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TESTIMONY

COMPREHENSIVE REGULATORY IMPACT ANALYSIS: THE CORNERSTONE OF REGULATORY REFORM

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Good morning Chairman Johnson, Ranking Member Carper, and members of the committee. Thank you for inviting me to testify today.

I am an economist and research fellow at the Mercatus Center, a 501(c)(3) research, educational, and outreach organization affiliated with George Mason University in Arlington, Virginia. I've previously served as a senior economist at the Joint Economic Committee and as deputy director of the Office of Policy Planning at the Federal Trade Commission. My principal research for the last 25 years has focused on the regulatory process, government performance, and the effects of government regulation. For these reasons, I'm delighted to testify on today's topic.

I work at a university. That means I'm for knowledge and against ignorance. I think that regulators have a moral responsibility to make decisions about regulations based on actual knowledge of a regulation's likely effects—not just on hopes, intentions, or wishful thinking. A decision maker's failure or refusal to acquire this knowledge before making decisions is a willful choice to act based on ignorance.

Executive orders, and sometimes laws, seek to encourage regulatory agencies to act based on knowledge rather than ignorance. For more than three decades, presidents of both political parties have instructed executive branch agencies to conduct regulatory impact analysis when issuing significant regulations. Some independent agencies, such as the Securities and Exchange Commission, are required by law to assess the economic effects of their regulations. Executive orders and laws requiring economic analysis of regulations reflect a bipartisan consensus that economic analysis should inform, but not dictate, regulatory decisions. A good regulatory impact analysis also lays the groundwork for an effective retrospective review of the regulation by identifying the outcomes that should be tracked in order to assess whether the regulation accomplishes the desired goals.

Unfortunately, agencies' regulatory impact analyses are not nearly as informative as they ought to be, and there is often scant evidence that agencies have utilized any part of the analysis in making decisions. These problems have persisted through multiple administrations of both political parties. The problem is institutional, not partisan or personal. Improvement in the quality and use of regulatory impact analysis will likely occur only as a result of legislative reform of the regulatory process. To achieve improvement, all agencies should be required to conduct thorough and objective regulatory impact analysis for major regulations and to explain how the results of the analysis informed their decisions.

Let me elaborate on each of these points.

WHY REGULATORY IMPACT ANALYSIS IS NECESSARY

We expect federal regulation to accomplish a lot of important things, such as protecting us from financial fraudsters, preventing workplace injuries, preserving clean air, and deterring terrorist attacks. Regulation also requires sacrifices; there is no free lunch. Depending on the regulation, consumers may pay more, workers may receive less, our retirement savings may grow more slowly due to reduced corporate profits, and we may have less privacy or less personal freedom. Regulatory impact analysis is the key tool that makes these tradeoffs more transparent to decision makers. So, understanding the effects of regulation has to start with sound regulatory impact analysis.

A thorough regulatory impact analysis should do four things:

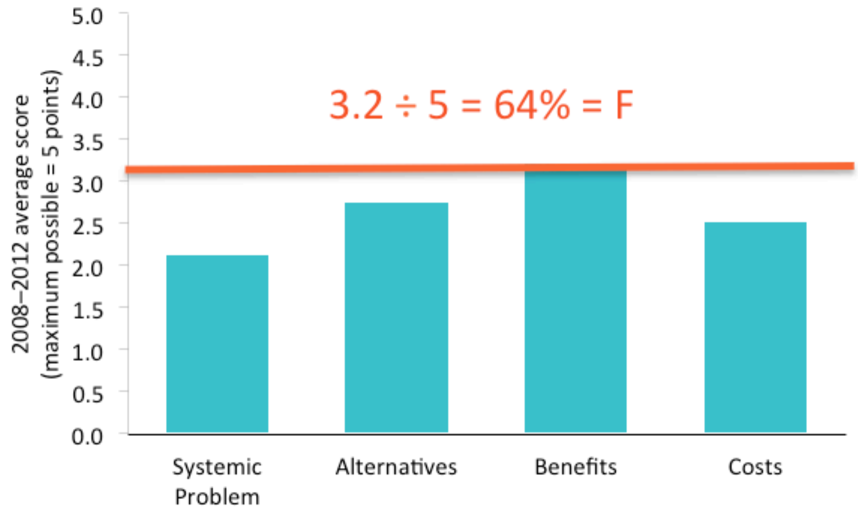
1. Assess the nature and significance of the problem that the agency is trying to solve, so the agency knows whether there is a problem that could be solved through regulation. If there is, the agency can tailor a solution that will effectively solve the problem.
2. Identify a wide variety of alternative solutions.
3. Define the benefits that the agency seeks to achieve in terms of ultimate outcomes that affect citizens' quality of life, and assess each alternative's ability to achieve those outcomes.
4. Identify the good things that regulated entities, consumers, and other stakeholders must sacrifice in order to achieve the desired outcomes under each alternative. In economics jargon, these sacrifices are known as "costs," but just like benefits, costs may involve far more than monetary expenditures.

