Comprehensive Regulatory Reform

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MERCATUS POLICY PRIMER

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Americans expect federal regulation to accomplish many important things, such as protecting the country from financial fraudsters, preventing workplace injuries, preserving clean air, and deterring terrorist attacks. Regulation also requires tradeoffs—there is no such thing as a free lunch. Depending on the regulation, consumers may pay more, workers may receive less, retirement savings may grow more slowly, and Americans may have less privacy or personal freedom. In a democratic society, these tradeoffs require government regulators to carefully and completely disclose the likely effects of individual rules and of the regulatory system as a whole. In this and other ways, our regulatory system has fallen short. Congress needs to address the shortcomings of this system with comprehensive regulatory reform.

During the past four decades, a bipartisan consensus has emerged reflecting the commonsense notion that regulations should solve real problems at an acceptable cost.[1] Unfortunately, this does not always occur, because the current regulatory process is broken. Regulatory legislation is often enacted, and regulations are adopted, with little or no evidence that they will effectively solve the problems they are intended to address. Policymakers at best view each regulation in isolation, paying little attention to the long-term buildup of rules—many of which are likely outdated or ineffective—or to how that regulatory accumulation affects Americans. Formal processes for retrospective analysis of rules, which would assess the actual results of individual rules or regulatory programs after they are implemented, have not been institutionalized in the United States.

1. Note that we did not say "monetized benefits must exceed monetized costs." That is a less universally accepted decision-making criterion. But there does appear to be a bipartisan consensus supporting the requirement in President Clinton's Executive Order 12866, which governs regulatory analysis and review in the executive branch to this day. Executive Order 12866 states that an agency should not regulate unless the benefits of the regulation justify the costs. This allows decision makers to take benefits and costs into account while also considering other values that may be neither benefits nor costs.

This buildup of unexamined regulations has serious consequences for Americans' standard of living. Over time, regulatory agencies have incentives to create more rules, and there is no formal culling process to modify or eliminate obsolete, duplicative, ineffective, or overly burdensome regulations. In 1950, for example, the *Code of Federal Regulations* (CFR)—the set of books that contains the entirety of regulations that are in effect at the time of publication—contained 9,745 pages spread over 47 volumes. By 2016, the CFR totaled nearly 180,000 pages in more than 200 volumes.

This accumulation of regulation represents a growing but hidden tax that hinders innovation and entrepreneurship, negatively affects wage growth in some occupations, and disproportionately harms low- and middle-income households. The perpetual accumulation of regulation slows annual GDP growth rates by nearly one percentage point.[2] Reasonable people can have different opinions about how much GDP they are willing to sacrifice to obtain various regulatory protections, but a regulatory system that allows decision makers to proceed in ignorance of the tradeoffs can hardly be said to promote the public interest.

The American people deserve a regulatory system that solves real problems at a reasonable cost. The current system has ingrained institutional flaws that often prevent this from happening. This primer will provide an overview of the problems with the federal regulatory system and identify an integrated set of solutions to accomplish comprehensive regulatory reform. First, this primer explains why some regulations are ineffective and documents the economic costs of regulatory accumulation. Next, the primer explains current problems with the regulatory process, from the very first step—overly broad or vague authorizing legislation—to the lack of retrospective analysis and proper oversight by Congress. Finally, the primer provides a roadmap for comprehensive regulatory reform at every step in the process, beginning and ending with congressional action.

REGULATIONS DO NOT ALWAYS SOLVE PROBLEMS

Federal regulators often have good intentions when proposing new regulations, such as increasing safety or protecting the environment. However, good intentions don't guarantee good policy.

Consider, for example, the Affordable Care Act regulation that defines what counts as a "grandfathered" health plan that would have been exempt

2. Bentley Coffey, Patrick A. McLaughlin, and Pietro Peretto, "The Cumulative Cost of Regulations" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2016).

from the requirement to include some of the new expensive coverages mandated under the law.[3] This is the regulation that was meant to fulfill the pledge, "If you like your health care plan, you'll be able to keep your health care plan."[4] Regulators had to define what kinds of changes a plan sponsor could make and still have it be considered the same plan. The regulation was written very narrowly; for example, it permitted some changes in copayments but prohibited any changes in coinsurance. The regulators considered but declined to adopt a more flexible "actuarial equivalence" standard that would have considered a health plan the same as long as it delivered the same dollar value of benefits to participants.[5]

Because the regulation was written narrowly, modest and routine changes prevented many plans from being grandfathered. Consequently, the Affordable Care Act regulation failed to accomplish the objective of allowing many individuals to keep their old health insurance plans—thus disrupting the health insurance market and creating significant political controversy.

Sometimes an agency fails to provide evidence that a regulation will solve a problem. In 2011, for example, the Securities and Exchange Commission (SEC) adopted a regulation that excludes the value of an investor's primary residence when determining whether the individual meets the $1 million net worth requirement to be considered an "accredited investor" who can purchase securities that are not registered with the SEC. The change was required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), but the law also allowed the SEC to adjust the definition of "accredited investor" as it "may deem appropriate for the protection of investors, in the public interest, and in light of the economy."[6]

The SEC could have examined whether individuals whose home values had recently put them above the $1 million threshold actually invested in unregistered securities and suffered any harm from doing so. It also could have considered whether a net worth test is sufficient to protect investors from

3. Internal Revenue Service, Employee Benefits Security Administration, and Office of Consumer Information and Insurance Oversight, Group Health Plans and Health Insurance, Interim Final Rules for Group Health Plans and Health Insurance Coverage Relating to Status as a Grandfathered Health Plan under the Patient Protection and Affordable Care Act, 75 Fed. Reg. 34548 (June 17, 2010).
4. Glenn Kessler, "Obama's Pledge that 'No One Will Take Away' Your Health Plan," *Washington Post*, October 30, 2013.
5. Christopher J. Conover and Jerry Ellig, "Beware the Rush to Presumption, Part A: Material Omissions in Regulatory Analyses for the Affordable Care Act's Interim Final Rules" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2012), 20.
6. 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 (2014): 410.

making bad investment decisions, or whether a financial sophistication test could achieve that objective more effectively.[7] The SEC conducted no such analyses, so it is not clear whether the regulation solves an actual problem or does so in the most effective way.

