The Mighty Waves of Regulatory Reform
Regulatory Budgets and the Future of Cost-Benefit Analysis

James Broughel
Abstract

In the past 70 or 80 years, there have been what might be called three “waves” of reforms to the process of creating and managing US federal regulations. The first wave began in 1946 with the passage of the federal Administrative Procedure Act, after which states went on to pass and formalize their own administrative procedures. The second wave began decades later in the mid-1970s, ushering in the era of cost-benefit analysis (CBA) reforms for regulations. This article focuses on the third wave of regulatory reforms that appears to be sweeping the nation currently and includes a prediction as to what the next wave might look like, which turns out to be a return to some unsettled issues from the past. The current wave consists of efforts to manage regulatory output under budget or inventory systems for regulations. States like Virginia and Idaho appear to be making the most significant headway as part of the current wave, although the federal government is engaged in a similar effort. The article next focuses on the future of regulatory reform, predicting that economists will revisit the theoretical foundations of CBA, the analytical tool used to evaluate regulations and their effects. Although academia will need to play a constructive role in this process, the states and federal independent agencies could also play a role by experimenting with regulatory institutions and, indeed, experimenting with different methods and modes of analysis.

JEL codes: D6, D7, H7, K2

Keywords: regulatory reform, regulatory budget, cost-benefit analysis

Author Affiliation and Contact Information

James Broughel
Senior Research Fellow, Mercatus Center at George Mason University
Adjunct Professor, Antonin Scalia Law School
jbroughel@mercatus.gmu.edu

Author’s Note

A version of this article is forthcoming in the Winter 2019 issue of the Business, Entrepreneurship & Tax Law Review.

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This paper can be accessed at http://mercatus.org/publications/regulation/mighty-waves-regulatory-reform-regulatory-budgets-future-cost-benefit-analysis
The Mighty Waves of Regulatory Reform:

Regulatory Budgets and the Future of Cost-Benefit Analysis

James Broughel

I. Introduction

The modern era of administratively driven governance began during the Progressive Era but took its modern form during the New Deal period in the 1930s and early 1940s. In the 70 or 80 years that have elapsed since then, there have been what might be called three “waves” of reforms to the process of creating and managing US federal regulations. The first wave began in 1946 with the passage of the federal Administrative Procedure Act (APA).\(^1\) This law set up a formal process by which federal regulatory agencies promulgate, or introduce and put into effect, rules. The most important elements of APA reforms were likely the requirements for public participation before rulemakings are finalized and judicial oversight of regulatory actions. After 1946, states went on to pass and formalize their own administrative procedures, usually in the form of an act that looked quite similar to the federal APA.\(^2\) Solidifying these formal administrative procedures constituted the first wave of US regulatory reforms.

The second wave of reforms began decades later in the mid-1970s, continued on through the 1980s, and continues, to some extent, to this day.\(^3\) This was, and is, the era of cost-benefit analysis (CBA) reforms for regulations. In 1981, President Reagan issued an executive order that

\(^2\) A list of years when states passed APA laws can be found in Rui J. P. de Figueiredo Jr. & Richard G. Vanden Bergh, Protecting the Weak: Why (and When) States Adopt an Administrative Procedure Act (2001) (unpublished manuscript) (Haas School of Business, University of California at Berkeley).
\(^3\) For example, New Mexico did not require cost-benefit analysis until 2018. See Governor Susana Martinez, Exec. Order No. 2018-055, Directing Boards, Commissions, and Agencies to Implement Rulemaking Reforms (Dec. 18, 2018).
formally required executive branch regulatory agencies to adopt CBA for so-called major regulations. However, this kind of analysis had already been used less formally in the federal government owing to various executive orders and policies imposed by previous presidents. In the years since Reagan’s executive order, the vast majority of states have adopted similar requirements for CBA for regulations, at least nominally. However, this state-level CBA tends to be fairly incomplete and not particularly sophisticated.

This article focuses on the third wave of regulatory reforms that appears to be sweeping the nation currently and includes a prediction as to what the next wave might look like, which turns out to be a return to some unsettled issues from the past. The current wave consists of efforts to manage regulatory output under budget or inventory systems for regulations. These efforts often come under the heading of regulatory reduction or red tape reduction initiatives, but they also constitute efforts to measure, track, and control aggregate regulation levels. It seems likely that these reforms have been set up, at least in part, to address the slow economic growth that the United States has been experiencing in recent years, which may be a result of the near-relentless growth of regulation over the last half century.

The first part of this article will focus on states like Virginia and Idaho that appear to be making the most significant headway as part of the current wave, although the federal government is also engaged in a similar effort. Because these efforts are ongoing, their permanence, durability, and ultimate success remain unclear. But the sheer momentum behind

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7 For example, a report by the Pew Foundation tracked cost-benefit analyses produced in the states, and none of those found were related to rulemaking even though many states require CBA. See Pew Charitable Trusts, STATES’ USE OF COST-BENEFIT ANALYSIS: IMPROVING RESULTS FOR TAXPAYERS (2013).
such efforts makes them notable. The current wave of reforms is also largely a partisan effort, advanced by Republicans, which raises additional questions about the durability of these reforms. It is worth noting, however, that the two previous waves of reforms also began as largely partisan efforts. If this history is any guide, once adopted, regulatory budgets may come to enjoy support from all sides of the political spectrum.

