

# MERCATUS CENTER

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## George Mason University

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Draft 2010 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities does not represent the views of any particular affected party or special interest group, but is designed to assist the Office of Information and Regulatory Affairs in the Office of Management and Budget as it seeks advice on this draft report.

### **I. Responding to the Purposes of the Regulatory-Right-to Know Act**

As required by the Regulatory-Right-to-Know Act of 1999, the Office of Management and Budget has prepared a draft of their 13<sup>th</sup> report to Congress on the Benefits and Costs of Federal Regulations. The purpose of this act was to:

- “(1) promote the public right-to-know about the costs and benefits of Federal regulatory programs and rules;
- (2) increase Government accountability; and
- (3) improve the quality of Federal regulatory programs and rules.”<sup>1</sup>

In fact, we argue that this report has failed to fully satisfy these goals, especially when compared to previous reports under both Democratic and Republican administrations. This report does not provide as much information on the costs and benefits of federal regulations as previous reports nor does it show that agencies made progress during FY 2009 in providing the public and

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<sup>1</sup> <http://www.ombwatch.org/files/regs/library/rrtka.pdf>

Congress with information on the expected impact of newly issued major regulations. In fact, the OMB report shows that the agencies are providing less information on the impacts of regulations than in the past. This may not be the fault of OMB since the report mainly summarizes agencies' estimates.

### **Goal 1: Promote the public right-to-know about the costs and benefits federal regulatory programs and rules**

This report does a good job, as usual, of summarizing the expected costs and benefits of the economically significant rules for which agencies are required to provide information and which OMB is required to review under Executive Order 12866 issued in 1993. Unfortunately, these rules are only a fraction of the rules that OMB reviews under the EO and about 1 percent of all the rules issued each year.

OMB reports that agencies monetized both benefits and costs for only 16 of the 33 major social regulations that it reviewed in 2009 (about 48 percent) and provided no cost, benefit or budget or transfer estimates for 13 of the 66 social and transfer regulations combined (about 20 percent). But the 48 percent estimate for 2009 is a decline from 62 percent in 2008 and 67 percent in 2007. And the finding that 20 percent of major regulations had no impact estimates in 2009 compares to the much better record of 5 percent for 2008 and zero percent for 2007. Clearly the agencies are providing less information about the costs, benefits, and economic impacts of their major regulations this last year, in violation to the spirit of the Regulatory-Right-to-Know Act, than they have in the past.

Based on an evaluation “of a few representative agencies” done in 2004, “OMB believes ... that the benefits and costs of all major rules account for the majority of the total benefits and costs of all rules subject to OMB review.”<sup>2</sup> While this conclusion may be warranted for the rules OMB reviews, it would be an act of faith to believe it has anything to do with the overall burden of costs and supply of benefits. In a statement that appears a little defensive and out of place, OMB asserts that, “in a noteworthy contrast to the first year of the two previous Administrations, the

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<sup>2</sup> Report to Congress on the Costs and Benefits of Federal Regulations, Office of Management and Budget, 1997, p. 17. <http://www.whitehouse.gov/omb/inforeg/chap1.aspx?print=1> This will be referred to in subsequent notes as the OMB Report.

quantified benefits of final rules significantly exceeded the quantified costs for the calendar year 2009.”<sup>3</sup> First, the aggregate data presented are not transparent or verifiable since the individual cost and benefit information is not listed, and second, non-published data from FY 2010 (that would ordinarily be used in next year’s report as has been done in the previous 12 reports) are used for the first time in this report. In fact, it is likely that OMB analysts would react negatively to a benefits claim presented in an RIA by an executive branch agency based on such weak evidence.

Although in various places OMB does a good job of acknowledging uncertainty in these estimates, perhaps after 13 years of these reports, it is time to report on some of the overall uncertainties. As this is the only report of its type intended to inform Congress about the benefits and costs of regulations generally, it should be acknowledged that OMB has extremely limited knowledge about the overall benefits and costs of regulations. First, as acknowledged, OMB only reports on a tiny fraction (about 1 percent) of all regulations promulgated in the previous year and most of the other regulations receive little to no analysis. Thus, it is impossible to know whether or not the rules reviewed constitute a significant source of the annual costs and benefits.

