencies to do analysis; in particular, it requires agencies to assess the impact of regulation on small entities, including small governments and firms. In addition, the RFA requires agencies to review within 10 years of publication the rules that impact a significant number of small entities to determine whether these rules should be continued.
- Unfunded Mandates Reform Act (UMRA) – imposes an informational requirement on regulations resulting in direct costs for intergovernmental or private sectors (covered mandates) not covered by the federal government. The informational requirement calls for the

- Congressional Budget Office (CBO) to estimate the mandated costs. It also requires issuing agencies to estimate the cost of regulation to the regulated entity.
- Information Quality Act (IQA) – requires the OMB to issue guidelines for federal agencies to ensure the quality, integrity, and utility of the information agencies disseminate. It also requires agencies to create their own guidelines for information quality and to establish procedures allowing affected persons to seek corrections to disseminated information that does not comply with OMB guidelines.
 - Executive Order no. 12,866 – requires OIRA to review regulatory analysis of major rules. Major rules include all executive branch rules with an economic impact exceeding \$100 million, as well as rules that may have an adverse impact on the U.S. economy or budget. In addition, the order requires agencies to produce a regulatory impact analysis for economically significant rules. The executive order’s scope is somewhat limited, however, as it does not apply to independent regulatory agencies. This order was reaffirmed by Executive Order no. 13,563 in January 2011.⁴³

The reforms have enjoyed limited success with regard to both the transparency of the process and the quality of analysis. Proposed rules generally receive substantial feedback during the public comment period. Agencies do respond to public comments and modify proposed rules as a result. Yet, most of these changes deal with definitions, deadlines, and other minor issues.⁴⁴ Agencies rarely change the substance of their rules in response to public comments and are generally free to dismiss comments that do not support agency decisions. Judicial review requirements also have had limited success. While some small businesses have successfully challenged federal agencies in court, many small business find the process intimidating.⁴⁵

Improvements in the quality of regulatory analysis have been marginal. Agencies routinely perform regulatory impact analyses (including benefit-cost analysis) for major regulations, but these analyses are hardly complete. In 2010, of the 66 major rules, only 18 quantified and monetized both benefits and costs.⁴⁶ In addition, the quality of analysis is still poor,⁴⁷ and even that analysis is often ignored in the final decision-making.⁴⁸

Several shortcomings have limited the reform efforts’ effectiveness. According to Government Accountability Office (GAO) reports, statutes attempting to limit the burden of regulation are often vague, leaving agencies substantial freedom in interpreting compliance requirements.⁴⁹ Further, many

⁴³ Executive Order no. 13,563.

⁴⁴ William West, “Administrative Rulemaking: An Old and Emerging Literature,” *Public Administration Review* 65, no. 6 (2005): 655–668.

⁴⁵ Jeffrey J. Polich, “Judicial Review and the Small Business Regulatory Enforcement Fairness Act: An Early Examination of When and Where Judges Are Using Their Newly Granted Power over Federal Regulatory Agencies,” *William and Mary Law Review* 41, no. 4 (2000): 1,425–1,461; Christopher M. Grengs, “Making the Unseen Seen: Issues and Options in Small Business Regulatory Reform,” *Minnesota Law Review* 85 (2001): 1,957–2,006.

⁴⁶ OMB, *2011 Report to Congress*.

⁴⁷ Ellig and Morrall, “Assessing the Quality of Regulatory Analysis.”

⁴⁸ Hahn and Tetlock, “Has Economic Analysis Improved Regulatory Decisions?”

⁴⁹ U.S. Government Accountability Office (GAO), *Regulatory Flexibility Act: Key Terms Still Need to Be Clarified* (Washington, DC: GPO, April 24, 2001), <http://www.gao.gov/new.items/d01669t.pdf>; GAO, *Federal Mandates: Few*

of these statutes lack strong oversight and enforcement mechanisms, making it difficult for affected parties and the general public to challenge federal agencies' regulatory activities. In its recommendations to Congress, the GAO suggested fixing the shortcomings by clarifying the existing guidelines and providing for stronger oversight.

Strengthening the oversight and enforcement mechanisms would be beneficial but not sufficient. For reforms to be effective, they must seek to change the institutional incentives of Congress and federal agencies in the rulemaking process, something that GAO suggestions fail to address. Reforms should seek to increase the accountability of not just federal agencies but Congress as well. In addition, they should seek to strengthen the system of checks and balances with regard to regulations' analytical quality. Finally, they should provide the federal agencies with incentives to continuously improve the efficiency and cost-effectiveness of their regulations.

Regulatory Reform Alternatives

The potential avenues for regulatory reform fall into three broad categories:

1. Strengthen congressional oversight of regulatory activity.
2. Improve the quality of regulatory analysis.
3. Eliminate inefficient regulations.

Reforms that change the institutional incentives have a higher chance of success. Reforms that require congressional legislation, as opposed to reforms that would be appropriate for an executive order, would likely be the most effective for several reasons.

First, Congress has the power to expand regulatory reforms to include independent agencies, which account for an increasing share of major regulations. Second, Congress can alter and streamline the existing statutory requirements that govern the regulatory process and analysis. Third, it can make analysis judicially reviewable. The advantages of this approach are discussed in more detail below. Appendix 1 lists other reform suggestions.