This article next focuses on the future of regulatory reform. Although there are no doubt numerous ways in which regulatory policy could be improved, the focus here will be on revisiting the foundations of CBA, the analytical tool used to evaluate regulations and their impacts. Although the implementation of this tool in regulatory policy constituted the second wave of regulatory reforms, as discussed above, critical problems with CBA remain unresolved by economists and are likely to be revisited as part of a future push for reform. Addressing these methodological problems will become increasingly urgent if CBA is to maintain a prominent place in regulatory policy and maintain credibility among economists, policymakers, and, most importantly, the public.

Although academia will need to play a constructive role in this process, the states and federal independent agencies could also play a role by experimenting with regulatory institutions and, indeed, experimenting with different methods and modes of analysis. This article will conclude by reviewing several interesting state regulatory analysis structures that differ significantly from the federal structure, which other jurisdictions may wish to emulate as they consider how to set up systems to analyze, review, and manage regulations.

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II. Regulating in an Era of Slow Economic Growth

Before delving into the nitty-gritty of regulatory reform, it is worth highlighting why regulation is so important in the first place and why excessive regulation in particular can be problematic. We live in an era of slow economic growth, at least relative to the 20th century. Table 1 presents compound annual growth rates of real GDP and real GDP per capita in the United States for every decade since 1950. A decline is evident—the United States has experienced slower growth in the two most recent decades relative to the second half of the 20th century in terms of both GDP and GDP per capita growth.

Table 1. Compound Annual Growth Rates, by Decade

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<tr>
<td>Real GDP (%)</td>
<td>3.60</td>
<td>4.27</td>
<td>3.16</td>
<td>3.32</td>
<td>3.44</td>
<td>1.74</td>
<td>2.20</td>
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<tr>
<td>Real GDP per Capita (%)</td>
<td>1.80</td>
<td>2.96</td>
<td>2.09</td>
<td>2.35</td>
<td>2.19</td>
<td>0.80</td>
<td>1.50</td>
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Note: Data in the “2010s” column are for the 2010–2018 period.
Source: Author’s calculations based on data from the US Bureau of Economic Analysis, “Real Gross Domestic Product [GDPC1]” and “Real Gross Domestic Product Per Capita [A939RX0Q048SBEA],” retrieved from FRED, Federal Reserve Bank of St. Louis, June 20, 2019.

Of course, GDP is not the same as human fulfillment. Some benefits of regulation do not show up in GDP. Nonetheless, a rising GDP is a reflection of a nation’s wealth increasing—more income is generated each year as national wealth increases—and more wealth is consistent with more opportunity, more jobs, and a better-educated and often healthier and safer

workforce. Increased wealth may even be consistent with more happiness. GDP may not be a perfect measure of a nation’s prosperity, but it may very well be one of the best ones we currently have.

Consider, for example, that if per capita income this century had continued to grow at the historical rate of the second half of the 20th century (2.28 percent) rather than at the rate at which it did grow (1.11 percent), GDP per capita would have been $69,769 in 2018 instead of $56,717 (2012$). This represents a difference of more than $13,000 for every individual in the United States. At some point, an economy that grows more quickly than another economy is so much richer in terms of wealth, technology, and opportunity that one can reasonably say that it is objectively better off in terms of human well-being.

A decline in economic growth is also evident at the state level during the first two decades of this century. For example (as this article is being published in a Missouri law journal), according to the US Bureau of Economic Analysis (BEA), Missouri real GDP grew at a compound annual rate of 0.9 percent from 2000 to 2010. From 2010 to 2017, the corresponding rate was just 0.3 percent annually.

The noticeable slowdown in economic growth, at both the national level and the state level, is a major problem that should be a top concern for policymakers. Even seemingly small differences in growth rates—such as tenths of a percentage point—can add up to billions and

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13 This is an important point because economists have long struggled with how to connect measurable variables like economic growth to human well-being. On this point, see Tyler Cowen, Stubborn Attachments: A Vision for a Society of Free, Prosperous, and Responsible Individuals (2018).
15 Real Total Gross Domestic Product for Missouri, FRED ECONOMIC DATA (May 14, 2019), https://fred.stlouisfed.org/series/MORGSP.
even trillions of dollars over time because of the compounding nature of economic growth. A state growing by 1 percent per year (roughly Missouri’s growth rate in 2017) will take about 70 years to double the size of its economy.\textsuperscript{16} If this rate can be increased to 2 percent annual growth (roughly the national rate in recent years), the doubling time falls to 35 years, which is half as long. In other words, by the end of a typical American life span, the economy would be double the size under the 2 percent growth scenario versus the 1 percent scenario. At 3 percent annual growth, the doubling time falls to 24 years. At this rate, the economy could double three times in an average American’s life span. The end result would be an economy that is four times larger at the end of a typical American life than it would be under the 1 percent scenario.\textsuperscript{17}