More importantly, we have been passing regulations since the middle of the 19<sup>th</sup> century and only a tiny fraction of those have ever been removed. Currently, there is no definition for the total number of regulations. That is, there are thousands of regulations with multiple requirements contained in each rule—in some cases hundreds of subparts. To begin to get a handle on the total amount of federal regulation, OMB might, for example, count the number of “musts” and “shalls” contained in the Code of Federal Regulations.

In fact, no one knows the true burden of regulations, which include transactions costs to learning and understanding regulations, rent-seeking and rent-avoidance expenditures, barriers to entry, loss of privacy and individual liberty, reduced economic growth, and weakened international competitiveness. The annual cost estimates that OMB has been reporting for the last 13 years tell us very little on the costs in individual years or on the overall continuing burden or benefits of those regulations. OMB does not cite in this report the study by Mark Crain performed for the Small Business Administration which estimates that the annual costs of federal regulations

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<sup>3</sup> OMB Report, p. 37.

exceeded \$1 trillion five years ago.<sup>4</sup> Certainly there is a good deal of uncertainty in this estimate, but that should only encourage OMB to produce a better estimate.

It is time to hold agencies accountable for producing complete, high-quality regulatory impact analysis for all rules that are considered significant by the definitions in the executive order. This would go a long way toward giving more information on the benefits and costs of rules to the public and the Congress and might also serve to produce better regulations.

Currently, there is a fairly heterogeneous mix of quality for regulatory analyses. If agencies are able to do a better job of analyzing regulations, several results should happen. First, stakeholders are better informed about potential impacts and should be able to provide more targeted comments to help improve regulations, including explaining what are likely to happen to markets in the absence of regulation. Second, better analysis in which agencies are exploring the existence and magnitude of systemic problems, as well as analyzing a broad variety of options for solving problems, should eliminate government failures in which agencies: 1) attempt to solve a problem that is not systemic; 2) fail to solve a problem of solve it in the most cost-beneficial manner; or 3) create unintended consequences that might be worse than the original problem.

So both in the rules themselves and in the OMB report, the public and Congress are left woefully short of information on the costs and benefits of these rules. If agencies are not thoroughly analyzing the social problems they are trying to solve, neither the American public nor Congress can have much faith in their ability to solve problems, particularly in a cost-effective manner. As OMB has limited staff and apparently limited ability to actually require agencies to do this analysis, one possible solution is for the two arms of the Office of Management and Budget, the Office of Information and Regulatory Affairs (OIRA) and the Budget Office, to work more closely together to tie budgets to the quality and use of regulatory analysis.

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<sup>4</sup> Crain, Mark W., "The Impact of Regulatory Costs on Small Firms," under contract to SBA SBHQ-03-0522, No. 264, September 2005. . On SBA's website on 6/21/2010 at <http://www.sba.gov/advo/research/rs264tot.pdf>.

## **Goal 2: Increase government accountability**

If Congress has used these reports in the past 13 years to increase the accountability of these agencies, as well as OMB accountability, that fact should be reflected in these reports so that the public can judge the utility of this report. For example, has Congress ever used the report to affect any agency's regulation or an agency's budget? OMB should include this information in the report.

## **Goal 3: Improve the quality of federal regulatory programs and rules**

Improving the quality of federal regulatory programs and rules is certainly an important and laudable goal. OMB may believe that the primary element of the report that contributes toward this goal is the annual set of suggestions for improving the regulatory process and regulatory analysis. Certain aspects of the report itself, however, highlight some weaknesses in the federal regulatory process. OMB could address these weaknesses by offering additional recommendations in the report, developing additional content for the report, or changing the way it administers Executive Order 12866 so that agencies themselves supply more useful content for the report.

Several weaknesses in the draft report and many previous reports stem from weaknesses in the federal regulatory process itself:

1. The quality of agency regulatory analyses varies widely, but OMB compiles the resulting benefit and cost figures into its annual report as if all estimates were equally valid.
2. Although the annual report often discusses new analytical initiatives that could improve the practice of regulatory analysis, it appears to do little to diffuse existing "best practices" across agencies.
3. The report does not present retrospective analysis of regulations' actual benefits and costs; it usually compiles agencies' *ex ante* predictions of benefits and costs at the time they issued the regulations.