1. Strengthen Congressional Oversight

Goal: Make both Congress and federal agencies accountable for producing efficient and cost-effective regulations. One of the biggest challenges of the current regulatory process is that the public does not hold Congress accountable for either the regulatory costs it imposes on the public or for the achievement of actual benefits. To the contrary, legislators often claim the mere passing of regulatory laws as victories. Consequently, legislators have no incentive to push for efficient or cost-effective regulations.

Strengthening congressional oversight would require Congress to authorize the full cost of regulation imposed by congressional statutes. Since regulatory costs of legislation become part of the congressional voting record, members of Congress would likely pass legislation only if benefits were expected to exceed costs. Similarly, agencies would be forced to consider the full costs of their regulatory activities when faced with more oversight from Congress and would have to prioritize regulation and choose more cost-effective options. The proposed reforms would also require Congress to empower the CBO (or a similar congressional institution) to check the agency analysis to ensure compliance.

Drawbacks: These reforms would apply only to new regulations. They provide no incentives for either Congress or federal agencies to review and improve existing regulations. This approach may also impose substantial burdens on Congress. In addition, accounting for the full costs of regulation is challenging. Indirect costs of regulation are often difficult to estimate, particularly when regulatory agencies have yet to work out the details. Differentiating between the compliance costs imposed by the legislation and the costs that businesses would have incurred voluntarily (in the absence of legislation) is equally tricky.

Implementation Alternatives: (1) establish a regulatory budget; (2) estimate the regulatory costs of each bill; (3) require congressional approval of major regulations.

1.1. Establish a Regulatory Budget

To implement a regulatory budget, Congress would set a ceiling for all regulatory costs imposed on the economy each year. It would further allocate a regulatory budget among individual agencies. The process would operate in a manner quite similar to the fiscal budgeting process. Agencies would request a regulatory budget (which would include both agency costs and the social costs the regulation was expected to impose on the private sector) at the beginning of the year. These budget requests would then be compiled into a unified regulatory budget, presumably by the OMB. Congress would review and modify the budget to fit congressional regulatory priorities. The final approved budget would limit the total cost of regulations issued for that year. Should agencies wish to exceed their allotted limits, they would have to return to Congress for authorization for specific regulatory actions.

Note that the regulatory budget is not set arbitrarily by Congress but is based on agency requests. Agencies would request sufficient amounts to operate and fulfill their mandates. They would have to justify their requests to Congress.

The main drawback of a regulatory budget is its complexity. Of the three alternatives for increasing congressional accountability, the regulatory budget imposes the highest burden of cost-accounting.

1.2. Estimate Regulatory Costs of Legislation

An alternative to a regulatory budget would be to set a ceiling for the regulatory costs of each new piece of legislation. Thus, for every new piece of legislation, the CBO would estimate the full cost of implementation. Agencies implementing the legislation would have to stay within an allocated budget. Should agencies exceed their budgets, they would have to explain why they were unable to accomplish

their missions within the given budget. If they believe that the mission should change, agencies would have to explain why in their requests for reauthorization.

The CBO already analyzes the spending or revenue effects of some legislative proposals under the Unfunded Mandates Reform Act (UMRA) of 1995. However, these estimates do not represent the full social cost of implementing regulations. The estimates include only the direct costs of regulation to government entities and the private sector. In contrast, the full cost of regulation should account for changes in incomes, prices, and the choices of consumers and businesses, which together can easily exceed the expenditures associated with compliance efforts.⁵⁰ Furthermore, UMRA only applies to a small subset of legislation. Congress does not estimate costs for most legislation. A statute expanding on UMRA requirements would enhance congressional accountability in the regulatory process.

One advantage of legislation cost estimates over a regulatory budget is relative simplicity. The task of calculating an agency-wide budget for the entire year is daunting. Estimating the costs for a single statute may be easier. Legislation cost estimates would also go to the root of many inefficient regulations—the congressional statutes that require them. If the CBO scores every new piece of legislation, Congress may be more cognizant of the regulatory costs it imposes on citizens. It might be less likely to push for inefficient regulations and more likely to pay attention to legislation whose costs can be justified.

On the downside, this approach does not allow for a comprehensive comparison of alternatives—each piece of legislation is considered in isolation. Hence, Congress and federal agencies would have no incentive to prioritize their regulatory activities.

1.3. Congressional Approval of Major Regulations

Another way to ensure that Congress and federal agencies pass laws and regulations that work would be to require congressional approval for all proposed major rules.⁵¹ Currently, under the Congressional Review Act (CRA), Congress reserves the right to review major rules and disapprove them through an expedited legislative process. In addition, it may control regulatory activities through its control over regulatory budgets and by holding oversight hearings. Consequently, Congress provides some legislative oversight of federal regulatory activity. However, critics have argued that the oversight mechanism is too weak to make a substantial difference. Under the CRA, proposed rules are approved by default; it takes a congressional action to disapprove a proposed rule. To date, Congress has exercised its right to review major rules only once in 15 years with OSHA's ergonomics rule.⁵² In contrast, under this alternative, proposed rules would require an affirmative vote in Congress to be enacted. This solution

⁵⁰ Maureen L. Cropper and Wallace E. Oates, "Environmental Economics: A Survey," *Journal of Economic Literature* 30, no. 2 (1992): 675–740.