There are also regulations that fail to target the principal cause of the problem. In 2015, the FDA finalized a regulation requiring firms that produce, process, pack, or handle animal food to have processes and procedures in place to ensure that animal food is as safe as human food.[8] The FDA's final regulatory impact analysis (RIA) estimated the regulation would generate $10.1 million to $138.8 million in benefits annually by protecting humans and pets from contaminated food. The FDA presented no empirical evidence of benefits for livestock, relying instead on a survey of experts who offered their opinions on how effective the rule would be in preventing contamination of livestock feed.[9]

To solve the problem that was actually documented by empirical evidence, the FDA could have applied the regulation only to pet food, rather than all animal feed—a change that would have substantially reduced costs because it would have covered a much smaller number of firms and facilities. Or the FDA could have considered alternatives, such as improving consumer education to encourage people to wash their hands after handling animals and their food. The agency missed these alternatives because of incomplete analysis. The preliminary RIA, conducted while the FDA was developing the regulation, did not even attempt to estimate the benefits or identify their sources.[10]

These regulations are not isolated examples.[11] The Mercatus Center at George Mason University's Regulatory Report Card project assessed the quality

7. Ibid., 410–11.

8. Food and Drug Administration, Current Good Manufacturing Practice and Hazard Analysis and Risk-Based Preventive Controls for Food for Animals, 80 Fed. Reg. 56170 (September 15, 2015).

9. Food and Drug Administration, Current Good Manufacturing Practice, Hazard Analysis and Risk-Based Preventive Controls for Food for Animals, Final Regulatory Impact Analysis, Docket No. FDA-2011-N-0922 (September 15, 2015), 31–51.

10. Jerry Ellig and Richard Williams, "FDA's Animal Food Regulation Is for the Birds," *Regulation* 37, no. 2 (2014): 54–61.

11. 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 (2008): 1–96; Robert W. Hahn et al., "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 (2001): 859–71; Robert W. Hahn and Patrick Dudley, "How Well Does the Government Do Cost–Benefit Analysis?," *Review of Environmental Economics and Policy* 1, no. 2 (2007): 192–211; Robert W. Hahn and Robert 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,

of regulatory impact analyses accompanying 130 economically significant prescriptive regulations proposed between 2008 and 2013.[12] Forty-eight percent of these regulations were accompanied by no significant evidence demonstrating the existence, size, or cause of the problem the regulation sought to solve.[13] Just 22 percent of the regulations were accompanied by reasonably thorough evidence that the regulation would likely achieve the desired outcomes.[14]

It appears that for the majority of regulations assessed in the Report Card, the benefits are promised but not demonstrated to be likely to come to fruition. And all these regulations were anticipated to have economic impacts exceeding $100 million annually. Surely regulations of such size and scope should be based on clear evidence that they will deliver positive outcomes for citizens—not just good intentions.

THE ECONOMIC PROBLEMS CREATED BY REGULATORY ACCUMULATION

The political system in the United States typically reacts to major events—perceived crises, new technologies, accounting scandals, and the like—by creating new laws, regulatory agencies, and regulations. Dodd-Frank, enacted in 2010 in response to the financial crisis of 2008, is a recent example of such a response. In the sense that Dodd-Frank has caused and will continue to cause the creation of new regulations, it is no different than any other act of Congress prescribing goals and duties to regulatory agencies.[15]

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," May 1998; Government Accountability Office, "Air Pollution: Information Contained in EPA's Regulatory Impact Analyses Can Be Made Clearer," April 1997.

12. Economically significant regulations are those that have costs or other economic effects that are estimated to exceed $100 million annually or that meet other criteria specified in Executive Order 12866, which governs regulatory analysis and review for executive branch agencies. Prescriptive regulations mandate or prohibit activities. See Jerry Ellig and Patrick A. McLaughlin, "The Quality and Use of Regulatory Impact Analysis in 2008," *Risk Analysis* 32, no. 5 (2012): 855–80.

13. Jerry Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis: The Mercatus Center's Regulatory Report Card, 2008–2013" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2016), 21.

14. Ibid., 23.

15. McLaughlin and Greene estimated that Dodd-Frank would cause regulatory restrictions targeting the financial industry to increase by 32 percent, once all agency rulemakings stemming from the act were finalized. Patrick A. McLaughlin and Robert Greene, "Dodd-Frank's Regulatory Surge: Quantifying Its Regulatory Restrictions and Improving Its Economic Analyses" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, February 2014).