Consider each of these issues in turn.

## 1. Varying quality of analysis

The regulatory analyses that OMB uses as an input into the annual benefit-cost report vary widely in quality. The Mercatus Center documented this variation in our recently-released study done using data from the Mercatus Regulatory Report Card, which assesses the quality and use of regulatory analysis for proposed, economically significant regulations.<sup>5</sup> In the report card, each proposed economically significant regulation receives a score ranging between 0 and 60 points, based on 12 criteria grouped into three general categories:

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

So far, for 2008 the results are not that encouraging. The best score for all of the economically significant regulations proposed in 2008 was 43, or about a "C." Scores varied widely; they ranged from a high of 43 points to a low of just 7 points. Even if we focus only on the "Analysis" criteria, which provide the narrowest measure of the quality of the analysis, actual 2008 scores range from zero to 16 out of a possible 20 points.

Clearly, some agency regulatory analyses are better done (and hence more reliable) than others. At a minimum, OMB should acknowledge the large uncertainties introduced by variability in the quality of agency analyses. More helpfully, OMB could indicate which estimates deserve more confidence than others, either by conducting its own review of the quality of individual regulatory analyses or by referencing reviews conducted by external researchers. Going forward,

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<sup>5</sup> Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008," Mercatus Center working paper, June 2010, available at <http://mercatus.org/publication/quality-and-use-regulatory-analysis-2008>. More information on the Regulatory Report Card project can be found at <http://mercatus.org/reportcard>.

the Mercatus Center plans to evaluate the quality of analysis accompanying proposed, economically significant regulations and make that analysis available during the public comment period. The Mercatus Report Card is not the only attempt to assess the quality of regulatory analyses; prior work includes a series of studies by Robert Hahn and Winston Harrington.<sup>6</sup>

## 2. Diffusion of best practices

The first results from the Mercatus Regulatory Report Card suggest that the overall quality of regulatory analysis could improve significantly if “best practices” were more widely diffused across agencies. On virtually all of our report card criteria, only a handful of regulations received the highest possible score of 5, indicating the presence of several best practices on that criterion. The most likely explanation is that economists and other analysts rarely have reason to talk with their counterparts in other agencies in the day-to-day course of work. As generalists who work with many different types of regulation, OIRA’s staff is ideally situated to help break down the “silos” that hamper communication between different regulatory agencies.

OIRA could take positive steps to improve the quality of regulatory analysis by fostering the diffusion of best practices across agencies. Of course, OIRA can accomplish some of this via its “consultative” role with agencies when working on individual regulations. But OIRA could also utilize the annual benefit-cost report to highlight particular examples of best analytical practices from the prior year that other agencies could emulate.

## 3. Lack of retrospective analysis

Section 5 of Executive Order 12866 requires agencies to periodically review significant regulations to determine whether they should be modified or eliminated. An expansive interpretation of this section would take it to mean that agencies should evaluate the costs and benefits of regulations after they have been adopted, regulated entities have complied, and secondary effects have worked their way through the economy. Apparently few agencies have interpreted the language this way. Regulatory agencies conduct numerous retrospective reviews of regulations, but these reviews only occasionally provide *ex post* estimates of costs and

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<sup>6</sup> See Robert W. Hahn and Paul C. Tetlock, “Has Economic Analysis Improved Regulatory Decisions?” *Journal of Economic Perspectives* 22(1) (Winter 2008), 67-84, and references cited therein; Winston Harrington, “Grading Estimates of the Benefits and Costs of Federal Regulation: A Review of Reviews.” Discussion Paper 06-39. Washington, DC: Resources for the Future, 2006.

benefits of either the regulation or of possible alternatives. A recent GAO report found that nine federal agencies conducted more than 1,300 regulatory reviews between 2001 and 2006, of widely varying scope. The report notes, “Our limited review of agency summaries and reports on completed retrospective reviews revealed that agencies’ reviews more often attempted to assess the effectiveness of their implementation of the regulation rather than the effectiveness of the regulation in achieving its goal.”<sup>7</sup>

Agencies rarely make explicit provisions for retrospective analysis at the time they issue individual regulations. The Mercatus Regulatory Report Card examined all 45 proposed regulations in 2008 that were economically significant—the same standard that determines whether an executive branch regulation gets included in OMB’s annual tally of benefits and costs. In only four cases did the agency establish goals or measures for any major outcome the regulation was supposed to produce. In only two cases did the agency enumerate the data it would use to evaluate major outcomes the regulation was supposed to produce. For 16 out of 45 regulations, the agency indicated that it might conduct some type of analysis in the future to assess some of the regulation’s effects.