It is difficult to conceive of what the US economy would look like if it were two to four times as large as it is today; the benefits in terms of technology, wealth, and opportunity are likely to stretch the bounds of the imagination. Furthermore, growth in the range of 3 to 4 percent, although ambitious, is not out of reach. Tennessee’s economy grew 2.8 percent in 2017, a rate nearly two percentage points higher than Missouri’s; Oregon’s economy grew 3.6 percent in 2017.\textsuperscript{18}

At the same time that growth has been slowing, regulation has been increasing. Over the last 70 years, by virtually every measure, federal regulation in the United States has increased dramatically. According to the Federal Register, there were fewer than 10,000 pages in the US


\textsuperscript{17} According to the Centers for Disease Control and Prevention, life expectancy at birth was 78.6 years in 2016. \textit{See Life Expectancy at Birth, at Age 65, and at Age 75, by Sex, Race, and Hispanic Origin: United States, Selected Years 1900–2016}, CTR. FOR DISEASE CONTROL (2017), https://www.cdc.gov/nchs/data/hus/2017/015.pdf.

\textsuperscript{18} Oregon BEARFACTS, U.S. BEA (Sep. 2018); Tennessee BEARFACTS, U.S. BEA (Sep. 2018).
Code of Federal Regulations in 1950, compared with more than 185,000 in 2018. Regulatory agencies had 57,109 employees in 1960, compared with 277,163 in 2017. Regulator budgets have increased in real terms from $3 billion in 1960 to $58 billion in 2017 (2009$). In 1970, there were roughly 406,000 regulatory restrictions in the US Code of Federal Regulations; by 2018 that number had risen to nearly 1.09 million.

The states also have sizable regulatory codes. As of 2017, Missouri had 113,000 regulatory restrictions on the books. Much of that regulation comes from just a handful of regulatory agencies, such as the state Department of Natural Resources; the Department of Insurance, Financial Institutions and Professional Registration; and the Department of Health and Senior Services.

These two trends—rising regulation and a slowdown in growth—are important because there is strong evidence that slower growth and higher levels of regulation are related. Empirical academic research suggests that regulation slows economic growth and negatively affects the factors that contribute to growth, such as investment, productivity, and innovation. Some progress has been made to reduce the buildup of unnecessary regulations at the state level in

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21 Regulatory restrictions are instances of the terms “shall,” “must,” “may not,” “prohibited,” and “required.”
22 Patrick A. McLaughlin & Oliver Sherouse, RegData 3.1 Annual (dataset), QuantGov, Mercatus Ctr. at George Mason Univ., https://quantgov.org/regdata-us/ (last visited Jun. 12, 2019).
24 Id.
recent years (including in Missouri), and reforms at the federal level are also occurring. But these efforts may not be enough to return growth rates to historical levels. This is especially important with respect to federal regulations because counts of federal regulations far exceed state regulations. In some cases, a single federal agency targets tens of thousands of restrictions at state businesses all by itself, which can be more than all the restrictions found in an entire state’s regulatory code. As just one example, the federal Environmental Protection Agency is estimated to impose more than 80,000 restrictions on the chemical manufacturing industry alone, whereas some states, such as Montana, have as few as 60,000 restrictions in their rulebooks.

III. The Current Wave of Regulatory Reform: Cutting Red Tape with Regulatory Budgets

Given disappointing economic growth in recent years, combined with the empirical observation that regulation has been increasing for decades, it is not surprising that governments are looking to regulatory reform to boost growth. Researchers at the Mercatus Center at George Mason University have estimated that federal regulation is slowing national economic growth by about 0.8 percentage points a year. Lowering growth by a little under one percentage point may not sound like a lot, but, put differently, it means that, had regulation levels been capped in the

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27 For example, the No Mo Red Tape initiative was a priority of the administration of Missouri Governor Eric Greitens.
30 Id.
33 Coffey et al., The Cumulative Cost of Regulations, supra note 25.
United States in 1980,\textsuperscript{34} 2012 GDP would have been $4 trillion larger, amounting to $13,000 in extra income for each American.

Other studies estimate even larger effects than this,\textsuperscript{35} and state regulations are an added burden layered on top of the federal regulatory burden. State and federal governments continue to struggle to rein in the explosive growth of the administrative state over the last 70 years, but two states’ efforts in particular are worth highlighting for their innovative attempts to curb regulatory growth. These are Virginia and Idaho.

\textit{A. Virginia}

In 2018, Virginia passed the Regulatory Reduction Pilot Program (RRPP).\textsuperscript{36} This legislation was quite remarkable for two reasons. First, in an era generally known for political polarization, it passed overwhelmingly with bipartisan support.\textsuperscript{37} The final bill sailed nearly unanimously through a legislature narrowly controlled by Republicans\textsuperscript{38} and was signed into law by Governor Ralph Northam, a Democrat. Second, the RRPP created one of the first state regulatory budgets in the United States.\textsuperscript{39}

Virginia’s new law likely achieved such consensus because it focuses—to start—on cutting occupational licensing requirements, a form of regulation that both liberals and

\footnotesize{\textsuperscript{34} Note that capping regulation at a particular year’s level is not the same as no new regulation after that year. New regulation would be allowed, but old regulations would have to be removed to allow for new regulations.}