Conversely, there is no mechanism built into the regulatory system for the removal of obsolete, inefficient, redundant, or otherwise undesirable regulations. The result is a consistent accumulation of federal regulations, which over time has facilitated the accumulation of a vast stock of regulations. In recent years, agencies have annually published between 2,500 and 4,500 new rules.[16] The *Code of Federal Regulations* now contains more than one million individual restrictions on Americans' behavior.[17]

As the quantity and scope of regulations grow, so does the degree to which they affect the economy. Regulatory accumulation can hinder technological progress and other drivers of productivity growth, thereby slowing economic growth over time and reducing the ability of businesses and workers alike to contribute to the economy. One recent study found that as regulations accumulated between 1980 and 2012, they slowed US economic growth by nearly one percentage point per year—primarily by distorting and deterring the business investments that normally lead to increased productivity.[18] Had the amount of regulation remained at its 1980 level, 2012 GDP would have been about $4 trillion—or 25 percent—higher than it was, which translates to a loss of about $13,000 for every person in the United States. A similar study published in 2013 went even further back in time, finding that the accumulation of regulation since 1949 may have slowed annual economic growth by as much as two percentage points on average.[19] A 2005 World Bank study found that an increase of 10 percentage points in a country's regulatory burden slows the annual growth rate of each citizen's personal income by one-half of a percentage point.[20]

Moreover, the burden of regulatory accumulation is not simply borne by businesses; it also imposes higher costs on the people those businesses serve, especially low-income households.[21] When regulations cause the prices of goods and services to increase, lower-income households have to make a choice: they may

16. Wayne Crews and Ryan Young, "The Towering Federal Register," *Daily Caller*, May 21, 2014.
17. Omar Al-Ubaydli and Patrick A. McLaughlin, "RegData: A Numerical Database on Industry-Specific Regulations for All U.S. Industries and Federal Regulations, 1997–2012," R*egulation & Governance* 11, no. 1 (2017): 109–23.
18. Coffey, McLaughlin, and Peretto, "The Cumulative Cost of Regulations."
19. John W. Dawson and John J. Seater, "Federal Regulation and Aggregate Economic Growth," *Journal of Economic Growth* 18, no. 2 (2013): 137–77.
20. Norman V. Loayza, Ana María Oviedo, and Luis Servén, "The Impact of Regulation on Growth and Informality: Cross-Country Evidence" (World Bank Policy Research Working Paper No. 3623, World Bank, Washington, DC, May 2005), 14–15, tables 2a and 3b. Calculated by setting the governance index at the world median (0.46) using the method of estimation set forth by table 3b, and setting overall regulation to 0.1 to represent an increase of 10 percentage points along the study's index.
21. Diana Thomas, "Regressive Effects of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2012).

stop buying those more expensive goods, buy fewer of them, or substitute other products, if possible. This can have the unintended consequence of preventing lower-income families from purchasing goods or services—such as medical necessities—that would have reduced the risk of accidental death or injury.[22] Regulations can therefore often act like a regressive sales tax.

While the costs of new regulations are borne by everyone through increases in consumer prices, many regulations target small risks or issues relevant only for particular groups. Wealthier households may receive many of the purported benefits of the rules if regulations reflect their risk preferences. For these reasons, some elements of successful regulatory reform could resemble a progressive tax refund.[23]

Regulatory accumulation can also increase income inequality. Sometimes, regulations can make entry into a market more difficult by corralling lower-skilled workers into lower-paying, less regulated fields or forcing them to operate illegally and incur the higher costs of doing so. If entry regulations require expensive education, testing, and fees, workers may choose instead to accept jobs that pay less and don't take full advantage of their skills.[24]

One study shows that an increase in the number of steps necessary to legally open a business is associated with an increase in the inequality of income distribution.[25] The accumulation of regulatory requirements can lead to income inequality because regulations can act as barriers to entry, and the higher those barriers to entry become, the costlier it is for an entrepreneur to start a business. When entrepreneurs cannot legally open a business because of the cost of dealing with regulations, they may abandon their ideas altogether.[26]

Regulatory accumulation may be particularly detrimental to economic prosperity to the extent that it deters entrepreneurship.[27] If larger existing firms

22. Patrick A. McLaughlin, "Regulatory Reform Can Amount to a Progressive Tax Refund, If Done Right" (Testimony before the House Committee on the Judiciary, Mercatus Center at George Mason University, Arlington, VA, March 2, 2015).
23. Ibid.
24. Steven Horwitz, "Breaking Down the Barriers: Three Ways State and Local Governments Can Improve the Lives of the Poor" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2015).
25. Patrick A. McLaughlin and Laura Stanley, "Regulation and Income Inequality: The Regressive Effects of Entry Regulations" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2016).
26. Patrick A. McLaughlin, "Regulations Contribute to Poverty" (Testimony before the House Committee on the Judiciary, Mercatus Center at George Mason University, Arlington, VA, February 24, 2016).
27. James Bailey and Diana Thomas, "Regulating Away Competition: The Effect of Regulation on Entrepreneurship and Employment" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2015).

can overcome the costs of complying with regulations more easily than new, small firms, the startups that often drive innovation and job growth might never emerge. Existing firms can benefit from regulation because it deters new market entrants, while new firms may never get off the ground.