OMB could remedy this deficiency by requiring agencies to make provisions for retrospective analysis when they issue economically significant regulations. Agencies should:

- identify the specific outcomes of value to the public that the regulation is supposed to produce;
- explain how these outcomes are related to the agency’s mission and one or more strategic goals in the agency’s strategic plan;
- identify what indicators the agency will use to measure progress toward these outcomes;
- estimate *ex ante* marginal benefits of proposed and final rules that measure, in terms of outcomes, how much of a goal each regulatory option is expected to achieve;
- determine what kinds of retrospective program evaluations will be necessary to identify how the regulation has affected outcomes;

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<sup>7</sup> Government Accountability Office, *Reexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* (2007), 20.

- identify and make provisions for gathering the data necessary to track a regulation’s *ex post* benefits and costs, and
- track and report the annual progress toward achieving a given goal and the social costs expended toward achieving that goal.

No proposed economically significant regulation should be cleared for publication by OIRA unless it includes these provisions for retrospective analysis.

The proposed outcomes, goals, and measures should be included in any Notice of Proposed Rulemaking so that the public has an opportunity to comment on them. There is precedent for regulatory agencies seeking comment on goals and performance measures for individual regulations. In 2005, the Federal Communications Commission sought public comment on goals and performance measures for telecommunications “universal service” programs.<sup>8</sup> These programs, created via regulatory proceedings at the FCC, impose charges on interstate telecommunications services in order to subsidize rural telephone companies, telephone service for low-income households, Internet service for schools and libraries, and telecommunications services for rural health care facilities. It is unfortunate that the FCC did not seek comment on performance measures until nine years after passage of the legislation directing the FCC to issue regulations creating the programs, but the FCC’s action demonstrates that it is entirely feasible for a regulatory agency to do so.

If agencies made provisions for retrospective analysis of regulations, OMB would then have access to actual, retrospective analysis that it could use to produce the annual benefit-cost report.

## **II. Alternative Reports that Might be More Informative**

Identifying benefits and costs of individual regulations is obviously extremely important. This may become even more important in areas where the marginal costs of more stringent regulations begin to exceed the marginal benefits, as may be the case in, for example, some environmental areas. But there are also systemic problems that arise in regulations that Congress

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<sup>8</sup> Federal Communications Commission, *In the Matter of Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking*, WC Docket No. 05-195 et. al. (adopted June 9, 2005), p. 24.

needs to be made aware of to provide legislative remedies. Identifying systemic weaknesses in analyses might be one such area. OMB could report those areas under the umbrella of the current charge. Mercatus's analysis of economically significant regulations in 2008 showed that agencies generally do a poor job of identifying a systemic market failure that they intend to address. As we gather more information, other issues may arise.

OMB could also report, by agency, which agencies have failed to produce analysis that is required by Executive Order 12866, by the Unfunded Mandates Reform Act, and by the Regulatory Flexibility Act as amended by the Small Business Regulatory Enforcement and Fairness Act. Such reports could help Congress in its oversight capacity, particularly with respect to agency funding.

In terms of informing the public, OMB could report more about how regulations affect individual consumers and sectors of the economy. This could include both new and existing regulations and could, as suggested earlier, be a more comprehensive look at transactions costs to learning and understanding regulations, rent-seeking and rent-avoidance expenditures, barriers to entry, loss of privacy and individual liberty, reduced economic growth, and weakened international competitiveness.

