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POLICY BRIEF

A Primer on Regulatory Impact Analysis

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For more than 40 years, federal regulators have produced economic analysis for some of their most significant rules. As part of this process, the Office of Management and Budget (OMB) reviews the rules and accompanying analysis from these regulators in an oversight capacity. This policy brief provides an overview of this process and aims to educate policymakers about how this system works so they can get more involved in the regulatory process. It also offers lessons for policymakers looking to build on analytical capabilities in their state or agency.

Regulatory impact analysis (RIA) can be seen as a decision-making framework applied to regulations. The core elements of RIA and its history are described in this brief. This framework has many advantages, but it also has some shortcomings, which will be discussed. A key lesson for federal and state policymakers is to be realistic about what RIA can and cannot do. Value judgments routinely enter the analysis, and these can be confused with statements of scientific fact. That said, RIA can still contribute considerable value.

Despite whatever limitations RIA may have, it is important that policies have some evidentiary basis. RIA is a tool to incorporate economic and scientific evidence into rulemaking, and it is based on the logic that evidence-based policies will be more likely to succeed. This decision-making framework does not always work perfectly, but it is better than most known alternatives. Moreover, there are many opportunities for reform. This especially true at the state level where the use of analysis to inform rulemaking is still quite limited.

HISTORY OF FEDERAL REGULATORY ANALYSIS AND OIRA REVIEW

In 1975, President Gerald Ford issued the first executive order requiring that federal executive branch agencies produce economic analysis for their major regulatory actions.[1] These regulatory analyses were originally referred to as "inflation impact statements."[2] In the mid-1970s, inflation was high, and many observers wondered if the growth of regulation was a contributing factor. The Council on Wage and Price Stability (CWPS) was set up a year earlier specifically to address the problem of inflation.[3] One of its main responsibilities ended up being commenting on federal regulatory actions from an economic point of view.[4]

President Ronald Reagan is most closely associated with institutionalizing RIA requirements for federal agencies. In 1981, Reagan issued Executive Order 12291, which required executive agencies to produce an RIA, including a cost-benefit analysis (CBA).[5] The order also required that major regulatory actions from executive branch agencies undergo review by the recently created Office of Information and Regulatory Affairs (OIRA), a small office within OMB that was tasked with tracking paperwork burdens.[6] OIRA's newly added responsibilities under Reagan's executive order can be seen as serving two primary roles. First, OIRA enhances presidential control over regulatory agencies.[7] In this sense, OIRA's reviewing of regulations makes the regulatory process more democratic by bringing unelected regulators under the direct control of the democratically elected president. Second, OIRA serves as a regulatory analysis watchdog, meaning it reviews analyses to ensure they meet certain minimal quality standards.[8]

Like the requirements for economic analysis for regulations, review of regulations by OMB predated Reagan's executive order. Precursors to OIRA include an environmental quality review established by President Richard Nixon's administration, a regulatory analysis review group that existed under President Jimmy Carter,[9] and the CWPS commenting process under President Gerald Ford. Indeed, some CWPS staff later went to work at OIRA.

Reagan's Executive Order 12291 formalized and made more permanent these procedures that were previously temporary and informal. In 1993, President Bill Clinton replaced it with Executive Order 12866, but this replacement retained most of Executive Order 12291's core elements, including requiring RIA and OIRA review for the most significant executive branch regulations.[10]

Clinton's executive order remains the law of the land to this day. Thus, the core analytical requirements of the federal regulatory system have now been in place for decades with few significant changes in the past 40 years,[11] thereby demonstrating the staying power of CBA, RIA, and OIRA review in the federal rulemaking process.

WHAT IS REGULATORY IMPACT ANALYSIS?

RIA is first and foremost a decision-making framework. It is broader than just a tally of various costs and benefits, which is what the CBA portion of an RIA is supposed to accomplish. In this sense, it is important not to conflate CBA with RIA. Even if there are problems with CBA as it is presently practiced, these problems are not grounds to dismiss every aspect of RIA.

A complete RIA should include at least four elements: (1) a description of the market failure or other systemic problem the regulation is addressing; (2) a description of the outcome the regulation is intending to achieve; (3) a discussion of alternative ways of addressing the problem to achieve the desired outcome; and (4) a CBA of each alternative, so that the alternative with the most net benefits can be identified among those considered.

The basic logic of RIA is that by following an organized decision-making process using evidence at each stage of analysis (usually based on empirical data and published academic research), regulations will be crafted so that they solve real problems without exorbitant cost to the public. Such a framework seems eminently reasonable, especially if the alternative is for regulations to be issued in response to the political winds of the day or at the request of special interests, not backed by evidence. Though executing and realizing the full potential of RIA is challenging, especially given political pressures inevitable in rulemaking, the underlying philosophy of RIA is hard to argue against.

IS COST-BENEFIT ANALYSIS CONTROVERSIAL?