⁵¹ To the extent that this proposal reverses the established practice of delegation of legislative powers from Congress to the executive agencies, its impact is far reaching and subject to vigorous debate. However, this paper is concerned primarily with changes in institutional incentives. Legal aspects of delegation of legislative powers are outside the scope of this paper.

⁵² Morton Rosenberg, *Congressional Review of Agency Rulemaking: An Update and Assessment of the Congressional Review Act after a Decade* (Washington, DC: Congressional Research Service, May 8, 2008).

would create a voting record for members of Congress in regard to the quality of regulations they have chosen to approve.

This alternative for establishing congressional accountability is the simplest of three discussed. It only requires that members make themselves aware of regulations that stem from the rules they have passed to ensure that the regulations are consistent with congressional intent and that the agencies have done due diligence in designing rules that are cost-beneficial.

On the downside, this option covers only a portion of regulatory activity—it only applies to major rules. It also imposes the highest burden on Congress in that legislators would have to vote on major rules in addition to passing legislation. In 2010, OIRA classified 66 rules as major. If each major rule required congressional approval, Congress would need to approve two regulations each week. However, with an affirmative vote required to pass the regulation, there would likely be fewer rules passed as the threshold for a successful rule was raised.

2. Improve the Quality and Use of Regulatory Analysis

Goal: Increase the transparency of the regulatory decision-making process by improving the quality of regulatory analysis. With high-quality regulatory analysis, inefficiencies of regulation become immediately apparent.

One possible reform would open up the agency rulemaking process to outside challenges. Currently, the executive branch has a monopoly on estimating both regulatory costs and benefits. Agencies produce the analysis (sometimes) and OIRA does its best to ensure the quality and use of analyses in regulatory decisions. But the constraints on OIRA in achieving this goal are widely known.⁵³ Consequently, agencies have strong incentives to tailor their analyses to support decisions that have already been made. If the public could challenge rules based on flawed or incomplete analysis or failure to use the analysis to inform the decision, rules might be more efficient and cost-effective.

Drawbacks: Alone, this reform only addresses incentives for federal agencies. It does not change Congress's incentives for mandating legislation that forces inefficient regulations. Particularly when congressional statutes are very prescriptive, agencies have little choice but to comply.⁵⁴

Implementation: (1) require regulatory analysis by statute; (2) require congressional review of regulatory analysis; (3) make regulatory analysis judicially reviewable; (4) require formal rulemaking; (5) require publication of preliminary regulatory analysis.

2.1. Require Regulatory Analysis by Statute

Since 1994, Congress has made numerous attempts to mandate regulatory impact analysis (RIA) by statute rather than by executive order. A statutory requirement for analysis could accomplish several

⁵³ GAO, *Regulatory Accounting: Analysis of OMB's Reports on the Costs and Benefits of Federal Regulation* (Washington, DC: GPO, April 1999), <http://www.gao.gov/archive/1999/gg99059.pdf>.

⁵⁴ Richard B. Stewart, "United States Environmental Regulation: A Failing Paradigm," *Journal of Law and Commerce* 15 (1996): 585–591.

goals depending on how it was implemented. For example, it could apply RIA requirements to both executive and independent regulatory agencies, streamline the multiple analytical requirements, and expand the analytical requirements beyond current RIA requirements.

To date, Executive Order no. 12,866 requiring agencies to conduct RIA for major rules has been applied only to executive branch agencies but not necessarily effectively.⁵⁵ Examination of regulatory impact analyses of economically significant rules since 2008 has shown that, in general, these analyses are not well done.⁵⁶ Independent agencies are encouraged but not required to consider regulation's costs and benefits. Numerous regulations are therefore not subject to the executive's economic efficiency requirements. For example, in 2010, independent agencies issued 17 major rules, compared to 66 major rules issued by the executive agencies.⁵⁷ None of these rules provides fully monetized cost and benefit estimates.⁵⁸ Since independent agencies are becoming a bigger factor in regulation (e.g., new Dodd-Frank mandates and new requirements for the Consumer Product Safety Commission), requiring economic analysis make sense. While this requirement may impose additional costs on independent agencies, the better quality of analysis would almost certainly be worth the cost.

The statutory requirement for analysis could also streamline the rulemaking process. At present, congressionally mandated requirements for agency rulemaking are spread over several statutes. The RFA requires agencies to estimate the impact of their regulations on small entities; the UMRA requires agencies to estimate the mandated costs regulations impose on state, local, or tribal governments; and the PRA requires agencies to justify any additional paperwork burden imposed on the public. Streamlining all these requirements in a single statute would remove redundancy in some of these statutory requirements, reduce confusion over their applicability, and make it easier for agencies to comply and harder to dismiss the requirements.