### **III. Regulatory Reform Efforts in Other Countries**

One section missing from this year's report present in previous reports is a discussion of regulatory reform efforts in other countries as well as the important work performed by international institutions that promote better regulation such as the EU, the World Bank, the Organization for Economic Co-operation and Development, and the Asia-Pacific Economic Cooperation. Regulatory transparency, accountability, and economic analysis have been promoted by these institutions and OMB for many years with the result that a majority of countries in the developed world, as well as many in the developing world, have adopted such reforms. The rest of the world, including the EU and China, pay close attention and report on developments in the U.S. regulatory state. But this year's report appears to ignore the rest of the world including both their reforms and what we could learn from them.

The United States is no longer at the top of the OECD and World Bank league tables as having the highest quality regulatory system. In the "2010 World Bank Doing Business" rankings, the

United States fell from the top a few years ago to number four behind Singapore, New Zealand, and Hong Kong, China (<http://www.doingbusiness.org/>). In the 1980s, the United States was one of only four countries with requirements to do regulatory impact analysis before major regulations could be issued. Now all 30 countries in the OECD as well as the EU itself have such programs. Many countries have wider coverage than ours. The United States may not have suffered an absolute decline in regulatory quality, but it has suffered a relative decline, and competitiveness is a relative concept. The “2010 World Bank Doing Business” study also reported that 287 reforms in 183 countries made it easier to do business. The United States did not implement one reform.

Some of the areas of regulatory reform that the United States lags behind some of its trading partners include those areas where we have made recommendations for improvement above. For example, the 2009 OECD report “Indicators of Regulatory Management Systems” show the United States lagging 14 of the 30 OECD countries in the *ex post* evaluation and updating of the stock of existing regulations. The United States also lags many other countries in not requiring *ex ante* analysis of primary legislation or the secondary legislation (regulation) of the independent agencies. If *ex ante* analysis usefully informs the executive branch, it should likewise inform these other branches of our government.

Congress should know and the public has a right to know how the United States is doing relative to the rest of the world. As international regulation and cooperation become more important, we urge OMB to reconsider its decision to not include a discussion of the regulatory developments occurring in the rest of the world and its impact on the United States.

#### **IV. Behavioral Economics**

We would like to commend OMB’s recommended “consideration of behaviorally informed approaches to regulation, with an emphasis on disclosure policies, simplification, appropriate default rules, salience, and the role of social norms.”<sup>9</sup> Where these behavioral factors are used in construction of regulatory alternatives, and are studied with the appropriate tools, they have the

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<sup>9</sup> OMB Report, p. 37.

potential to reduce the social costs of regulation, particularly compared to antique “command and control” strategies. It is important, however, and OMB should make clear the distinction between failures of markets (which may or may not justify federal regulatory interventions) and failures of individuals in information processing. The two should never be confused for two reasons: 1) individual decision-making heuristics by surveys may not accurately identify actual practices and 2) even where individuals make “errors” in decisions, markets tend to produce accurate relative prices as errors tend to wash out and prices are determined at the margin.

As recent Nobel Prize winner in economics Vernon Smith pointed out, the verbal behavior that individuals exhibit “strongly contradicts what their actual behavior achieves.”<sup>10</sup> That is, in order to predict what individuals will do, as opposed to what they say, you would need to replicate the market experience, which is very difficult to do. This is why you cannot automatically presume that verbal choice errors imply that people will make mistakes in real-world settings. By interacting with others in markets, rational outcomes are achieved much more readily than when individual humans are verbally tested. Thus, while individuals can and do make errors, particularly in testing, markets often achieve relatively efficient outcomes despite these errors.

In some cases however, providing information to individuals in a way that makes that information simple and easy to use can produce better results. For example, the administration’s push to supplement the Nutrition Facts Panel (NFP) with front-of-package icons that identify foods that are healthier choices is one way to help shoppers and restaurant-goers quickly identify better choices without having to sort through the trade-offs between macro-nutrients contained in the NFP. A counter example would be drug patient package inserts, which are loaded with dense information that is difficult for consumers to understand.