\footnotesize{\textsuperscript{35} For example, Dawson and Seater estimate that GDP in 2011 would have been $39 trillion larger had regulation been capped at 1949 levels. See Dawson & Seater, supra note 25.}


\footnotesize{\textsuperscript{37} James Broughel, \textit{A Reform That Offers Hope for Centrists}, WASH. POST (Mar. 14, 2018).}

\footnotesize{\textsuperscript{38} The bill passed 40 Yea votes to 0 Nays in the Senate and 96 to 3 in the House. LEGISCAN, https://legiscan.com/VA/votes/HB883/2018 (last visited May 14, 2019).}

\footnotesize{\textsuperscript{39} The federal government has also been experimenting with regulatory budgeting. See Exec. Order No. 13,771 supra note 28.}
conservatives tend to disfavor.\textsuperscript{40} There is widespread agreement among economists in particular that licensing regulations often limit upward mobility, harm traditionally disadvantaged groups, and stifle competition.\textsuperscript{41} Furthermore, by focusing reform on occupational licensing in general, rather than on specific licenses, the effort may face less concentrated opposition from regulated professions, which often hinders such reforms.\textsuperscript{42}

The Virginia law includes several key elements. First, it tasks two state agencies—the Department of Criminal Justice Services and the Department of Professional and Occupational Regulation—with producing a baseline count of their regulations and regulatory requirements.\textsuperscript{43} This process will establish an inventory of the agencies’ requirements. As of late 2018, the agencies began reporting their counts, finding 6,226 requirements between them.\textsuperscript{44} Roughly 80 percent of these are discretionary, meaning the requirements are not required by law, so the relevant agency has the ability to remove them. Of the 4,947 discretionary requirements, the agencies are required to cut 25 percent of them.\textsuperscript{45} This amounts to roughly 1,200 requirements that the agencies must eliminate by the end of 2021. If they fail to achieve the reduction,

\begin{itemize}
\item \textsuperscript{40} James Broughel, Licensing, Justice Reform Will Aid Virginia’s Poorest, CHARLOTTESVILLE DAILY PROGRESS (Mar. 25, 2018).
\item \textsuperscript{42} For example, many occupational licensing requirements exist to protect established interests rather than to serve the public interest. See MELLOR & CARPENTER, supra note 41.
\item \textsuperscript{44} See Letter from Aubrey L. Layne Jr., Va. Secretary of Finance, to members of the Va. House of Delegates and Senate (Oct. 22, 2018), available at https://gallery.mailchimp.com/e8c66a6ccb254adb5e21e438b/files/7ba34af5-8103-436d-b2a8-19e7aedbf20d/20181025105757192.pdf.
\item \textsuperscript{45} Technically, the law requires agencies to identify discretionary and nondiscretionary requirements, and the reduction target of 25 percent is set based on the overall count. In practice, the two agencies have set the reduction goal based on discretionary requirements only.
\end{itemize}
alternative measures will be considered—for example, the implementation of a policy whereby for every requirement added, two must be eliminated.\textsuperscript{46}

In addition—and perhaps more importantly—by July 1, 2020, all executive branch agencies subject to the state Administrative Process Act will have to produce a baseline regulatory catalog and report their catalog data. At that point, it is quite possible that the pilot program will be expanded to other, and perhaps even all, state agencies. It remains unclear whether reporting will continue beyond the pilot phase or whether additional reductions will be required beyond the two initial pilot agencies. But if the Virginia reform is successful at meeting the reduction targets—and it seems to be on track so far—while also maintaining high levels of public health and safety, it seems likely the new regulatory budget could become a permanent feature of Virginia’s regulatory process.

Notably, in 2018, CNBC named Virginia one of America’s best states for business, citing the new regulatory reduction law as a major reason for Virginia’s strong improvement in the rankings from the previous year.\textsuperscript{47} Given this positive response from the media, it is not surprising that other states are considering emulating Virginia’s reforms.\textsuperscript{48}

\textbf{B. Idaho}

Idaho is also in the early stages of enacting a regulatory budget. Shortly after taking office in January of 2019, Governor Brad Little made regulatory reform one of his top priorities by


\textsuperscript{47} Jeff Clabaugh, \textit{Virginia Ranks 4th Among CNBC’s Best States for Business}, WTOP (Jul. 10, 2018).

signing two executive orders targeting regulatory burdens.\textsuperscript{49} Little’s Executive Order 2019-02 establishes a policy whereby for each new regulation added, two will have to be identified for elimination or significant simplification.\textsuperscript{50} As in Virginia, policymakers in Idaho are also estimating a baseline count of regulations. The order identifies a total of 8,200 pages and 72,000 restrictions in the Idaho Administrative Code.\textsuperscript{51} These estimates provide a benchmark against which future cuts in regulation can be measured. The order also establishes clear lines of responsibility, designating rules-review officers within state agencies and tasking the state Office of Financial Management (OFM) with regular reporting on the effort. The OFM will also review agency rule and repeal activity before rules are formally proposed, thereby ensuring that the one-in, two-out policy is followed.