A different set of goals can be targeted by expanding analytical requirements to include, where appropriate, federalism analysis, risk/risk analysis, and competition analysis. Federalism analysis would ensure that the problem is appropriately addressed at the federal level—one of the main criteria for efficient analysis discussed earlier in this paper. Risk/risk analysis would ensure that regulation aiming to reduce risk in one area does not increase risks elsewhere. As discussed earlier, risk tradeoffs can be a major issue with regulations. Finally, agencies ought to consider the impact of proposed regulations on market competition. As noted previously, regulation sought by the private sector often benefits businesses at consumers' expense. Agencies should question whether a regulation's benefits exceed the

⁵⁵ For example, Administrator Browner under the EPA in the 1990s made a speech on the 30th anniversary of Earth Day and remarked, "The nation committed itself to the task of eliminating pollution, to restoring our lands and waters to their uses, and to protecting public health without regard to cost. Let me repeat those last four words—*without regard to cost.*" Cited in Robert W. Hahn, Sheila M. Olmstead, and Robert N. Stavins, "Environmental Regulation in the 1990s: A Retrospective Analysis," *Harvard Environmental Law Review* 27 (2003): 377–415.

⁵⁶ Ellig and Morrall, "Assessing the Quality of Regulatory Analysis."

⁵⁷ OMB, *2011 Report to Congress*.

⁵⁸ It is unclear precisely how many independent agency rules are major given that these agencies are not required to estimate the impacts of their rules.

welfare loss to consumers (whether domestic or international) and whether the rule can be tailored to reduce any impact on free-market competition.⁵⁹

The primary drawback of this approach is the increased cost of analysis for the federal agencies. On the other hand, more comprehensive analysis would allow agencies to improve the quality of their rulemaking.

2.2. Require Congressional Review of Regulatory Analysis

To increase federal agencies' accountability, Congress could charge an independent body such as the GAO or the CBO with checking the quality and use of analyses as a further check beyond OIRA. As mentioned in the previous section, this alternative would be required if Congress chooses to implement regulatory budgets or to require congressional approval for major regulations. Unlike the federal agencies, these independent reviewers are expected to be less biased and less likely to tilt the analysis toward supporting a pre-chosen regulatory option. Agencies themselves are likely to improve the quality of the analysis for fear of challenge to their estimates.

Congress must ensure the reviewing agency's independence. Expanding the role of OIRA, which is already charged with evaluating economically significant regulations, would still leave the function entirely within the executive branch. Politically, it is difficult for an executive-branch agency to publically challenge another agency's estimate.⁶⁰ Adding an additional check by a congressional agency, such as the GAO, the CBO, or a new congressional agency, would provide a check on federal agencies' regulatory activity independent of the executive branch.⁶¹

The main drawback of this approach is its cost. It requires additional funding for an existing agency or the establishment of a new agency.

2.3. Make Regulatory Analysis Judicially Reviewable

Another way to make agencies accountable for their regulatory decision-making is to make all data and analysis used in rulemaking judicially reviewable. This proposal would allow affected parties to challenge the quality of agency analysis and data (scientific and economic) in court. It would help to ensure the scientific integrity of agency analysis and expose analysis that is tailored toward a particular outcome for political reasons. This proposal does not envision federal judges evaluating the quality of analysis.

⁵⁹ Deborah Platt Majoras, "Opening Remarks" (presented at the Role of Competition Analysis in Regulatory Decisions workshop, Washington, DC, AEI/Brookings Joint Center, May 15, 2007), <http://www.ftc.gov/speeches/majoras/070515aei.pdf>.

⁶⁰ GAO, *Regulatory Accounting*.

⁶¹ House Subcommittee on Courts, Commercial and Administrative Law, Committee on the Judiciary, *APA at 65 - Is Reform Needed to Create Jobs, Promote Economic Growth, and Reduce Costs?* 112th Cong., 1st sess., 2011, http://judiciary.house.gov/hearings/printers/112th/112-17_64854.PDF.

Rather, it relies on the larger scientific community for expertise. Judges' role is to check whether agency analysis is clearly biased.⁶²

The advantage of this approach is that it introduces crowdsourcing into the process. Crowdsourcing allows numerous outside experts to review, assess, and challenge the validity of the data and theoretical models used in the regulatory analysis. As shown by the success of public websites like Wikipedia, virtually any subject has a subgroup of people interested in promoting accurate information. Judicial challenge would force federal agencies to examine and respond to these disputes. Agencies would not be able to dismiss public comments with a perfunctory statement as they commonly do in informal rulemaking.⁶³ Consequently, the scientific quality of agency analysis will face considerably higher review standards.

The main disadvantage of this approach is that some incentives would not change. Mounting a successful challenge to federal agencies in courts is costly. The benefits to the public from better regulatory analysis are generally dispersed. The general public is unlikely to be interested in the better analysis as any benefit to an individual from a good economic analysis is fairly small. For any individual regulation, the only group interested in getting the analysis right would be stakeholders who are adversely affected; but, equally, if there is a group of stakeholders who stand to gain from the regulation, they will not want better analysis. Thus, there is not much of a constituency for consistently good economic analysis. One group of stakeholders who often bear most of the costs of regulation is small businesses. Because of that, Congress passed two laws, the RFA and SBREFA, to ensure that small businesses' interests are represented. One provision of the SBREFA allows small entities to challenge poor regulatory flexibility analysis. But even in this case, where there is something to gain by challenging the agencies, the laws have not been effective because of the considerable costs of litigation and judicial deference shown to federal agencies.⁶⁴

2.4 Require Formal Rulemaking

As an alternative or in addition to judicial review, Congress could require a formal rulemaking process for all major regulations. Formal rulemaking provides for trial-type hearings in which interested parties may testify on the proposed regulation and cross-examine adverse witnesses. Most importantly, substantial evidence must support decisions. An agency official or an administrative law judge presides over the hearings.