One area in the psychological area that has been explored in other fields but is also relevant for regulations is in compliance with rules. The availability heuristic (salience) might imply, for example, that regulated entities will spend most of their time complying with the most recent rules or rules that have recently been brought to their attention. The problem with this behavior is that recent rules may not be as important as rules passed 30, 60, or 100 months or even years ago. The rules are not prioritized, and those that are no longer beneficial are rarely taken off the

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<sup>10</sup> Smith, Vernon L. “Rational Choice: The Contrast Between Economics and Psychology,” The Journal of Political Economy, 99(4) August 1991, p. 881.

books (as we noted earlier about agencies retrospective review efforts). Yet, all are treated, at least theoretically, equally. The very first OMB Report to Congress identified the problem: “Some regulations are critically important (such as safety criteria for airlines or nuclear power plants); some are relatively trivial (such as setting the times that a draw bridge may be raised or lowered). But each has the force and effect of law and each must be taken seriously.”<sup>11</sup> As benefits and costs are directly related to the distribution and emphasis of compliance with rules, this only adds to the uncertainty of their effect. OMB should encourage agencies to prioritize existing rules and remove those that are no longer relatively important.

In addition to prioritizing rules, there is the problem of too many rules. Is it really possible to maintain a focus over thousands of rules that affect an individual company? Studies in numerous fields document the adverse effects from having too many rules. One author notes, “While generally there is an understanding that rules are useful guides for safe behavior, there is also an increasing concern that too many rules incrementally developed will not make up a good system to help human actors do the right thing, especially in states of abnormal operation where they would need strong, but also flexible guidance.”<sup>12</sup> In a sense, too many rules are like information overload. Hwang and Lin report that “if information load keeps increasing and finally exceeds the capacity of decision makers, information processing will cease being increased. Instead, decision makers will decrease information processing as they experience a phenomenon termed ‘information overload.’”<sup>13</sup>

The approach for the last 150 years of regulation has always been to continually add and refine rules. Hale examines the general approach of adding more and more rules:

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<sup>11</sup> Report to Congress on the Costs and Benefits of Federal Regulations, 1997, p. 2.  
<http://www.whitehouse.gov/omb/infocreg/chap1.aspx>

<sup>12</sup> Grote, Gudela and Johann Weichbrodt, “Uncertainty Management Through Flexible Routines in a High Risk Organization,” Organization, Work & Technology Group, Department of Management, Technology and Economics, Swiss Federal Institute of Technology (ETH Zürich), Zurich, Switzerland, Paper presented at the 2nd Annual Cambridge Conference on Regulation, Inspection & Improvement: “The End of Zero Risk Regulation: Risk Tolerant in Regulatory Practice” Cambridge, UK, September 12, 2007p. 4. See also, Amalberti, R. (1999). “Risk management by regulation” Paper presented at the 19th Myron B. Laver International Postgraduate Course “Risk Management”; Dekker, S. (2003). “Failure to adapt or adaptations that fail: contrasting models on procedures and safety.” *Applied Ergonomics*, 34(3), 233-238.; Woods, D. D., & Shattuck, L. G. (2000). Distant Supervision-Local Action Given the Potential for Surprise. *Cognition, Technology & Work*, 2(4), 242-245.

<sup>13</sup> Hwang, Mark, I. and Jerry Lin, “Information Dimension, Information Overload and Decision Quality,” *Journal of Information Science*, 25(3), 1999, p. 213.

The second line of defense in many systems, if the human could not be eliminated, has been to try to turn the human into a robot by specifying rules and imposing them rigidly. The railway industry has been one of the main protagonists of this approach, alongside the nuclear, and to lesser extent, the chemical industries. Accidents were then analyzed up to the point where it became clear that someone had broken a rule (at which point discipline was appropriate) or that there was no rule for this eventuality (in which case a new one was made). In this way rulebooks continually grew and never diminished. This rules-fix is also a hankering after certainty. Ultimately we get a rule for everything and safety is seen as something which requires no thinking any longer, but simply good training, a prodigious memory, a large safety manual or computer to refer to, and an iron discipline. Management does not need to do any more thinking or planning, because it is all fixed in the rule system. Reason (1990, 1997), among others has shown clearly how this approach ossifies an organization and forces its staff into being habitual and professional violators of rules, just to get their work done.<sup>14</sup>