Signed on the same day as Executive Order 2019-02, Executive Order 2019-01 implemented occupational licensing reforms by establishing sunrise and sunset reviews for Idaho state licenses.\textsuperscript{52} The actions of both Virginia and Idaho highlight how states sometimes pair specific targeted regulatory reforms, like occupational licensing or criminal justice reform, with broader regulatory process reforms like regulatory budgets. Such piggybacking of broad-based regulatory reforms with consensus reforms may be a wise strategy. It suggests that relatively uncontroversial reforms may be a useful launching pad for more general reforms that might be perceived as somewhat controversial on their own. Kicking off broader reforms with pilot

\textsuperscript{50} Alternatively, the agency will have to explain why this is impossible. See Governor Brad Little, Exec. Order No. 2019-02 (Jan. 21, 2019), https://gov.idaho.gov/wp-content/uploads/sites/74/2019/01/eo-2019-02.pdf.
\textsuperscript{51} Id.
programs may also help produce new knowledge by allowing experimentation to occur before reforms are implemented more broadly.

Several elements of Idaho’s reform effort are notable, as they have been identified as critical to the success of regulatory reduction efforts in other jurisdictions, most notably in Canada. 53 These elements include a baseline count of the total amount of regulations in place, a process by which to achieve a meaningful reduction (one in, two out), oversight mechanisms, and regular reporting. 54

Interestingly, due to the somewhat unusual regulatory process in Idaho, Governor Little also has a unique opportunity to replace the entire Idaho Administrative Code with a new version more to his administration’s liking. The Idaho legislature is required to pass a rule reauthorization bill each year, or else all regulations in its code expire. 55 In 2019, the legislature failed to pass the bill. 56 All regulations on the books therefore expire on July 1, 2019, unless passed as emergency regulations, allowing the administration to, in essence, repeal and replace the entire Idaho Administrative Code.

Before the Idaho legislature opted to let the state code expire, the Little administration had to justify any deregulatory action by issuing a new rulemaking. But with entire code set to sunset, the administration has to justify any regulations that it wants to keep by formally issuing a new rule, which has reversed the burden of proof. The results are already showing. At the end

53 Laura Jones, Cutting Red Tape in Canada: A Regulatory Reform Model for the United States? (Mercatus Research, Mercatus Ctr. at George Mason Univ., 2015).
56 James Broughel, Mercatus Ctr. at George Mason Univ., Idaho Repeals Its Regulatory Code, THE BRIDGE (May 9, 2019).
of June 2019, the Little administration announced it would allow 20 percent of all rule chapters and 900 pages (out of 8,200) to expire on the July 1 deadline.\(^57\)

This situation highlights the potential power of sunset provisions built into regulatory codes. Not only can sunsets return some accountability to the legislative branch of government by forcing legislators to take a yea or nay vote on rules, but sunsets can also be used to trigger retrospective review and evaluation of existing rules by forcing rules back through the rulemaking process, to be justified anew. For example, Rhode Island is another state that forced a regulatory reset by setting a one-time expiration date for its entire code, in this case for the purpose of moving rules to an online system. In the process it eliminated 31 percent of the state’s rule volume.\(^58\)

The Idaho reform is truly innovative and should be watched closely going forward. While there is the danger that Idaho’s regulatory reset could unleash uncertainty in the marketplace, it also has the potential to spur reductions in regulatory burdens that would simply be unachievable in more conventional settings.

**C. Other Promising Efforts**

President Donald Trump’s administration has also been experimenting with a regulatory budget in recent years.\(^59\) The federal regulatory budget is of a more traditional form than those the states are establishing, because it relies on cost estimates. In other words, the administration allocates a limited amount of cost burden to agencies each year, and they are not allowed to exceed this

\(^{57}\) Press Release, Governor Brad Little, How Idaho Ushered In the Largest Regulatory Cuts in State History (Jun. 19, 2019).

\(^{58}\) Press Release, Governor Marie Raimondo, Governor Raimondo Announces Largest Successful Regulatory Reform Effort in State History (Oct. 15, 2018).

burden with their regulations. By contrast, the states are limiting the number of regulatory requirements or restrictions.\textsuperscript{60} The federal regulatory budget is also an incremental budget, setting annual allowances for new regulations only, whereas the Virginia budget is based on regulatory totals, which is more comprehensive.

In theory, basing agency allocations on regulatory cost makes sense because different individual restrictions or requirements could have vastly different economic impacts. However, there are also limitations to relying on cost estimates, most notably that so few regulations even have credible cost estimates.\textsuperscript{61} Even when federal agencies attempt to estimate the costs of their regulations, their estimates can be compromised by political factors or may not be accurate owing to uncertainty.\textsuperscript{62} Thus, the simpler regulatory budgets being implemented in the states (some of which take a pay-as-you-go approach by requiring that new regulations be offset by eliminating old ones) may be more practical and even more efficient than cost-based budgets. Despite any shortcomings with its approach, however, the Trump administration deserves credit for helping to usher in the current wave of regulatory budgets. It seems likely that, by making regulatory reform an early priority of his administration, President Trump has inspired and built momentum for similar state efforts.