One key factor that should improve with formal rulemaking is the administrative record. Under informal rulemaking, agencies control how they respond to comments, and they often dismiss substantive

⁶² It should be noted, however, that recent Securities and Exchange Commission court rulings have taken a fairly sophisticated look at the quality of their economic analysis. See, e.g., *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *American Equity Investment Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

⁶³ *Business Roundtable v. SEC*.

⁶⁴ Polich, "Judicial Review and the Small Business Regulatory Enforcement Fairness Act."

comments.⁶⁵ With formal rulemaking, agencies must respond with reasoned arguments as to why, for example, a suggested option is not relevant or why a scientific study should be dismissed.

The main drawback of the formal rulemaking process is that it can be hijacked by special interests, leading to drawn-out hearings that could last years.⁶⁶ It could also increase the costs of agency rulemaking, although, if it leads to fewer judicial challenges later in the process, it could actually lower costs.

2.5 Require Early Publication of Preliminary Regulatory Impact Analysis

A less adversarial approach to increasing transparency and accountability in the rulemaking process would be to require agencies to publish their draft RIAs prior to making a proposal that contained their preferred alternative. This approach would give interested parties a chance to examine the evidence and potential options prior to decisions becoming a *fait accompli*. Since RIA findings are preliminary at this stage, agencies may be more responsive to public comments alerting them to errors, omissions, or additional information crucial to making better decisions. All too often, agencies ignore public comments that challenge agency data because the agencies have already made up their minds and believe the costs of rethinking the proposed alternatives are too high. Currently, to the degree that agencies take public comments into consideration, the changes are often cosmetic.⁶⁷

In addition, this proposal would push agencies to view cost–benefit analysis as an integral part of the rulemaking process rather than an afterthought used to justify a decision that has already been made. As a result, they might take a broader public-interest view of regulation rather than focus narrowly on options favored by individual program managers or options that reflect the status quo.⁶⁸

The main disadvantage of this proposal is that agencies would still be free to ignore preliminary comments. To the degree that agencies have strong incentives to favor inefficient regulation, this proposal is unlikely to have much impact if not accompanied by other reforms.

3. Eliminate Inefficient Regulations

Goal: Improve the quality of existing regulations. The alternatives discussed in the preceding sections focus primarily on the flow of new regulations. Yet, there is already a substantial stock of inefficient regulations in the Code of Federal Regulations. A separate set of regulatory reforms would focus on eliminating or restructuring the regulations that are already on the books.

Drawbacks: a retrospective review of the entire stock of existing regulations could be a daunting challenge and would require substantial effort and expense. In addition, it may provide little relief to the public. If most of the costs of an inefficient regulation are upfront and the public has already invested in complying with the regulation, eliminating such regulations will not increase public welfare.

⁶⁵ Williams, "Influence of Regulatory Economists."

⁶⁶ Ernest Gellhorn, *Administrative Law and Process in a Nutshell* (St. Paul, MN: West, 1997); Richard J. Pierce, *Administrative Law* (New York: Foundation Press, 2008).

⁶⁷ West, "Administrative Rulemaking."

⁶⁸ See Williams, "Influence of Regulatory Economists."

Implementation: Congress could adopt either a big-bang or an incremental approach to eliminating inefficient regulations. In particular, it could consider the following: (1) designating a panel of experts to eliminate or modify existing regulations; (2) establishing regulatory PAYGO to require agencies to eliminate an existing rule before establishing a new rule.

3.1 Designate a Panel of Experts

One approach to reforming the current stock of regulations is to replace the key actors (regulatory agencies) who are now charged with reviewing their own rules instead of trying to change their incentives. In a process modeled after Base Realignment and Closure (BRAC), a program created to navigate the contentious process of military base closures and consolidation, Congress could appoint a panel of independent experts to select inefficient programs and packages of regulations for modification or elimination. The experts' plans would be enacted by default unless Congress voted in a joint resolution to overturn the entire plan. Congress would not be able to modify any part of the plan and would vote on the entire package. This system would prevent legislators from trying to shield their pet projects and undermining the entire endeavor. It would also allow them to shift the blame for unpopular decisions onto the expert panel, making the process more palatable for the legislators.

The advantage of this approach is that it allows for a comprehensive overhaul of inefficient regulations. Furthermore, it resolves the problem of incentives for key actors by replacing them with an independent expert panel. One way to accomplish this is to select panel members, perhaps jointly by the executive and legislative branches, based on their subject matter expertise, not on their vested interest in the outcome. In addition, the panel would not include current office holders or government officials. Since the panel would not be beholden to special interests or federal agencies, it would be less likely to be biased in its approach.