One problem with additional rules in the nuclear power industry identified by one author is that “Regulators and industry officials come to view conformity or compliance with the rules rather than actual performance indicators as the measure of safety. So much time and attention are devoted to these surrogate measures of safety (‘complying with the regulations’) that the larger goal of such regulation is frequently neglected.”<sup>15</sup>

Academics who have studied classroom rules come to a similar conclusion: “Too many rules result in rules that are not enforced. The ones that are not enforced become targets of abuse that erode the effectiveness of the others.”<sup>16</sup> For accounting, Nelson finds that adding rules to increase precision “can increase the complexity of the standard, thereby creating communication

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<sup>14</sup> Hale, Andrew, “Railway Safety Management: The Challenge of the New Millennium,” Based on a keynote address to the Occupational Safety & Health Conference of the Union Internationale des Chemins de Fer (UIC). Paris September 1999 pp. 7-8.

<sup>15</sup> Barkenbus, Jack N. “Is Self Regulation Possible?” *Journal of Policy Analysis and Management* 2(4), Summer 1983, p. 578.

<sup>16</sup> Malone, Bobby G. and Cheryl L Tietjens, “Re-Examination of Classroom Rules: The Need for Clarity and Specified Behavior,” *Special Services in the Schools* 16(1/2) 2000 Haworth Press, Inc. p. 165.

problems that offset the communication benefits provided by increased precision.”<sup>17</sup> A key conclusion in this study is “a key to accurate communication is striking the right balance between providing enough rules to communicate clearly and not so many rules that practitioners are overwhelmed.”<sup>18</sup>

These examples are not intended to be conclusive but rather suggestive that both too many rules and not knowing which ones are important can defeat the original congressional intent of these rules. Understanding better when and where this may happen to regulatory agencies would seem essential information for Congress and the public to have before committing to more and more additions to the regulations stockpile.

## **V. Cost-Effectiveness Studies**

This year OMB reports on cost-effectiveness analysis for regulations intended to reduce mortality risks in order to obtain the “net cost per life saved.”<sup>19</sup> The reason for this calculation is to reduce emphasis on assigning a monetary value to reductions in mortality risk, which some have assumed to be problematic. It may be time to question the wisdom of providing cost-effectiveness figures to the exclusion of benefit-cost results. The first objections to “valuing life” were directed primarily at earlier attempts to place values on lost lives by calculating the expected earnings of an individual at the time of death. The foregone earnings approach was appropriately discarded. More robust measures have been developed that calculated the willingness-to-pay for a small reduction in the risk of mortality. Although there are some who still criticize this approach (and indeed the entire benefit-cost approach), those critics, with some prominent exceptions, are fewer in number today. As evidenced by new organizations that represent growing acceptance of the benefit-cost framework, such as New York University’s Institute for Policy Integrity, it may be that objections to valuing small increments of risk have grown vanishingly small.

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<sup>17</sup> Nelson, Mark W., “Behavioral Evidence on the Effects of Principles-and Rules-Based Standards,” *Accounting Horizons*, 17(1), March 2003, p. 94.

<sup>18</sup> *IBID.* P. 100.

<sup>19</sup> OMB Report, p. 23.

The problems with cost-effectiveness studies are widely known. For cases that do not involve health outcomes, cost-effectiveness analysis can evaluate achieving a goal that is not worth achieving, albeit in a cost-effective manner. This generally does not apply to rules that attempt to reduce mortality but where there are other benefits that dominate the estimates, particularly morbidity, the cost-effectiveness estimates begin to look nonsensical. For example, the first submission from HHS/FDA in Table 1-5, Prevention of Salmonella Enteritidis in Shell Eggs, produces a negative net cost per life saved. The reason for this is that salmonella produces very few fatalities per case; most are mild and self-resolving morbidity cases. Thus, the benefits of morbidity reduction alone exceed the costs of the rule and provide net benefits. It makes no sense then to say that the mortality costs are negative, this really only confuses the issue of total net benefits. The same result, negative net cost per life saved, obtains in 3 of the 4 examples presented. Cost-effectiveness analysis is likely to effectively persuade some decision makers where there is a single benefit, e.g., homeland security risk. However, where there are multiple benefits and mortality benefits are not the prime benefit, benefit-cost analysis is a better way to go.