These problems with regulatory accumulation affect the economy overall. For example, there is some evidence that job displacement of any type is very costly for individuals, families, and communities.[28] Agencies ignore the impact of job loss in industries they regulate, as well as other industries not directly regulated. For example, the Environmental Protection Agency found in 2011 that its proposed Toxics Rule would raise the price of electricity by nearly 4 percent, and as a result, higher energy prices would raise prices and reduce sales in 19 associated industries. If the Environmental Protection Agency had carried its analysis further, it would have found that for every job lost in the electrical industry, 11 jobs would have been lost in other industries.[29]

Regulations add to costs, increasing prices for regulated goods and services and reducing the final amounts of these goods and services being bought and sold. As production declines, so does the demand for workers engaged in production. This shrinkage in the size of the market can decrease employment, not only in regulated industries but also in industries downstream that use the now-more-expensive goods and services.[30]

More regulation also leads companies to shift from hiring workers who produce things to hiring workers who perform regulatory compliance, which reduces overall economic productivity.[31] Even if workers displaced by new regulations eventually find new employment, they often face permanent losses in lifetime earnings, which can be as high as almost three years of their previous annual income. This is largely because of skill mismatches between the jobs lost and the new jobs created in the economy.[32]

PROBLEMS WITH THE CURRENT REGULATORY PROCESS

Recognition of the need to revisit existing regulations is neither new nor partisan. Every administration since Jimmy Carter's has undertaken efforts to modify

28. Keith Hall, "The Employment Costs of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2013).
29. Ibid.
30. Ibid.
31. Ibid.
32. Ibid.

or eliminate obsolete, duplicative, ineffective, or inefficient regulations.[33] Despite past administrations' efforts, regulatory accumulation continues to hold back the economy. Congressional oversight of regulatory agencies is more limited than ever, owing to the sheer volume of rules produced.

The current regulatory process has several key gaps that force decision makers to act based on ignorance rather than knowledge. Regulatory agency spending appears in the budget, but because regulations also direct how individuals, organizations, and state and local governments must use their resources, most regulatory costs do not appear as federal outlays. When Congress enacts authorizing legislation or appropriates money to regulatory agencies, it rarely knows either the costs of solving a problem or the likelihood that agencies can effectively solve it. Executive orders require executive branch agencies to estimate the benefits and costs of some regulations when they are proposed, but these requirements do not apply to independent agencies or to the vast majority of regulations issued by executive branch agencies.[34] Even when regulatory agencies produce projections of benefits and costs, the estimates are often seriously incomplete.[35]

Furthermore, there is little follow-up to determine the actual social costs incurred and benefits achieved from either legislation or regulations that legislation authorizes,[36] in spite of legislation that requires federal agencies to report annually on their performance.[37] These "knowledge gaps" in the current regulatory process are found in authorizing legislation, regulation writing, judicial review, retrospective analysis, and congressional oversight, all of which will require substantial reform to solve the problem of regulatory accumulation.

Authorizing Legislation

No agency can issue a regulation unless Congress has enacted legislation that gives it the authority to do so—legislation that either mandates a rule or grants an agency

33. Exec. Order No. 12044, 3 C.F.R. 152 (1978). See also Patrick A. McLaughlin and Richard Williams, "The Consequences of Regulatory Accumulation and a Proposed Solution" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2014).
34. Richard Williams and James Broughel, "OIRA Quality Control Is Missing for Most Regulations," Mercatus Center at George Mason University, October 1, 2014.
35. Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis."
36. Jason J. Fichtner and Patrick A. McLaughlin, "Legislative Impact Accounting: Rethinking How to Account for Policies' Economic Costs in the Federal Budget Process" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2015).
37. Government Performance and Results Act of 1993, Pub. L. No. 103-62 (1994); GPRA Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866 (2011).

discretionary authority.[38] When a bill is proposed, the Congressional Budget Office often "scores" the impact of the bill on federal expenditures. But when Congress considers legislation that authorizes regulation, there is no organized process to ensure that legislators know the root cause of the problem the legislation seeks to solve, the effectiveness of alternative solutions, or the costs of alternative solutions.

For example, a 2016 rule subjecting domestic catfish processing plants to inspections by the US Department of Agriculture was mandated by an amendment tacked onto the 2008 Farm Bill without any committee hearing, floor debate, or scientific finding.[39] The Government Accountability Office, an investigative arm of Congress, concluded that the new catfish regulation "would result in duplication of federal programs and cost taxpayers millions of dollars annually without enhancing the safety of catfish intended for human consumption."[40] Unfortunately, the Government Accountability Office's assessment was conducted after the legislation passed.

Even when Congress conducts hearings on regulatory proposals, the hearings often focus on anecdotal accounts of problems, rather than in-depth investigation of their nature, significance, or whether they are likely to persist.[41] Even when a desired outcome is specified in authorizing legislation, agencies often promulgate regulations without demonstrating—with evidence—that the authorized regulation is in fact likely to accomplish the outcome. Good intentions alone are assumed to deliver the desired outcomes.

Regulation Writing

After Congress enacts authorizing legislation, the action moves to the regulatory agencies. Executive orders require executive branch agencies to identify the problem, consider alternative solutions, and estimate the benefits and costs of alternatives when they propose significant new regulations.[42]

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38. J. W. Hampton, Jr. & Co. v. United States, 276 U.S. 394 (1928). "If Congress shall lay down by legislative act an intelligible principle to which the person or body authorized to fix such rates is directed to conform, such legislative action is not a forbidden delegation of legislative power."
39. US Department of Agriculture, Mandatory Inspection of Fish of the Order Siluriformes and Products Derived from Such Fish; Final Rule, 80 Fed. Reg. 75589–630 (2015); Chelsea Fernandez Gold, "Bottomfeeding: How the USDA's Noodling with Catfish Regulations Violates the United States' WTO Obligations," *Berkeley Journal of International Law* 33, no. 2 (2015): 355.
40. Government Accountability Office, "High-Risk Series: An Update," February 2013.
41. Jerry Ellig and Michael Horney, "Preventing a Regulatory Train Wreck: Mandated Regulation and the Cautionary Tale of Positive Train Control" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2016).
42. Exec. Order No. 12866, 3 C.F.R. 638 (1993).