On the downside, this approach may not be sustainable in the long run. The sense of urgency necessary for this approach is often predicated on a widespread perception of crisis. As the crisis passes, public resolve to reform the regulatory system may fade, and all the culprits will revert to business as usual.

While in most countries the approach to regulatory reform has been incremental, there are a few examples of a "big-bang" approach, most notably in South Korea in the wake of the Asian financial crisis in 1997.⁶⁹ Faced with a dire economic situation, the president ordered government agencies to slash the number of regulations by half within a year. Each agency was charged with submitting a full inventory of its existing regulations and presenting a plan to reduce it by half to the newly formed Regulatory Review Committee. The agencies also had to justify the remaining regulations. The plan was reasonably successful, reducing the number of regulations from 11,125 in 1997 to 7,127 in 1999. However, it focused solely on the number of regulations and not on their quality or economic impact, and it was later abandoned for an incremental approach.

⁶⁹ OECD, *OECD Reviews of Regulatory Reform Korea: Progress in Implementing Regulatory Reform* (Paris: OECD Publishing, 2007).

The United Kingdom also has an approach to eliminating multiple regulations.⁷⁰ It publishes regulations affecting individual industries as well as regulations of general effect and asks for comments. The default presumption for every regulation published is that it will be eliminated unless Cabinet ministers decide to keep it. However, this program only applies to those regulations passed by the U.K. government, not by those coming from the European Union.

In the United States, BRAC provides an example of a successful big-bang approach.⁷¹ Traditionally, members of Congress would vocally oppose Department of Defense (DOD) plans for base closures in their districts because base closure spells substantial job losses for most districts. In addition, legislators accused the DOD of using base-closure decisions to reward or punish specific members of Congress.⁷² The compromise solution was to create an expert panel charged with drawing up a list of bases to be moved or closed. The president and Congress could either approve or reject the plan in its entirety, but neither could change the specifics of the commission's recommendations. The BRAC process resulted in five consecutive rounds of base closures in 1988, 1991, 1993, 1995, and 2005. The last round was the most extensive and complex round of base closures to date. It called for the closure or realignment of 182 bases and is expected to save \$13.7 billion by 2025.⁷³

BRAC's success was in many ways predicated on the DOD's sustained support of the program. The military had no use for the bases and could use the savings elsewhere. The primary resistance in this case came from the legislators in Congress whose districts would be affected by the closures. BRAC allowed the military to circumvent this resistance. Another key factor in the program's success was the silent approval process, which meant that the commission's recommendations became law unless they were overturned by a joint resolution.⁷⁴

In contrast, many in Congress and the federal agencies may resist the regulatory cleanup we propose and, at a minimum, support for this program is likely to diminish over time. However, this approach is likely to be useful as a one-time tool for streamlining and improving the existing stock of regulations. Nevertheless, given the large number of existing inefficient regulations, this measure may yield substantial benefits even if it only operates for a short time. It should, of course, be combined with long-term measures to improve the quality of future regulations.

3.2. Establish Regulatory PAYGO

An incremental approach to eliminating inefficient regulations would be to enact regulatory PAYGO, which would require that for each new rule, agencies eliminate an existing rule or a set of rules of

⁷⁰ HM Government Cabinet Office, "How It Works," Red Tape Challenge, <http://www.redtapechallenge.cabinetoffice.gov.uk/how-it-works/>.

⁷¹ GAO, *Military Base Realignments and Closures: DOD Faces Challenges in Implementing Recommendations on Time and Is Not Consistently Updating Savings Estimates* (Washington, DC: GPO, January 30, 2009), <http://www.gao.gov/new.items/d09217.pdf>.

⁷² Kenneth R. Mayer, "The Limits of Delegation: The Rise and Fall of BRAC," *Regulation* 22, no. 3 (1999): 32–39.

⁷³ GAO, *Military Base Realignments and Closures*.

⁷⁴ Jerry Brito, "The BRAC Model for Spending Reform," *Mercatus on Policy* 70 (Arlington, VA: Mercatus Center at George Mason University, 2010), <http://mercatus.org/sites/default/files/publication/The%20BRAC%20Model%20for%20Spending%20Reform.pdf>.

similar cost.⁷⁵ Alternatively, an agency could negotiate with another agency to eliminate an existing rule on its behalf (like a tradable permit).⁷⁶ As with the regulatory budget, the agency estimate would have to be verified by an independent reviewer. The goal of regulatory PAYGO would be to provide federal agencies with an incentive to review existing rules and eliminate inefficient ones.

The main advantage of this option is its relative simplicity. The only costs that need to be estimated are the costs of new and eliminated regulations.⁷⁷ Agencies, faced with a PAYGO constraint, would be forced to prioritize regulations.⁷⁸ They would have to evaluate the effectiveness and necessity of existing regulations and identify the less effective regulations for elimination. Failure to do so would prevent them from passing new, higher-priority regulations. Consequently, this alternative would provide agencies with a strong incentive for retrospective review of existing regulations. According to a GAO study, retrospective reviews are most effective when initiated internally by the agencies.⁷⁹ Giving agencies an incentive for such reviews may be an effective means to incremental improvement in the current stock of regulations.