Without all this information, regulatory decisions are likely to be based on hopes, intentions, and wishful thinking rather than on reality. Regulators should not adopt a regulation without knowing whether it will solve a significant problem at a reasonable cost. Given the enormous influence regulation has on our day-to-day lives, decision makers have a moral responsibility to act based on knowledge of regulation's likely effects, not just good intentions.

High-quality regulatory impact analysis is also essential for effective congressional oversight.

Mechanisms that provide for congressional approval or disapproval of individual regulations, such as the Congressional Review Act or the proposed REINS Act, presume that members of Congress have thorough knowledge about the root cause of the problem that the regulation seeks to solve and about the benefits and costs of alternatives. After all, how can legislators make a responsible decision to approve or disapprove a regulation if they do not know whether the regulation solves a real problem or whether there is a better alternative solution than the proposed regulation? Oversight of existing regulatory programs also presumes that congressional committees have good information about the outcomes that the regulation is intended to achieve and the results that are expected. A high-quality regulatory impact analysis provides that information.

Figure 1. Average Scores for Major Elements of Regulatory Impact Analysis for 108 Economically Significant Regulations, 2008–2012



Source: Author's calculations based on data available at www.mercatus.org/reportcard.

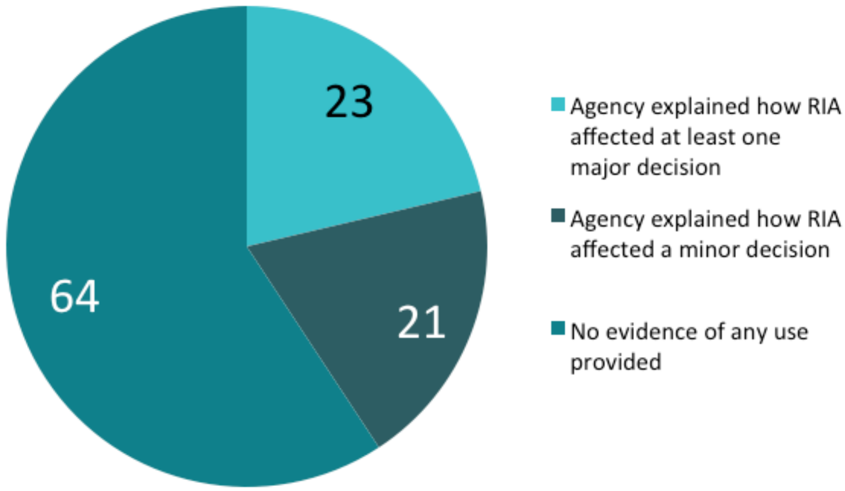
SHORTCOMINGS IN THE QUALITY AND USE OF REGULATORY IMPACT ANALYSIS

Scholarly research demonstrates that regulatory impact analysis often falls short of the standards articulated in executive orders and in guidance from the Office of Management and Budget (OMB). More often than not, agencies appear not to use regulatory impact analyses to inform major decisions. Instead, regulatory impact analyses have often seemed to be advocacy documents written to justify decisions that were already made.[1]