These requirements apply to only about 8 percent of all proposed federal regulations.[43] The most stringent analytical requirements apply to economically significant regulations, which account for only 2 percent of all regulations.[44] Executive Order 12866 requires that these economically significant rules be reviewed by the Office of Information and Regulatory Affairs (OIRA), an executive branch office housed within the Office of Management and Budget.

In the decade preceding 2014, only 116 out of 37,000 federal regulations were accompanied by monetized figures for both benefits and costs.[45] Some independent agencies have statutory requirements to analyze or consider benefits and costs of their proposed regulation,[46] but research has shown that many independent agencies conduct even less economic analysis than executive agencies.[47]

Even for the regulations subject to the most stringent analytical requirements, independent research has identified significant gaps in agency analysis. Agencies often fail to (1) conduct an evidence-based assessment of the underlying problem, (2) identify a small number or limited range of alternatives, (3) assert benefits that are not clearly linked to the root cause of the problem, or (4) ignore significant social costs.[48]

Whether intentionally or not, agencies often avoid procedural requirements. A recent study found that agencies avoided the notice-and-comment process—which facilitates public participation in rulemaking—for almost 52 percent of regulations finalized from 1995 to 2012.[49] Meanwhile, only about 8 percent of final regulations underwent OIRA scrutiny between fiscal years 2004 and 2013.[50]

Judicial Review

Judicial review is necessary to ensure that agencies design regulations based on fact rather than just good intentions. Judicial review can give stakeholders an

43. Williams and Broughel, "OIRA Quality Control Is Missing for Most Regulations."
44. Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis," 12.
45. Williams and Broughel, "OIRA Quality Control Is Missing for Most Regulations."
46. Jerry Ellig, "Improving Regulatory Impact Analysis through Process Reform" (Testimony before the Joint Economic Committee, Mercatus Center at George Mason University, Arlington, VA, June 26, 2013).
47. Arthur Fraas and Randall L. Lutter, "On the Economic Analysis of Regulations at Independent Regulatory Commissions," *Administrative Law Review* 63, Special Edition (2011): 213–41; Ellig and Peirce, "SEC Regulatory Analysis."
48. Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis"; Ellig and Peirce, "SEC Regulatory Analysis."
49. John D. Graham and James Broughel, "Confronting the Problem of Stealth Regulation" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, April 2015).
50. Williams and Broughel, "OIRA Quality Control Is Missing for Most Regulations."

opportunity to challenge regulatory impact analyses that are incomplete or that ignore important evidence in the rulemaking record.

Courts currently examine the quality of an agency's regulatory impact analysis or other economic analysis only under specific limited circumstances, such as when the analysis is mandated by statute or the agency itself refers to the analysis as justification for its decisions. Surveying these court decisions, scholars have found examples of courts competently and carefully assessing the agency's treatment of all major elements of regulatory impact analysis: analysis of the systemic problem, development of alternatives, and estimation of the benefits and costs of the alternatives. Agencies typically improved their analysis in response to court decisions that remanded regulations.[51] When appeals courts examine regulatory agencies' economic analysis, they show no pro- or anti-regulatory bias in their rulings, and they actually uphold regulations more frequently than they strike them down.[52]

One of the most comprehensive examples of the salutary effects of judicial review is the Securities and Exchange Commission. The SEC is subject to statutory language that courts have interpreted to require benefit-cost analysis when the SEC determines whether a regulation is in the public interest.[53] After losing several court cases that ruled it had performed insufficient analysis, the SEC issued new staff guidance in 2012 on regulatory analysis, which is based on principles similar to those that executive branch agencies must follow. The quality of the SEC's analysis improved measurably after it adopted the new guidance.[54]

Unfortunately, such results are the exception rather than the rule. Under existing law, it is unclear whether analyses not mandated by statue are subject to judicial review.[55] Though agencies are often required by statute or executive order to conduct economic analysis to inform regulatory decisions, the quality of this analysis is often relatively poor, and a major cause is limited judicial oversight. Assessments by independent scholars and government agencies have identified serious deficiencies in agency regulatory impact analyses for major regulations.[56]

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51. Reeve Bull and Jerry Ellig, "Judicial Review of Regulatory Impact Analysis: Why Not the Best?" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2017).
52. Ibid.
53. Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).
54. Jerry Ellig, "Improvements in SEC Economic Analysis after *Business Roundtable*: A Structured Assessment" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2016).
55. Bull and Ellig, "Judicial Review of Regulatory Impact Analysis."
56. Ibid.; Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis."

The rigor of judicial review of agency regulations also varies greatly from case to case. The current judicial review standard under the Administrative Procedure Act, which requires that regulations not be "arbitrary and capricious," is vague, leading to highly inconsistent court decisions. Courts may be capable of giving regulatory impact analysis a careful review, but they don't always do so—a result of the act's vague standard.[57]

Retrospective Analysis

Authorizing legislation for regulatory agencies may specify an amount of authorized spending, but neither the authorized spending nor the appropriations in subsequent years are linked to the outcomes Congress expects the regulators to accomplish. Budgetary outlays for regulatory agencies grew by 352 percent between 1975 and 2016.[58] But without some process for systematic retrospective analysis of regulations, it is difficult to determine whether the growth in on-budget spending on agencies has delivered the positive outcomes desired.