The main disadvantage of this proposal is that it does not address the large stock of existing regulations. It also applies only to the federal agencies; the incentives for legislators remain unchanged. Congress would have strong incentives to carve out exceptions to this rule.

The United Kingdom adopted a version of this approach, called the “one-in, one-out” principle, in 2010. However, it is too soon to tell whether it has improved the regulatory process. In the Netherlands, the Dutch government successfully implemented a four-year program to reduce the administrative burdens for businesses by 25 percent between 2003 and 2007.⁸⁰ The government measured the 25 percent cost reduction with reference to a calculated baseline cost of administrative burdens. The reduction targets, distributed among the government agencies, were tied to budgets, providing agencies with additional incentives to meet their goals. Since the program focused primarily on regulation’s administrative costs, it did not run into political opposition. In a follow-up program, the Dutch government has expanded its focus to include compliance costs in addition to the administrative burden. Its goal is to reduce regulatory compliance costs by €544 million (\$805 million) from 2007 to 2011.⁸¹ The government’s latest

⁷⁵ Clyde Wayne Crews, “Promise and Peril: Implementing a Regulatory Budget,” *Policy Sciences* 31, no. 4 (January 1, 1998): 343–369.

⁷⁶ Tradable permits are used in environmental regulation. Firms buy permits to pollute from other firms who can reduce their own pollution more cost-efficiently.

⁷⁷ Costs for existing rules are the costs that incumbent firms continue to pay and costs that new entrants into an industry would have to pay (start-up costs). These costs would be compared with the costs of new rules, which include start-up and on-going costs for both incumbents and, in the future, new entrants.

⁷⁸ Better Regulation Task Force (BRTF), *Regulation - Less is More: Reducing Burdens, Improving Outcomes*, BRTF Report to the Prime Minister (London: BRTF, March 2005), <http://www.bis.gov.uk/files/file22967.pdf>.

⁷⁹ GAO, *Reexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* (Washington, DC: GPO, July 16, 2007), <http://www.gao.gov/new.items/d07791.pdf>.

⁸⁰ OECD, *Better Regulation in Europe: Netherlands* (Paris: OECD Publishing, 2010).

⁸¹ Ministry of Economic Affairs, Agriculture and Innovation, *Regulatory Burdens on Business Progress Report* (The Hague, Netherlands: Ministry of Economic Affairs, Agriculture and Innovation, November 2009), http://english.minInv.nl/txmpub/files/?p_file_id=2001870. We calculated the U.S. dollar equivalent using an

report indicated that it is on schedule to meet its target. Yet, there is some evidence that the follow-up program may enjoy less political support.⁸²

Regulatory Reform: The Path Forward

No single approach will comprehensively overhaul the regulatory system. The ideal reform would improve the existing stock of regulations as well as ensure the high quality of future regulations. It would also improve the quality and use of regulatory analysis, since the primary goals of regulatory reform cannot be achieved without accurate and reliable estimates of regulation's impact. Comprehensive regulatory reform will require a combination of the approaches described in this paper.

Based on our assessment of the potential impact and expected costs of each reform proposal, we recommend an initial reform package that includes the following three options:

1. Require congressional approval of major regulations.

The main goal of this reform proposal would be to make Congress and federal agencies accountable for regulatory decision-making. Congress would be especially sensitive to whether agencies have shown that the rules they have passed will achieve the benefits they claim at a reasonable cost. This proposal goes to the heart of the problem by changing the institutional incentives for Congress, and of the three proposals that address congressional incentives, this one is by far the simplest to implement. In contrast, regulatory budgets would impose considerably higher analytical burdens and administrative costs on both the federal agencies and an independent congressional reviewer.

2. Require regulatory analysis by statute.

This reform would extend the rigorous analytical requirements for major regulations to the independent agencies. Given that independent agencies account for a substantial portion of major rules, it is crucial to improve the quality of their regulatory analysis. The statutory requirement would make the analyses open to judicial challenge by the public, which would bring crowdsourcing into assuring the quality and use of these analyses. Creating such a statute would also facilitate the combination and expansion of analytical requirements, particularly to cover risk/risk trade-offs and competition analysis. This analysis should be presented to the public for review well before the agency produces a proposed rule. Early presentation will give the public adequate time to react and to help develop proposed rules. It also may produce better analysis that is not constrained by agency decision makers hoping to find a preselected option in the analytically preferred option.

3. Include independent agencies in requirements for regulatory impact analysis and congressional approval.

Given the passage of Dodd Frank and other significant legislation, it makes sense to apply these reforms to independent agencies and to bring them into OIRA review.

exchange rate of EUR/USD = \$1.48, effective at the time the *Regulatory Burdens on Business Progress Report* was published.

⁸² OECD, *Better Regulation in Europe*.

Having members of Congress accrue a voting record for major regulations should change the incentives for members to vote for ineffective or inefficient regulations, particularly for those members who expect to still be in Congress when new regulations are enacted.⁸³ In addition, statutorily required regulatory impact analysis that is reviewable by courts is likely to produce much better analyses, particularly because stakeholders would be able to challenge all economic and scientific data to ensure that agencies soundly analyze their decisions. Challenges could reduce incentives for agencies to pay for scientific or economic data and analysis that will not hold up to public scrutiny and should also force agencies to better define problems and to explore all relevant alternatives.