At least 20 states have initiated red tape reduction efforts since 2010.\textsuperscript{63} Some of them include elements of a regulatory budget, such as putting in place caps or limits on regulatory restrictions, requiring regulatory offsets, or setting reduction targets. These have mostly been

\textsuperscript{60} Historically, placing limits on regulatory cost has been the traditional way regulatory budgets have been framed. See, e.g., S. 51, 96th Cong., introduced by Senator Lloyd Bentsen in 1979, http://www.thecre.com/forum2/wp-content/uploads/2015/08/S-51-2.pdf.

\textsuperscript{61} James Broughel & Laura Jones, \textit{Effective Regulatory Reform}, supra note 54.

\textsuperscript{62} Id.

\textsuperscript{63} Justin Smith, \textit{No Mo Red Tape: Cutting Burdensome Rules in Missouri}, Univ. of Missouri Law School symposium, \textit{Protecting the Public While Fostering Innovation and Entrepreneurship: First Principles for Optimal Regulation} (Feb. 8, 2019).
governor-led efforts, often initiated via an executive order. Though none of these efforts to date have implemented a permanent, comprehensive state budgeting system for regulations, such a system may indeed be coming. Furthermore, the emphasis that governors are placing on measuring regulations and on reducing regulatory burdens is notable, suggesting a pervasive sense that the United States is overregulated. The momentum behind the current wave of reforms may just be getting started.

IV. The Next Wave of Regulatory Reform: Revisiting the Foundations of Cost-Benefit Analysis

Despite CBA being a dominant analytical framework for evaluating the potential effects of regulations, the outputs of CBA are neither objective nor even particularly meaningful, as this section will explain. Given the roughly 40-year history of CBA as applied to regulations, many might be surprised to learn that there is no consensus among economists as to what cost-benefit analysis measures. Some economists see the welfare measure underlying CBA as a form of economic efficiency, formally known as Kaldor–Hicks efficiency. Other economists are not interested in this approach, largely because efficiency, in part, depends on the initial distribution

65 The two dominant approaches to discounting in CBA are focused on different measures of welfare. See Three Approaches to the Social Discount Rate, MERCATUS CTR. AT GEORGE MASON UNIV. (Dec. 6, 2018), https://www.mercatus.org/publications/regulation/social-discount-rate.
66 For an example of an economist who prefers that CBA measure efficiency, see David Burgess, The Appropriate Measure of the Social Discount Rate and Its Role in the Analysis of Policies with Long-Run Consequences (Mercatus Symposium, Three Approaches to the Social Discount Rate, Mercatus Ctr. at George Mason Univ., Dec. 6, 2018).
of wealth. Critics of efficiency, who seem more concerned with the distribution of wealth than with the overall amount, base CBA on a mathematical function representing social welfare.

Strangely, neither those who say they measure efficiency nor those who say they measure social welfare actually measure what they claim to measure. The problem with the social welfare approach is that economists generally agree that individual preferences cannot be aggregated into a community-wide social welfare function. Kenneth Arrow’s famous impossibility theorem proved that, under certain reasonable restrictions, it is mathematically impossible to aggregate individual preferences into a cumulative social welfare function. There are ways around Arrow’s impossibility theorem by relaxing the restrictive assumptions. For instance, if economists could map individual levels of consumption into units of cardinal utility, then a social welfare function might be obtainable. But no credible, agreed-upon method of mapping in this way exists, which is one reason why Kaldor–Hicks efficiency tends to enjoy ongoing support among economists.

Kaldor and Hicks’s approach came in response to a particular problem: how should economists deal with interpersonal comparisons of utility? If two people each receive one dollar, but one is rich and one is poor, who is made better off in terms of utility? The answer

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69 Sometimes this welfare function is interpreted as describing a social planner’s welfare. For an example of economists who prefer that CBA measure social welfare, see Mark Moore & Aidan Vining, The Social Rate of Time Preference and the Social Discount Rate (Mercatus Symposium, Three Approaches to the Social Discount Rate, Mercatus Ctr. at George Mason Univ., Dec. 6, 2018).

70 KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (3rd ed. 2012 [1951]).

71 Such as the assumption that no single individual is allowed to be a dictator whose preferences are always satisfied.


73 Indeed, some researchers try to do just this. See MATTHEW ADLER, WELL-BEING AND FAIR DISTRIBUTION: BEYOND COST-BENEFIT ANALYSIS (2012).

74 On the current inability to map consumption to utilities in a satisfactory manner, see Cass Sunstein, Cost-Benefit Analysis: Who’s Your Daddy? 7 J. OF BENEFIT-COST ANALYSIS 107 (2016).

75 See Lionel Robbins, Interpersonal Comparisons of Utility: A Comment, ECON. J. 635 (1938); Kaldor, supra note 67, and Hicks, supra note 67.
Kaldor, Hicks, and other economists such as Lionel Robbins settled upon was that economists should not make value judgements about such situations. Economists are well positioned to make assessments as to whether the overall economic pie has increased or decreased. Their expertise can also provide insights into whether a particular policy is likely to lead to a specified end result. These assessments involve positive analysis. But Kaldor, Hicks, Robbins and others believed economists should avoid making interpersonal comparisons of utility that involve normative judgments about how the economic pie should be distributed and whether particular distributions of wealth are superior to alternative distributions. These are matters on which economists have no particular expertise.