## **Obesity**

The Draft Report cites a paper by Elston, et. al. making the case that obesity has costs that represent a market failure.<sup>20</sup> In that paper, they argue that there is an increase in Medicare, Medicaid, and Veterans—i.e., public insurers’—costs associated with obesity, which represents an externality.<sup>21</sup> They go on to argue that overweight individuals receive a public subsidy of \$1,900 over their lifetime in “collectively financed programs such as health insurance, sick-leave coverage, disability insurance and group life insurance.”<sup>22</sup> Because, they argue, society as a whole bears these costs, they represent a negative externality. But the government causes the “externality,” which is really a transfer from tax payers to the overweight and is known in economics as a pecuniary externality. This should not be confused with a technical externality. Such reasoning represents an imprecise use of economic terminology.

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<sup>20</sup> Elston, Julie A. et. al. “Tax Solutions to the external Costs of Obesity” in Obesity, Business, and Public Policy, Zoltan Acs and Alan Lyles, eds., Northampton, Mass: Edward Elgar Publishing, 2007, 171-187.

<sup>21</sup> IBID., p. 173.

<sup>22</sup> IBID., p. 174.

If society chooses to collectivize costs through such programs, it can hardly be argued that that is a *market* failure. If individuals who are not overweight are subsidizing those who are overweight, that is a result of the socialization of costs decision which is a *government* failure, not a market failure. If we did not socialize these costs, markets would be likely to reach an efficient price trade-off between maintaining extra weight and paying for the these services. Viewed as a government failure, not a market failure, suggests a need for more cost-sharing that accurately prices overweight.

Nevertheless, we do believe that the administration is taking the correct steps towards simpler, front-of-pack labeling that encompasses key nutrients in single icons that have the potential to affect obesity rates. We also agree with the discussion on the appropriate role of experimental studies versus focus groups to study potential communication devices deserves particular merit. One recommendation for a change in the current draft, however, is to correct the evidence for some of the nutrition references. Although it is correct that the “Nutrition Facts” labels were studied in advance of putting them on labels, Congress, through the Nutrition Labeling and Education Act, sharply constrained the type of information that could be studied and presented on food labels. Research since then has uncovered considerable problems with how this information is used, and it is likely that much better formats could be discovered that will be more useful to consumers. This problem is particularly true, for example, of percent daily values (DVs), which almost no consumers understand, even after all of these years.<sup>23</sup>

### **Publicly Accessible Summaries of Key Information**

In this section OMB specifies the key information that should be written in plain language so that the public can have ready access to this information. We believe that one correction should be made to the requirements, where OMB says that “agencies should provide a description of the *need for regulatory action*.” Too frequently in regulations, those descriptions are insufficient. Agencies merely recite the law that requires or allows them to issue the regulation. But a legal justification is not the same thing as a documented, social-science-based explanation of the origins of a problem and a cause-and-effect analysis of potential solutions. Agencies should be required to provide a description of a *systemic social problem*, which should primarily be market

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<sup>23</sup> IBID., P.43.

failures, as well as multiple possible solutions to those systemic social problems. Benefits and costs should be provided for each possible solution where the benefits identify a mechanism for how the problem will be solved (at least in part).

## **Summary**

As always, OMB has produced a very thorough report based on the instructions provided in the Regulatory-Right-to Know Act. Nevertheless, it is time to re-examine this report to see if it can be made more useful for those responsible for the regulatory state. First, more pressure must be brought to bear on regulatory agencies to do more and higher quality regulatory analysis, and this could be greatly facilitated by OMB reporting not just on successes, but on discrepancies. The Mercatus Center believes that we will be able to help in that endeavor. Second, while we applaud the use of behavioral economics in constructing remedies, care must be taken not to construe individual decision rules as market failures nor ignore the existence of market failures. Also, we recommend that OMB seek information about how firms comply with the sometimes thousands of regulations for which they are responsible. Third, we believe cost-effectiveness analysis should only be used when there is a single benefit, otherwise benefit-cost analysis is likely to be more useful. Finally, we suggest that a more careful look at economic theory is warranted as the government seeks to intervene in the obesity arena, although we acknowledge that to be a significant public health concern.