Further complicating things, the off-budget costs of regulatory compliance and other regulatory effects on citizens are not systematically considered or compared with the outcomes, even though the off-budget costs of regulation likely dwarf regulatory agencies' on-budget spending.[59] The cumulative effects of multiple regulations authorized by the same legislation, or multiple regulatory programs authorized by different pieces of legislation, are rarely considered, despite a growing body of evidence of cumulative effects and executive order requirements to consider them.[60]

Agencies rarely make provisions for retrospective analysis when they propose or finalize new regulations. Virtually no agency has an ongoing, robust effort to assess the actual benefits and costs of all major regulations.[61]

Presidents of both parties typically direct agencies to modify or eliminate rules that are no longer necessary.[62] However, these efforts focus on a small portion

57. Bull and Ellig, "Judicial Review of Regulatory Impact Analysis."
58. Susan E. Dudley and Melinda Warren, "Regulators' Budget from Eisenhower to Obama: An Analysis of the U.S. Budget for Fiscal Years 1960 to 2017" (St. Louis and Washington, DC: Weidenbaum Center at Washington University and George Washington University Regulatory Studies Center, May 2016).
59. John W. Dawson and John J. Seater, "Federal Regulation and Aggregate Economic Growth," *Journal of Economic Growth* 18, no. 2 (2013): 137–77.
60. McLaughlin and Williams, "The Consequences of Regulatory Accumulation"; Exec. Order No. 12866; Exec. Order No. 13563, 3 C.F.R. 13563 (2011).
61. McLaughlin and Williams, "The Consequences of Regulatory Accumulation."
62. Exec. Order No. 13771, 82 Fed. Reg. 9339 (2017).

of the low-hanging fruit of obviously outmoded rules, while paying little attention to more recent rules that may have failed to accomplish their goals. Such reviews rarely assess whether existing regulations are producing the intended results, and at what cost. A study commissioned by the Administrative Conference of the United States indicates that the results of the most recent round of retrospective reviews in the Obama administration are typical in this regard:

> The vast majority of status updates on agencies' retrospective review programs do not include evidence of formal retrospective analysis, such as ex post estimates of benefits, costs, or efficacy. . . . Most of the analyses, such as estimated cost savings from removing regulatory burdens, in agency reviews focus on what can be achieved through reducing paperwork and reporting obligations, or transforming some of these obligations to electronic reporting. . . .
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> Streamlining the way the government collects information on the actions of regulated firms is fundamentally different than an assessment of whether an economically important rule is delivering on societal objectives identified in authorizing legislation and doing so in a cost-effective and/or efficient manner.[63]

In order for agencies to effectively identify many of the failed rules currently on the books, more comprehensive retrospective review is necessary.

Congressional Oversight

Before a regulation becomes final, Congress technically can disapprove it under the Congressional Review Act.[64] Currently, Congress must rely primarily on analysis of the likely effects of regulations that is performed by the agencies that make the decisions. Much of this analysis is done after a decision has already been made and, rather than informing the decision, is simply used to justify a decision.[65] Congress is therefore sometimes reliant on agency analysis

63. Joseph E. Aldy, "Learning from Experience: An Assessment of the Retrospective Reviews of Agency Rules and the Evidence for Improving the Design and Implementation of Regulatory Policy," Administrative Conference of the United States, November 17, 2014, 52–53.
64. Richard S. Beth, "Disapproval of Regulations by Congress: Procedure under the Congressional Review Act," Congressional Research Service, October 11, 2001.
65. Jerry Ellig, "Improving Regulatory Impact Analysis."

of questionable quality, rather than a high-quality independent analysis, when making decisions under the Congressional Review Act.

After regulations are implemented, Congress can conduct oversight hearings. Congress can also examine regulatory agencies' performance periodically when it considers reauthorizing the agency or annually as part of the appropriations process. Effective oversight requires a robust program of retrospective analysis to assess the actual results of regulations after they have taken effect. Currently, there is no systematic retrospective review process that produces the required information to inform congressional decisions.[66] Because some regulations involve large up-front expenditures on compliance, decisions to reverse or sunset regulatory laws and regulations, while helpful, will often be too little, too late.

Congress itself has no analytical arm that annually estimates the benefits and costs of regulations in a manner analogous to the way the Congressional Budget Office scores the budget. Perhaps as a result, congressional oversight under both parties has traditionally focused more on anecdotes and producing political "gotcha" moments than sober, systematic assessment of all the results of a regulation or regulatory program.

COMPREHENSIVE REGULATORY REFORM

The problems with the regulatory process identified above have occurred under administrations and Congresses controlled by both political parties.[67] The problems are institutional, not political, so they can only be solved through reforms to the regulatory process. Regulatory reform needs to address two general types of problems:

- Too many new regulations are produced without a sound demonstration—using scientific and economic analysis—that the regulations will accomplish policy objectives at a reasonable cost.
- The regulatory process does not require rigorous and objective examination of cumulated regulations already on the books for effectiveness, efficiency, duplication, or obsolescence.

66. McLaughlin and Williams, "The Consequences of Regulatory Accumulation"; Joseph E. Aldy, "Learning from Experience," 52.
67. Jerry Ellig, Patrick A. McLaughlin, and John Morrall III, "Continuity, Change, and Priorities: The Quality and Use of Regulatory Analysis across US Administrations," *Regulation & Governance* 7, no. 2 (2013): 153–73; Jerry Ellig and Rosemarie Fike, "Regulatory Process, Regulatory Reform, and the Quality of Regulatory Impact Analysis," *Journal of Benefit-Cost Analysis* 7, no. 3 (2016), 523–59; Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis."