The Mercatus Center's Regulatory Report Card provides some of the most recent evidence on the quality and use of regulatory impact analysis.[2] The Regulatory Report Card is a qualitative evaluation of both the quality and use of regulatory analysis in federal agencies. The scoring process uses 12 criteria based on Executive Order 12866 and OMB guidance to agencies.[3] For each criterion, trained evaluators assign a score ranging from 0 (no useful content) to 5 (comprehensive analysis with potential best practices).[4] The Report Card assesses how well a notice of proposed rulemaking and the accompanying regulatory impact analysis complies with key principles in Executive Order 12866. The scores do not assess whether the evaluators agree with the results of the analysis or believe the regulation is a good idea.

1. Richard Williams, "The Influence of Regulatory Economists in Federal Health and Safety Agencies" (Working Paper No. 08-15, Mercatus Center at George Mason University, July 2008), http://mercatus.org/publication/influence-regulatory-economists-federal-health-and-safety-agencies; Wendy E. Wagner, "The CAIR RIA: Advocacy Dressed Up as Policy Analysis," in *Reforming Regulatory Impact Analysis*, ed. Winston Harrington et al. (Washington, DC: Resources for the Future, 2009), 57.
2. The Report Card methodology and 2008 scoring results are in Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008," *Risk Analysis* 32, no. 5 (May 2012): 855–80. Scores for all regulations evaluated in 2008 and subsequent years are available at www.mercatus.org/reportcard. For a summary of the 2008–2012 findings, see Jerry Ellig and Sherzod Abdukadirov, "Regulatory Analysis and Regulatory Reform: An Update" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, January 2015), http://mercatus.org/publication/regulatory-analysis-and-regulatory-reform-update.
3. Executive Order No. 12866, 58 Fed. Reg. 51735–44 (1993). President Obama reaffirmed Executive Order 12866 in Executive Order 13563, "Improving Regulation and Regulatory Review," 76 Fed. Reg. 3821–23 (2011).
4. For the first several years, the evaluators were senior Mercatus Center regulatory scholars and graduate students trained in regulatory impact analysis. Since 2010, we have developed a nationwide team of economics professors who serve as evaluators in conjunction with senior Mercatus Center regulatory scholars. Biographical information on current evaluators is available at www.mercatus.org/reportcard.

Figure 2. Use of Regulatory Impact Analyses in 108 Economically Significant Regulations, 2008–2012



Source: Author's calculations based on data available at www.mercatus.org/reportcard.

The online Report Card database now includes evaluations of every economically significant prescriptive regulation proposed between 2008 and 2012—a total of 108 regulations.[5] Figure 1 shows average scores for the four major elements of regulatory impact analysis. None of the average scores exceed 3.2 out of 5 possible points. If I were assigning letter grades, every one of these regulatory impact analyses would earn an F.

The broadest Report Card criterion, which measures use of analysis, asks whether the agency claimed to use or appeared to use any part of the analysis to guide any of the decisions. As figure 2 demonstrates, agencies often fail to provide any significant evidence that any part of the regulatory impact analysis helped inform their decisions. Perhaps the analysis affects decisions more frequently than these statistics suggest, but agencies fail to document this, either in the notice of proposed rulemaking or in the regulatory impact analysis. If the analyses are informing agency decisions more than documented, then at a minimum there is a significant transparency problem.

For each Report Card criterion, we have found a few examples that demonstrate reasonably good quality or use of analysis. These are documented in past testimony and in a series of short Mercatus on Policy publications.[6] But best practices are not widespread.