Kaldor–Hicks efficiency, therefore, is indifferent to the distributional outcomes of policy. In efficiency analysis, the net benefits calculation identifies whether total wealth increases from a policy change, irrespective of its distribution, and the analyst need not make any particular claims as to whether overall social utility has increased.

It should be obvious, therefore, that treating a unit of consumption as if it provides differing amounts of utility depending on who receives it is inconsistent with efficiency. But this is precisely what economists do when they engage in the practice of discounting. A social discount rate places weights on consumption based on the assumption that a unit of consumption will provide differing amounts of utility depending on when it is delivered in time. Discounting in this manner makes interpersonal comparisons of utility, violates the assumption that analysis

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76 Note that efficiency in the Kaldor–Hicks sense, which is how the term is used here, is different from efficiency in the Pareto sense, which is a situation in which no one can be made better off without making at least one other person worse off. Kaldor–Hicks improvements are sometimes referred to as “potential Pareto improvements” because if compensation from winners to losers took place, efficient projects would result in at least one person being made better off without making anyone else worse off, i.e., a Pareto improvement. While Pareto improvements are generally more desirable, virtually all policies create some losers, so judging policies on the basis of whether they are Kaldor–Hicks improvements has proved more practical, since compensation is usually unrealistic.
is indifferent with respect to the distribution of wealth, and is therefore inconsistent with efficiency in the Kaldor–Hicks sense. Curiously, those economists who say they want CBA to measure efficiency do not seem to mean it, because they insist on the practice of discounting consumption in CBA.\textsuperscript{77} Their stated and revealed preferences diverge.

Some might argue that these problems involving welfare measures are not so important. For example, despite economists not agreeing on what CBA measures, perhaps the different approaches are not so different from one another in their recommendations. This view is mistaken for two reasons. First, \textit{it is not clear what cost-benefit analysis measures}. Even if standard approaches produce similar recommendations, they may not measure anything meaningful,\textsuperscript{78} in which case an entirely different approach is needed. Second, since standard methods do not actually measure Kaldor–Hicks efficiency, the most obvious alternative to present practices is to measure efficiency, which many economists already support.

Unfortunately, such an approach is likely to lead to dramatically different policy recommendations compared with present approaches, because a steadfast commitment to wealth maximization, combined with distributional indifference, would mean a commitment to pursuing capital accumulation and economic growth above all other considerations.\textsuperscript{79}

Whether or not economists are willing to tackle these challenges is unclear. Revisiting the foundations of CBA might mean admitting that decades of academic research have led economists down a dead end. On the other hand, if economists do not revisit these issues, the

\textsuperscript{77} See James Broughel, \textit{The Unsettled Matter of Discounting the Future} (Mercatus Symposium, \textit{Three Approaches to the Social Discount Rate}, Mercatus Ctr. at George Mason Univ., Dec. 6, 2018).
prospects for CBA look dim because the credibility of CBA, as well as any policies based on it, is in doubt. This article is a call for such reconsideration by economists.

V. Procedural Reforms Might Result in Higher-Quality Cost-Benefit Analysis

Given the problems with CBA outlined above, one might wonder whether there is any value in producing CBA at all. However, there are several reasons to believe CBA is not worth abandoning just yet. First, CBA’s foundations could be firmed up relatively easily by simply measuring efficiency rather than some vague notion of social welfare or distributive fairness. Second, it is unclear what an alternative to CBA would be.

However, the problems identified in section IV of this article are damning in one way: they give reason to believe that the institutions that govern the federal regulatory process do not work well. Otherwise, how could these issues have been allowed to fester unresolved for so long? This suggests that perhaps the states and territories should experiment with different regulatory regimes than those that currently exist at the federal level.

CBA is still relatively rare in the states, so questionable CBA practices may not yet be entrenched in state governments the way they are in Washington, DC, or in academia. Obviously, academic economists must play an important role in reshaping the CBA of the future. But perhaps institutional experimentation, including experimentation with welfare measures, could help improve the quality of regulatory analysis and, more importantly, make CBA useful for practical policy decisions. In addition to states, so-called independent agencies in Washington, DC, which have traditionally been exempt from many CBA requirements, could be well positioned to experiment along similar lines.
Several examples in the states offer a glimpse of what improvements in the regulatory analysis and review process might look like. One example comes from New Hampshire, which requires a “fiscal impact statement” for proposed regulations.\textsuperscript{80} Notably, this analysis is supposed to capture more than just the budgetary impacts of rules to the state government. It must also include “a narrative stating the costs and benefits to the citizens of the state and to the political subdivisions of the intended action.”\textsuperscript{81} This model is noteworthy in that the analysis is produced by the legislative budget assistant in the legislature,\textsuperscript{82} not by the agencies that regulate (although the two often work together to construct the final analysis). This process helps address the issue—commonly found in federal regulatory analyses—that analysis is produced to reach a predetermined conclusion or to defend a regulation, as opposed to honestly assess the outcomes of the regulation.\textsuperscript{83} Regulatory agencies are run by political personnel who come into office with agendas and may pressure analysts to bend analysis to support policy objectives.\textsuperscript{84} Thus, analytical independence from these political forces is important.