While the rulemaking process is complex, the application of the correct levers at just a few points in the regulatory process could dramatically improve regulatory outcomes. Comprehensive regulatory reform involves five changes: (1) assess the likely effects of legislation that authorizes regulation before Congress votes on the legislation, (2) improve regulatory agencies' information about regulations' likely effects before they write regulations, (3) clarify how courts are expected to review agency economic analysis, (4) analyze old regulations to see if they are working, and (5) create a feedback loop to properly inform Congress what effects its laws are having.

1. Assess the Likely Effects of Legislation That Authorizes Regulation before Congress Votes on the Legislation

Regulations are created by executive agencies, but only because Congress originally vested these agencies with regulatory powers and occasionally hands them new statutory mandates. For example, Dodd-Frank was estimated to induce the creation of about 400 new regulations and to increase regulatory restrictions targeting the finance industry by 32 percent.[68]

Congress often makes key regulatory decisions when it writes statutes that authorize or reauthorize regulations. The current system provides Congress with a flood of information but little structured means to produce high-quality analysis of the problems that regulatory legislation seeks to solve and the benefits and costs of alternative solutions. Before enacting major regulatory legislation, Congress should have a comprehensive, objective assessment of the legislation's likely effects. To accomplish this, Congress should develop a system for obtaining impartial "legislative impact accounting," similar to the regulatory impact analysis currently required of executive branch agencies, when it authorizes new regulation or reauthorizes existing regulation.[69]

2. Improve Agencies' Information about Regulations' Likely Effects before They Write Regulations

President Clinton's Executive Order 12866 requires that before issuing an economically significant regulation, executive branch agencies must understand the nature and cause of the problem they are trying to solve, develop alterna-

68. McLaughlin and Greene, "Dodd-Frank's Regulatory Surge."
69. Fichtner and McLaughlin, "Legislative Impact Accounting."

tive solutions, and assess the benefits and costs of each alternative.[70] 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 the promulgating agency knows the administrator can win the ensuing political argument within the administration.[71]

Independent agencies are not currently subject to the executive orders on regulatory analysis and review. Some independent agencies face statutory requirements for economic analysis, but these are by no means universal or uniform. Many independent agencies do not engage in prospective economic analysis of rules at all, while others do so in a limited fashion.

Several changes would help improve the quality of the analysis that informs agencies' regulatory decisions:

- Statutorily require all agencies to conduct regulatory impact analysis for regulations with economic effects exceeding a certain threshold, such as the $100 million per year threshold used in Executive Order 12866.[72] Indicate in the statute the topics the analysis must cover: assessment of the existence, extent, and cause of the problem; development of alternatives; and assessment of the benefits and costs of alternatives.
- Require agencies to publish for public comment their preliminary analysis of the problem and the benefits and costs of each alternative they are considering, before they select a preferred approach and write a regulation.[73]
- Within agencies, free economists and other analysts to conduct objective analysis by locating them in a unit other than the program office that writes regulations. Have analysts report to and be managed by other analysts, with

70. Exec. Order No. 12866. President Obama reaffirmed Exec. Order No. 12866 in Exec. Order No. 13563.
71. 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. 3–4 (2014): 305–20.
72. Of course, a regulation below this threshold may also have unintended and unpredicted economic effects exceeding $100 million. This is another reason why retrospective assessment is important.
73. Ellig and Fike, "Regulatory Process, Regulatory Reform."

clear criteria for career advancement based on the quality and objectivity of their analysis.

3. Clarify How Courts Are Expected to Review Agencies' Economic Analysis

Federal courts can effectively and impartially review the quality of regulatory agencies' regulatory impact analysis, but Congress must clarify when and how the courts are to conduct this review. Currently, the thoroughness of court review of agency analysis under the Administrative Procedure Act's "arbitrary and capricious" standard is highly inconsistent. Courts sometimes evaluate the quality of evidence in an agency's regulatory impact analysis, but at other times they simply allow an agency to assert a pro forma rationale for its decisions.

Three legislative changes would clarify the courts' role in reviewing agency analysis and ensure that courts carry out that review consistently. Congress should specify by statute the topics a regulatory impact analysis must cover—analysis of the problem, alternatives, benefits, and costs. Additionally, Congress should require agencies to base their regulatory impact analysis on the best available evidence. Finally, Congress should make the agency's regulatory impact analysis or other economic analysis part of the rulemaking record, reviewable by courts only if a deficiency in the analysis made a material difference in a regulatory decision.[74]

These changes would help ensure that courts scrutinize significant analytical deficiencies that affect regulatory decisions, but the changes would also prevent courts from remanding regulations for trivial errors or omissions in the agency's analysis.

4. Analyze Regulations to See If They Are Working

Congress often legislates in response to perceived crises, creating missions for regulatory agencies that last well beyond the crisis. Unfortunately, there is no feedback loop to pass information to Congress regarding the outcomes of the regulations that a piece of legislation mandated. The next stage of reform would be to institutionalize retrospective analysis of regulations. While prospective analysis can certainly help avoid some regulatory pitfalls, only in hindsight can an

74. Bull and Ellig, "Judicial Review of Regulatory Impact Analysis."

analysis determine whether the benefits that a rule was intended to achieve are being realized and whether those benefits do indeed justify the costs of the rule.

Problems may arise via two mechanisms: nonfunctional (obsolete, inefficient, or ineffective) rules and regulatory accumulation. Importantly, nonfunctional rules could perfectly follow legislative intent but still not accomplish the desired economic goal.[75] Whatever the merits of promulgating any individual rule, the accumulation of rules presents another unique set of problems, such as potential interactive effects, duplicative costs, a diversion of scarce enforcement resources from functional rules to nonfunctional rules, and unnecessary complexity, all of which can limit competition and entry.