Unfortunately, these less-than-stellar Report Card results are consistent with prior published research on regulatory impact analysis. Case studies document instances in which regulatory impact analysis helped improve

5. "Prescriptive" regulations are what most people think of when they think of regulations: they mandate or prohibit certain activities. This is distinct from budget regulations, which implement federal spending programs or revenue collection measures. The Report Card evaluated budget regulations in 2008 and 2009, then discontinued evaluating budget regulations in subsequent years because it was clear that the budget regulations have much lower-quality analysis. See Patrick A. McLaughlin and Jerry Ellig, "Does OIRA Review Improve the Quality of Regulatory Impact Analysis? Evidence from the Bush II Administration," *Administrative Law Review* 63 (2011): 179–202; Jerry Ellig, Patrick A. McLaughlin, and John F. Morrall III, "Continuity, Change, and Priorities: The Quality and Use of Regulatory Analysis Across U.S. Administrations," *Regulation & Governance* 7 (2013): 153–73.

6. Jerry Ellig, "Look Before You Leap: Improving Pre-Proposal Regulatory Analysis," Testimony before the Committee on the Judiciary, Subcommittee on the Courts, Commercial, and Administrative Law, US House of Representatives (March 29, 2011); Jerry Ellig and James Broughel, "Regulation: What's the Problem?" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, November 2011); Jerry Ellig and James Broughel, "Regulatory Alternatives: Best and Worst Practices" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, February 2012); Jerry Ellig and James Broughel, "Baselines: A Fundamental Element of Regulatory Impact Analysis" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, June 2012).

regulatory decisions by providing additional options that regulators could consider or by unearthing new information about benefits or costs of particular modifications to the regulation.[7] But studies by the Government Accountability Office (GAO) and scholarly research reveal that in many cases, regulatory impact analyses are not sufficiently complete to serve as a guide for agency decisions. The quality of analysis varies widely, but even the most elaborate analyses have problems.[8] Surveying the scholarly evidence as of 2008, Robert Hahn and Paul Tetlock concluded that economic analysis has not had much impact, and the general quality of regulatory impact analysis is low.[9] The Mercatus Center's Regulatory Report Card suggests that matters have not improved since then.

What I have just said may seem to contradict a GAO report released in September 2014 that was prepared at the request of Senator Johnson and Senator Warner.[10] The GAO report defined four major elements of regulatory analysis: discussion of the need for the regulatory action, analysis of alternatives, and assessment of both the benefits and the costs of the regulation. For economically significant regulations issued between July 1, 2011, and June 30, 2013, the GAO found that agencies always included a statement of the regulation's purpose, discussed alternatives 81 percent of the time, always discussed benefits and costs, provided a monetized estimate of costs 97 percent of the time, and provided a monetized estimate of benefits 76 percent of the time. This sounds pretty good.

A closer look at the report, however, reveals that GAO did not evaluate the quality of any of these aspects of agencies' analysis. The report notes, "[O]ur analysis was not designed to evaluate the quality of the cost-benefit analysis in the rules. The presence of all key elements does not provide information regarding the quality of the analysis, nor does the absence of a key element necessarily imply a deficiency in a cost-benefit analysis."[11] For example, GAO checked to see whether an agency included a statement of the purpose of the regulation, but it apparently accepted a statement that the regulation is required by law as a sufficient statement of purpose.[12] Citing a statute is not the same thing as articulating a goal or identifying the root cause of the problem that an agency seeks to solve. Similarly, an agency can provide a monetary estimate of some benefits or costs without necessarily addressing all major benefits or costs that the regulation is likely to create. GAO notes that it did not ascertain whether agencies addressed all relevant benefits or costs.[13]

