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TESTIMONY

VIRGINIA'S APPROACH TO REDUCING REGULATORY BURDEN AS A MODEL FOR PENNSYLVANIA

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Regulatory Reform and Cutting the Red Tape in Pennsylvania

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Regulations play a vital role in modern society, and with good design and management, regulations deliver important public benefits. Poor design of individual regulations, however, can lead to rules that create only costs and no public benefits. More importantly, poor regulatory management of accumulated regulations stifles innovation and hinders economic growth.

A unique challenge for policymakers today is to find a way to trim unnecessary regulations while preserving necessary public protections. I'd like to describe an innovative approach developed by the state of Virginia. I believe Virginia's solution to regulatory management can serve as a model for Pennsylvania and other states interested in regulatory process reform.

Virginia's approach addresses the two potential failure points in the regulatory process I highlighted above: (1) failure in the design of individual regulations and (2) failure in the management of accumulated regulations. Recognizing the importance of regulatory modernization, Governor Glenn Youngkin on his first day in office issued a call for reducing regulations by 25 percent.[1] Executive Directive Number One created the general framework for achieving that goal.

Roughly six months into his term, Governor Youngkin issued a second pronouncement, Executive Order (EO) Number 19, setting forth in greater detail how Virginia agencies would achieve the administration's regulatory modernization goals.[2] While the EO also makes important contributions on

[1] Commonwealth of Virginia, Executive Directive Number One (2022), "Laying a Strong Foundation for Job Creation and Economic Growth Through Targeted Regulatory Reductions," https://www.governor.virginia.gov/media/governorvirginiagov/governor-of-virginia/pdf/ed/ED-1-Regulatory-Reduction.pdf.

[2] Commonwealth of Virginia, Office of the Governor, Executive Order Number 19 (2022), "Development and Review of State Agency Regulations," https://www.governor.virginia.gov/media/governorvirginiagov/governor-of-virginia/pdf/eo/EO-19-Development-and-Review-of-State-Agency-Regulations.pdf.

transparency and permitting, the specific components of the governor's plan I'll discuss today include the following:

- Requiring all regulations and guidance documents to undergo a full benefit-cost analysis, as well as targeted analyses on their effects on local governments, families, and small businesses
- Reviewing all regulations with the aim of reducing regulatory requirements by at least 25 percent by the end of the administration
- Creating an Office of Regulatory Management (ORM) to oversee all aspects of the Commonwealth's regulatory process

FAILURE POINTS IN THE REGULATORY PROCESS

The first regulatory process failure point that Virginia addressed has to do with crafting new regulations. When an agency is considering a new regulation, the fundamental question to ask is, Does it do more good than harm? Regulatory economic analysis ensures that the answer is yes for *new* regulations.

The second failure point has to do with managing the stock of existing regulations. As of 2022, Virginia regulatory code had 145,519 regulatory restrictions (that is, words that create prohibitions or obligations in the text of regulations themselves). That put Virginia as the 16th most-regulated state. Pennsylvania, for the record, had 166,219 regulatory restrictions on the books in 2022, ranking it as the 11th most-regulated state.

These numbers and rankings have economic significance, as indicated by research on the effects of regulatory accumulation.[3] The two main research themes have been (1) the effects on economic growth and (2) the regressive nature of regulatory accumulation. Regarding the first theme, it has been shown that the effect of cumulated regulations on economic growth is enormous. Best estimates of the negative effect on growth range from 0.8 percentage point to two percentage points lost. Considering that historic yearly economic growth rates have been approximately two to three percent, losing one to two percentage points from the growth rate means the economy is substantially smaller than it could be.