In fact, the economic consequences of regulatory accumulation are rarely considered during congressional legislative debates. Whenever Congress enacts new regulatory legislation, the effects are not known for several years as regulations are promulgated and their effects are realized. Once they are realized and understood—if a regulatory reform required retrospective analyses of regulations to be produced, for example—then such information should be made transparent, facilitating corrections or eliminating legislation that leads to nonfunctional regulations.

Currently, retrospective analysis, when it occurs, is left in the hands of the agencies that made the same regulations that are being reviewed. This is not a recipe for robust, honest analysis. Instead, an independent body should be charged with analyzing existing regulations, and it should do so with a predetermined methodology.[76]

There is another institutional incentive for retrospective analysis that could work: a legislative requirement that agencies eliminate one or more existing regulations for every new regulation proposed.[77] This policy has had success in British Columbia and was recently adopted by the Government of Canada, as well. In British Columbia, regulatory requirements—including those contained in administrative guidance documents—were reduced from 330,812 in 2001 to 173,439 in 2016, a decrease of 47.6 percent.

75. Jerry Ellig, "Regulatory Impact Analysis: Four Decades of Foibles" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, January 2015).
76. For some discussion of possible methodologies and their importance, see McLaughlin and Williams, "The Consequences of Regulatory Accumulation."
77. While Executive Order 13771 implements this policy for executive branch agencies, it could be easily repealed by a future president, and it does not apply to independent agencies. Exec. Order No. 13771.

5. Create a Feedback Loop for Congress

The information created in these independent analyses should be transmitted to Congress in a way that enables Congress to act upon it. For example, suppose Congress passes an act with the broad goal of reducing systemic financial risk to the economy. Over time, this act may or may not actually lead to regulations that achieve that economic goal. Regulatory agencies could perfectly execute all of the legislative intent of the act, but the economic intent of the act may remain unfulfilled or may even be contravened.

With legislative impact accounting, Congress could use its existing budgetary authority—the power of the purse—to correct the courses of regulatory programs if information about those programs' economic effects were produced and transmitted to Congress in a timely and dependable manner.[78] Extensive costs associated with policy actions—in particular, the costs of regulations—are not accounted for in the current budgeting process. Just as one's decision to buy a home and save for retirement today affects one's future economic security, policy decisions by Congress and agencies have an impact on the nation's economic well-being in the future.

Legislative impact accounting has the potential to improve policy outcomes and aid congressional and agency decision-making well into the 21st century. Legislative impact accounting of the actions of government can help avoid ill-advised or bad policies with harmful consequences like lost economic output and the erosion in public trust of government to govern efficiently and equitably.

Under legislative impact accounting, agencies would be responsible for managing their regulatory and enforcement duties within the account levels appropriated by Congress. If the costs of new regulations exceeded the limited amount accounted for by Congress, the affected regulator would have to modify the proposed regulation or identify a regulatory offset—for example, a change in one or more existing regulations—in order to meet the account limit. Any such system of accounting would likely entail either the creation of an independent body to estimate prospective regulatory costs of proposed legislation or the granting of such authority to an existing independent organization such as CBO.[79]

As agencies look to adopt new regulations by modifying or canceling old regulations, Congress and agencies would also have the benefit of systematically looking back over previous regulations. Legislative impact accounting, including accounts of the impact of specific regulatory programs associated with

78. See Fichtner and McLaughlin, "Legislative Impact Accounting."
79. Ibid.

their authorizing legislation, could initiate the creation of a systematic process, overseen by Congress through CBO or another independent body, to increase understanding of the economic outcomes of existing regulation and also whether regulations have been effective, efficient, and equitable. Over time, Congress would be able to study whether the analyses that accompany economically significant regulations offered reasonable predictions of benefits and costs.[80]

CONCLUSION

Despite broad and bipartisan recognition that the accumulation of regulations in the United States likely has significant negative economic impact, particularly affecting lower-income households, the problem continues to grow. Agencies, despite direction from several presidents, have incentives to maintain and grow their regulations in order to maximize their budgets.[81] In turn, to retain regulations that would be eliminated otherwise, agencies may either hide or fail to produce information that would help identify obsolete regulations in the first place.

Congress has the opportunity to enact comprehensive regulatory reform, but it must reform multiple steps in the regulatory process. Before writing new authorizing legislation for regulatory agencies, Congress should assess the economic impact of regulatory legislation. Before any regulatory agency proposes a new regulation, it should be required to assess the economic impact of its proposed rule. Congress should motivate agencies to conduct high-quality analysis by clarifying when and how courts should review agency economic impact analyses. After new rules are adopted, both Congress and the agencies should work together to assess whether the rules are working as intended, and they should seek to eliminate rules that do not work or cost more than they benefit society.

Regulation is a significant feature of modern government. Given the important values at stake, Congress and regulatory agencies should craft regulations with full knowledge of their results. Decision-making in the dark should not be an option. Regulation should be done intelligently, efficiently, and effectively. The current regulatory process fails to meet these basic requirements of good government, generating regulations that are sometimes ineffective and impose significant costs on businesses and consumers. This primer has identified specific, actionable steps Congress could take to accomplish comprehensive regulatory reform.

80. Ibid.
81. William Niskanen, "Bureaucrats and Politicians," *Journal of Law and Economics* 18, no. 3 (1975): 617.

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