7. Winston Harrington, Lisa Heinzerling, and Richard D. Morgenstern, eds., *Reforming Regulatory Impact Analysis* (Washington, DC: Resources for the Future, 2009); Richard D. Morgenstern, ed., Economic Analyses at EPA: *Assessing Regulatory Impact* (Washington, DC: Resources for the Future, 1997); Thomas O. McGarity, *Reinventing Rationality: The Role of Regulatory Analysis in the Federal Bureaucracy* (New York: Cambridge University Press, 1991).
8. See Art Fraas and Randall Lutter, "The Challenges of Improving the Economic Analysis of Pending Regulations: The Experience of OMB Circular A-4," *Annual Review of Resource Economics* 3, no. 1 (2011): 71–85; Jamie Belcore and Jerry Ellig, "Homeland Security and Regulatory Analysis: Are We Safe Yet?," *Rutgers Law Journal* 40, no. 1 (Fall 2008): 1–96; Robert W. Hahn, Jason K. Burnett, Yee-Ho I. Chan, Elizabeth A. Mader, and Petrea R. Moyle, "Assessing Regulatory Impact Analyses: The Failure of Agencies to Comply with Executive Order 12,866," *Harvard Journal of Law and Public Policy* 23, no. 3 (2000): 859–71; Robert W. Hahn and Patrick M. Dudley, "How Well Does the U.S. Government Do Cost–Benefit Analysis?," *Review of Environmental Economics and Policy* 1, no. 2 (2007): 192–211; Robert W. Hahn and Robert E. Litan, "Counting Regulatory Benefits and Costs: Lessons for the U.S. and Europe," *Journal of International Economic Law* 8, no. 2 (2005): 473–508; Robert W. Hahn, Randall W. Lutter, and W. Kip Viscusi, *Do Federal Regulations Reduce Mortality?* (Washington, DC: AEI-Brookings Joint Center for Regulatory Studies, 2000); Government Accountability Office, *Regulatory Reform: Agencies Could Improve Development, Documentation, and Clarity of Regulatory Economic Analyses*, Report GAO/RCED-98-142 (May 1998); Government Accountability Office, *Air Pollution: Information Contained in EPA's Regulatory Impact Analyses Can Be Made Clearer*, Report GAO/RCED 97-38 (April 1997).
9. Robert W. Hahn and Paul C. Tetlock, "Has Economic Analysis Improved Regulatory Decisions?," *Journal of Economic Perspectives* 22, no. 1 (Winter 2008): 67–84.
10. Government Accountability Office, "Federal Rulemaking: Agencies Included Key Elements of Cost-Benefit Analysis, but Explanations of Regulations' Significance Could Be More Transparent," Report GAO-14-714 (September 2014).
11. Ibid., 4.
12. Ibid., 22.
13. Ibid., 23.

IMPROVEMENT IN THE QUALITY AND USE OF REGULATORY IMPACT ANALYSIS REQUIRES REFORM OF THE REGULATORY PROCESS

The problems identified by the Report Card have occurred under both President Bush and President Obama. An econometric analysis that controls for other factors affecting the quality and use of analysis finds that there is no statistically significant difference in Report Card scores between the Bush and Obama administrations, although Bush administration regulations that cleared review by the Office of Information and Regulatory Affairs (OIRA) after June 1, 2008, tended to have lower Report Card scores.[14] Previous research by other scholars also finds little variation in the quality of regulatory impact analysis across administrations of different parties.[15] Another consistent—but disturbing—pattern is that administrations of both parties appear to require less thorough analyses from agencies that are more central to the administration's policy priorities. The Bush administration, for example, permitted the Department of Homeland Security to proceed with a number of regulations that were accompanied by very incomplete regulatory impact analysis; the Obama administration did likewise with the first major regulations implementing the Patient Protection and Affordable Care Act.[16] This same pattern appears to occur with other agencies.[17]

The persistence of mediocre regulatory impact analysis across administrations is an institutional problem, not a personal or partisan problem. Executive branch agencies often produce mediocre regulatory analysis in spite of executive orders and OIRA review. This happens for two related reasons. First, since executive orders are the president's instructions to agencies, agencies can ignore the analytical requirements when the White House decides that other priorities take precedence. Second, OIRA review essentially means that the administration reviews its own regulations. Since OIRA's decision to block a regulation can be appealed to the vice president, the OIRA administrator can credibly threaten to block a regulation only if he knows he can win the ensuing political argument within the administration.

