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BLUEPRINT FOR REGULATORY REFORM

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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 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:

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[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

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[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

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[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 Morrall, "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

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[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

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[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

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[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.

Rules Trigger Unfunded Mandates Reform Act (Washington, DC: GPO, February 15, 2011), http://www.gao.gov/new.items/d11385t.pdf.

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

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[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

<u>Goal</u>: 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.

<u>Drawbacks</u>: 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]

<u>Implementation</u>: (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

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[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

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[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.

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[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

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[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

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[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.minlnv.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://opencrs.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	*Reward or punish agencies, programs, people*	
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	*Cut regulations*	
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	*Introduce more checks and balances into the system*	

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
ANALYSIS	*Increase the quality and use of regulatory analysis beyond what is required now by executive order*	
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
PROCESS	*Improve rulemaking process by opening it up to challenge*	
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