Better analysis presents Congress with a more comprehensive record upon which to base its decisions. Rules that have costs that are not justified by the benefits are unlikely to survive unless there are very strong reasons for promulgating them. Having the suggested reforms in place should reduce the influence of those who seek rules to advance their own interests. Better regulatory analysis exposes not only the overall benefits and costs of each provision, but shows who benefits and who pays for the rules. Exposing those parties makes it more difficult for Congress to reward special interests through laws and regulations. Including independent agencies provides much-needed oversight by the other two branches of government as well as by the public.

The proposed reform package, however, does not provide for a review of the existing stock of regulations. A more aggressive approach to reviewing and streamlining the existing stock of regulations involves creating a BRAC-style independent panel of experts. An incremental approach, on the other hand, would be modeled on the Dutch or British experience by enacting regulatory PAYGO. Further research is necessary to understand what approach would be most effective in improving existing regulations.

Americans should care about regulation because it affects almost every aspect of our lives. We should care because the outcomes of regulatory policy affect the quality of the environment, the safety of consumer goods and industrial processes, and the adoption of quality-of-life-enhancing technology. All of these depend to a great degree on the implementation of regulatory policy.

We should also care because regulations impose a significant cost on the economy and on our ability to be competitive in an increasingly globally linked world. Better regulatory policy will solve social problems at lower cost, which will, in turn, keep the United States competitive—and that affects everyone.

⁸³ The average tenure for a senator now is about 13 years; for a Congressman, it is about 10 years. CRS, *Congressional Careers: Service Tenure and Patterns of Member Service, 1789–2011* (Washington, DC: CRS, January 7, 2011), <http://openocrs.com/document/R41545/>. These typical term lengths mean that, on average, members would face voting for regulations that are passed within five and six years from the passage of the authorizing legislation.

Appendix 1. Regulatory Reform Alternatives

| Reform Options | Intended Results | Change in Incentives for Congress and Agencies |
|---|---|---|
| BUDGETS | | |
| <i>Reward or punish agencies, programs, people</i> | | |
| Tie funding to the success of specific programs | Improve the quality of existing regulations | Incentives for agencies to improve the regulatory quality of underperforming programs No incentives for Congress to enforce the rule |
| Tie funding to agency successes | Improve the quality of existing regulations | Incentives for agencies to improve regulatory quality No incentives for Congress to enforce the rule |
| Introduce regulatory budgets | Control the costs of new regulations | Forces both Congress and agencies to consider the costs of regulation |
| Stop rewarding senior staff in agencies for passing new regulations | Reduce the number of new regulations | Reduces incentives for agencies to create new regulations Does not alter incentives for Congress |
| ELIMINATION | | |
| <i>Cut regulations</i> | | |
| Enforce moratorium on new regulation | Reduce the number of new regulations | Does not alter incentives for either Congress or agencies Both wait out moratorium |
| Enforce regulatory PAYGO | Reduce (or at least keep constant) the cost of regulation | Incentives for agencies to improve regulatory quality Does not alter incentives for Congress |
| Sunset rules | Reduce the number of existing regulations | No incentive for either Congress or agencies to enforce the rule |
| Eliminate regulations through BRAC-style commission | Reduce the number of existing regulations | Replace key actors. Strong incentive for commission members Incentives for Congress may depend on the political environment |
| Eliminate agencies | Reduce the number of regulatory agencies | No incentives for either Congress or agencies |
| OVERSIGHT | | |
| <i>Introduce more checks and balances into the system</i> | | |

| | | |
|---|---|---|
| Increase the size of OIRA | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| Require congressional approval of major regulations | Reduce the number of new regulations | Incentives for agencies to improve regulatory quality Incentives for Congress to control the costs of regulation |
| Require GAO to complete a competing analysis of major rules | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| <hr/> | | |
| ANALYSIS | <i>Increase the quality and use of regulatory analysis beyond what is required now by executive order</i> | |
| <hr/> | | |
| Require cost–benefit analysis by statute | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress Incentives for affected entities to challenge agencies in court |
| Give SBA the authority to return rules based on poor RIA | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| Apply executive order to independent agencies | Improve the quality of regulation from independent agencies | Some incentives for independent agencies to improve analysis quality Does not alter incentives for Congress |
| Require risk/risk analysis | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| Require competition and federalism analysis | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| <hr/> | | |
| PROCESS | <i>Improve rulemaking process by opening it up to challenge</i> | |
| <hr/> | | |
| Require formal rulemaking for major rules | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |

| | | |
|---|---|--|
| Require challenges to science under the IQA to be judicially reviewable | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| Shift public comment period to the beginning of the rulemaking process | Improve the quality of regulatory impact analysis | Some incentives for agencies to improve analysis quality Does not alter incentives for Congress |
| Require Congress to do cost-benefit analysis of rules requiring or allowing for regulations | Reduce the number of new regulations | Incentives for Congress to limit areas of rulemaking for agencies |