Scholarly research has found that many independent agencies conduct even less thorough economic analysis than executive branch agencies.[18] Independent agencies are not currently subject to the executive orders on regulatory analysis and review. Some, such as the Securities and Exchange Commission, are required by law to conduct economic analysis when determining whether their regulations are in the public interest. Others have no such requirement.

A statutory requirement that all regulatory agencies conduct regulatory impact analysis and explain how it informed their decisions, combined with judicial review to ensure that the analysis and explanation meet minimum quality standards, would provide a clear legal requirement and a credible enforcement mechanism. Courts routinely weigh the strength of conflicting evidentiary claims, guided by statutory language specifying the standards for review. There is no reason courts could not perform the procedural task of checking to see that agencies adequately perform the analysis that the statute instructs them to perform and clearly explain how the analysis affected their decisions about regulations. The Securities and Exchange Commission, for example, has pledged to improve its economic analysis, employing the principles in Executive Order 12866, after losing several court cases due to insufficient analysis.[19]

14. See Ellig et al., "Continuity, Change, and Priorities"; Jerry Ellig, "Midnight Regulation: Decisions in the Dark?" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, August 2012).
15. Hahn and Dudley, "How Well Does the Government Do Cost-Benefit Analysis?"
16. Belcore and Ellig, "Homeland Security and Regulatory Analysis"; Jerry Ellig and Christopher J. Conover, "Presidential Priorities, Congressional Control, and the Quality of Regulatory Impact Analysis: An Application to Health Care and Homeland Security," *Public Choice* 161, no. 3 (2014): 305–20; Christopher J. Conover and Jerry Ellig, "Rushed Regulation Reform" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, January 2012).
17. Ellig et al., "Continuity, Change, and Priorities."
18. Arthur Fraas and Randall L. Lutter, "On the Economic Analysis of Regulations at Independent Regulatory Commissions," *Administrative Law Review* 63 (2011): 213–41; Jerry Ellig and Hester Peirce, "SEC Regulatory Analysis: A Long Way to Go and a Short Time to Get There," Brooklyn Journal of Corporate, Financial & Commercial Law 8, no. 2 (Spring 2014): 361–437.
19. See Ellig and Peirce, "SEC Regulatory Analysis."

To enforce the law, judges would not need to engage in benefit-cost balancing nor would they need to second-guess agency policy decisions. They would merely need to check that an agency's analysis covered the topics specified in the law (such as analysis of the systemic problem, development of alternatives, and assessment of benefits and costs of alternatives), ensure that the analysis included the quality of evidence required by the legislation, and ensure that the agency explained how the results of the analysis affected its decisions.

Debates over regulatory process reform often take a distinctly partisan tone. But the fundamental conflict in the debate over regulatory process reform is not Republicans versus Democrats, liberals versus conservatives, or even business versus the public. It's knowledge versus ignorance. Decision makers should choose knowledge over ignorance.

Thank you for your time, and I look forward to your questions.

ADDITIONAL READING

Jerry Ellig. *Ten Principles for Better Regulation*. Arlington, VA: Mercatus Center at George Mason University, 2013. http://mercatus.org/publication/ten-principles-better-regulations.

Jerry Ellig. "Regulatory Impact Analysis: Four Decades of Foibles." Mercatus on Policy, Mercatus Center at George Mason University, January 2015. http://mercatus.org/publication/regulatory-impact-analysis-four-decades-foibles.

Jerry Ellig and Sherzod Abdukadirov. "Regulatory Analysis and Regulatory Reform: An Update." Mercatus on Policy, Mercatus Center at George Mason University, January 2015. http://mercatus.org/publication/regulatory-analysis-and-regulatory-reform-update.

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John Morrall and James Broughel. *The Role of Regulatory Impact Analysis in Federal Rulemaking*. Arlington, VA: Mercatus Center at George Mason University, 2014. http://mercatus.org/publication/role-regulatory-impact-analysis-federal-rulemaking.