But the studies also reveal an opportunity. A recent study of the province of British Columbia found that by reducing accumulated regulations by about 40 percent, the province's economy increased its growth rate by nearly one percentage point.[4]

[3] Bentley Coffey, Patrick A. McLaughlin, and Pietro Peretto, "The Cumulative Cost of Regulations," *Review of Economic Dynamics*, No. 38 (2020): 1–21; Dustin Chambers, Patrick A. McLaughlin, and Tyler Richards, "Regulation, Entrepreneurship, and Firm Size," *Journal of Regulatory Economics* 61, no. 2 (2022): 108-134; Dustin Chambers, Patrick A. McLaughlin, and Laura Stanley, "Regulation and Poverty: An Empirical Examination of the Relationship Between the Incidence of Federal Regulation and the Occurrence of Poverty Across the US States," *Public Choice* 180, no. 1-2 (2019): 131-144; Dustin Chambers, Patrick A. McLaughlin, and Laura Stanley, "Barriers to Prosperity: The Harmful Impact of Entry Regulations on Income Inequality" *Public Choice* 180, No. 1-2 (2019): 165-190; and Sanchari Choudhury, "The Causal Effect of Regulation on Income Inequality Across the U.S. States," *European Journal of Political Economy* (forthcoming).

[4] Bentley Coffey and Patrick A. McLaughlin, "Regulation and Economic Growth: Evidence from British Columbia's Experiment in Regulatory Budgeting," (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, May 2021).

The second theme is the regressive effects of regulatory accumulation. These range from the inflationary effects of regulations and how those disproportionately fall on low-income households to evidence that higher levels of regulation actually *cause* greater income inequality. Small businesses in particular have found it exceedingly difficult to navigate the modern regulatory thicket, with the result that many businesses simply close down, or never formally launch, rather than incur the considerable costs of achieving full regulatory compliance or run the risk of violating the law.

Virginia has addressed these failure points by applying a streamlined analysis to all new regulations and creating incentives for agencies to review existing regulations 1) to ensure they are delivering the intended public benefit and 2) to find ways to curtail those that are not.

STREAMLINED REGULATORY ANALYSIS

The economic analysis of a new regulation typically entails an attempt to estimate its likely benefits and costs. In Virginia, however, this approach was not comprehensive. For instance, prior to Virginia's regulatory reforms, Virginia agencies considered specific aspects of rules' economic effects without conducting a comprehensive benefit-cost analysis.

Virginia now requires agencies to conduct a full economic analysis of all regulatory actions, which includes a complete benefit-cost analysis as well as an analysis of the regulation's effects on local governments, families, and small businesses. While this may sound expensive, Virginia's newly created Office of Regulatory Management provides streamlined guidance on how to conduct an economic analysis of a new regulation—guidance so straightforward, even a two-armed economist could follow it. The ORM reviews all agency regulations and the associated economic analyses, thereby providing not only suggestions for improvement but also accountability.

Agency analyses must follow four key steps:

- Identify the underlying problem.
- Identify a reasonable range of alternative approaches.
- Monetize the benefits and costs associated with each alternative.
- Select the most attractive alternative among the options considered.

RED TAPE REDUCTION

Virginia also implemented a form of regulatory budget designed to reduce the harms of regulatory accumulation. As did some other state governments (as well as some provinces of Canada), Virginia adopted a 25 percent regulatory reduction target, and a focus on regulatory requirements (including "musts" and "shalls") rather than the total number of regulations or their cumulative costs. Virginia differs from other states in that the ORM provides agencies with guidance on how to achieve reduction-target goals and receive partial credit for showing how their actions produce cost savings.

Virginia's approach to achieving the reduction target requires agencies to first complete an inventory of restrictions, not only in the regulations themselves but also in guidance materials and documents incorporated by reference. Agencies are then directed to focus on "discretionary" restrictions, as opposed to those that are mandated by statute. Finally, agencies are charged with finding ways to reduce discretionary requirements without undermining public-benefits goals such as health and safety. Notably, agencies can meet the 25 percent goal by reducing burdens as well as by striking requirements. For example, reducing the training hours required to become a cosmetologist from 1,500 to 1,000 does not technically eliminate any requirement, but substantially reduces the burden.

Undergirding these reforms is the principle of transparency. All regulations are now available on the Virginia Regulatory Town Hall website, and the regulatory reform process has been designed to be clear to the public and to facilitate public input.

Virginia's work remains in progress, and its commitment to transparency means first-year results will be available soon. Moreover, the economics research I mentioned earlier lets me predict that if Virginia does achieve its goal of reducing red tape by at least 25 percent within three years, the economic benefits will be substantial.

Pennsylvania, with even more regulations than Virginia, stands to potentially gain even more if it were to adopt similar measures.