The New Hampshire process requires review by the Joint Legislative Committee on Administrative Rules (JLCAR), including a review of analysis.\textsuperscript{85} Thus, both the production of analysis and its review take place in the legislative branch, away from the political influence of...

\textsuperscript{80} N.H. Rev. Stat. § 541-A:5.
\textsuperscript{81} N.H. Rev. Stat. § 541-A:5(IV)(a).
\textsuperscript{82} N.H. Rev. Stat. § 541-A:5(IV).
\textsuperscript{83} This is why regulatory analyses are commonly referred to as “advocacy documents.” See E. Donald Elliott, \textit{Rationing Analysis of Job Losses and Gains: An Exercise in Domestic Comparative Law, in DOES REGULATION KILL JOBS?}, (Cary Coglianese et al. ed., 2014); and Christopher Carrigan & Stuart Shapiro, \textit{What's Wrong with the Back of the Envelope? A Call for Simple (and Timely) Benefit–Cost Analysis}, 11 Regulation and Governance 203 (2017).
\textsuperscript{84} This is confirmed by news stories and interviews with agency economists. See Carol Davenport & Eric Lipton, \textit{Scott Pruitt Is Carrying Out His E.P.A. Agenda in Secret, Critics Say}, N.Y. Times (Aug. 11, 2017); Stuart Shapiro, \textit{ANALYSIS AND PUBLIC POLICY: SUCCESSES, FAILURES, AND DIRECTIONS FOR REFORM} (2016); and Richard Williams, \textit{The Influence of Regulatory Economists in Federal Health and Safety Agencies} (Working Paper, Mercatus Ctr. at George Mason Univ., Jul. 2008).
the governor and his administration. By contrast, at the federal level, both production and review of analysis take place in the executive branch.\textsuperscript{86} This is not to say New Hampshire’s process works perfectly. For one thing, the reviews by the JLCAR seem to focus mostly on legal criteria rather than on economic impacts, and legislatures are also political, of course. Nonetheless, the New Hampshire model is one that is well worth considering.

Another possible best practice comes from Wisconsin, where legislators can request an alternative CBA, distinct from one produced by the regulatory agency, to be commissioned, for example from an outside consulting firm.\textsuperscript{87} This raises the possibility of competing analyses. Notably, if the total implementation and compliance costs estimated in a second analysis vary from the agency’s original estimate by 15 percent or more, the cost of the CBA is then charged to the agency’s budget.\textsuperscript{88} This provides a financial incentive for agencies to be accurate and honest up front. Having legislators request the CBA also changes incentives from what they might be if firms were contracted by a regulatory agency directly.\textsuperscript{89}

Taken together, New Hampshire and Wisconsin raise interesting questions about whether independent production of analysis and third-party review of analysis from outside the executive branch are potential improvements to administrative procedures that would result in higher-quality, more credible, and more useful analysis. There is no guarantee such reforms would bring about better CBA, especially without shoring up CBA’s theoretical foundations. Nonetheless, these experiments are notable and worth thinking about carefully.

\textsuperscript{87} WIS. STAT. § 227.137(4m).
\textsuperscript{88} WIS. STAT. § 227.137(4m)(b)(2)(a).
\textsuperscript{89} For example, if an agency wants its actions portrayed in the best light possible, and contractors know this, those contractors who want recurring work from an agency can be expected to give agencies the answers they want.
VI. Conclusion

Although the federal government has been experimenting with innovative reforms in recent years, including a regulatory budget, the states have been more aggressive when it comes to setting up procedures to review old regulations, establishing budget infrastructure for regulations, and setting benchmarks for reducing red tape. Virginia and Idaho in particular appear to be models that other states should look to for inspiration, and other states may be close behind. Given years of slow growth in the United States, coinciding with steady regulatory accumulation, these efforts are a welcome development.

Going forward, reforming CBA should be the next top priority of reformers. The lack of a coherent welfare measure underlying CBA in particular is the most troubling aspect of modern CBA. This is not to say that CBA should be abandoned—far from it. In fact, committing CBA to the measurement of allocative efficiency is a practical way forward that would almost certainly pave the way for vast improvements in evidence-based policy. Present practices seem designed to justify predetermined policy preferences rather than to assess the actual consequences of policy.

The states are way behind the federal government when it comes to adopting cost-benefit analysis for regulations, but this may well prove to be an advantage rather than a shortcoming. The states can learn from the many missed opportunities at the federal level, perhaps by establishing independent production and review of analysis outside the executive branch, as well as setting clearer standards for what cost-benefit analysis should look like and what it should measure. Such experimentation in the laboratories of democracy may prove to be the best hope for ushering in the next critical wave of US regulatory reform. Although the challenges associated with regulatory reform are great, they are not insurmountable, and the lessons learned
from the previous waves of reform are many. If those lessons are heeded, the next wave may prove to be the most successful of all.