As noted earlier, OIRA serves primarily two roles in the rulemaking process: (1) enhancing presidential control over regulations, and (2) ensuring that regulatory analysis meets minimal standards of quality.

In the first role, OIRA has been successful. Before OIRA's creation, presidents often complained about the difficulty of controlling executive agencies.[12] In the decades since, those calls have grown less common, in major part because of OIRA. In the second role, however, OIRA's effectiveness is far less clear. The quality of RIA produced by federal agencies has long been criticized, for example.[13] One reason is that many RIAs do not include the basic elements discussed earlier, such as a description of the problem the agency is addressing, a discussion of the outcome sought, a list of alternative solutions, and a CBA of each alternative.

Moreover, the CBA portion of RIA, which often receives the most attention from policymakers and journalists, has long been subject to certain controversies. In part, this is because CBA includes a mix of positive and normative attributes. The *positive* attributes of CBA are the statements of objective scientific fact. Examples include estimates of how much compliance spending a regulation has caused in the past or how many deaths it could potentially prevent. Though sometimes imprecise, such estimates are nevertheless arrived at through scientific means and measurement. The *normative* attributes are value judgments, which enter CBA at various stages. These include underlying assumptions—sometimes made explicit but very often not—such as whose welfare should be considered in the analysis or how much weight the welfare of people living in the future should receive relative to the welfare of those living today.[14]

Some economists believe that CBA should take better account of distributional factors. For example, the Biden administration is considering updating RIA guidelines to take more account of equity.[15] CBA could also deal better with the issue of opportunity cost. The opportunity cost of resources relates to what would happen with those resources in absence of a particular policy action.[16] Although OMB and many regulatory agencies mention opportunity cost in their guidelines on RIA,[17] in practice it tends to go neglected in CBA.[18]

As a result of some problematic core assumptions, value judgements, and philosophical disagreements, some view the CBA skeptically. However, analyses simply reflect the values of the analysts who produce them. It is perfectly reasonable to disagree with those values, but it is also within those analysts' rights to hold those values, no matter how much one might find them objectionable.

LESSONS FOR STATE AND FEDERAL REFORM

Like the federal government, many states have some regulatory analysis requirements.[19] Some states, such as Rhode Island, have a budget office review that mimics OIRA review.[20] In general, analysis at the state level tends to be cursory. This is a problem because it means regulations are being implemented without much evidence. However, it presents an opportunity because it means states do not have the institutional baggage that the federal government does that might make it hard to reform its process. In other words, practices in the states have not become entrenched to the same extent, creating constituencies that benefit from institutional continuity and therefore are resistant to change.

A state looking to establish analytical competencies for regulations might look to OIRA as a model, but it is far from clear that this is the best model. One alternative model worth considering comes from the West Virginia Division of Regulatory and Fiscal Affairs.[21] This is a legislative office overseen by a PhD economist with a staff of four fiscal analysts. Unlike OIRA, which is in the executive branch, an analytical office housed in the legislative branch can be independent of the political pressures imposed by the executive. To be clear, OIRA enhances democratic accountability, but its quality of analysis almost certainly suffers as a result. Moreover, legislatively produced analysis could facilitate legislative oversight of the executive branch. Thus, both the states and the federal government should consider whether a legislative regulatory analysis office makes sense.

In general, policymakers should think carefully about what entity should produce analysis and whether such entities should be located inside the government (and which branch or agency they should be a part of), outside the government, or both. There could be an OIRA-like office in the executive branch whose primary responsibility is to ensure state regulations conform with executive priorities, and there could be an office in the legislative branch that is tasked primarily with producing analysis, much like how the Congressional Budget Office analyzes fiscal impacts of legislation. This would separate the political and analytical roles, unlike at OIRA, a place where politics and analysis are known to clash (with politics usually winning).[22] Subdividing responsibilities in this manner would preserve democratic accountability while also creating a role for objective and independent analysis.

CONCLUSION

RIA has many advantages. It brings a coherent and rational decision-making framework into the administrative rulemaking process. That said, CBA allows many value judgments to enter RIA in a manner that is sometimes opaque. Fortunately, CBA is not the only function of RIA, and it is not even necessarily the most important. Equally if not more important functions of RIA are defining the problems at hand and considering alternative ways of addressing them.

Despite its shortcomings, CBA, even in its current form, is better than nothing. CBA at least forces agencies to offer a justification for their rules, backed by some evidence as to why they believe their regulation improves social welfare. Furthermore, it seems reasonable that policies should be judged on the basis of their benefits and costs, even if analysis does not always determine this basis directly.

The states may be better positioned than the federal government to improve on analytical procedures, if for no other reason than that most states are not wedded to particular political arrangements or analytical approaches. OIRA review offers one model for how states could set up analytical institutions, but this is not the only model and may not be the best model.

The federal government should also experiment to update and improve procedures that have changed very little in the past 40 years. In this sense, it is a welcome development that the Biden administration is considering making changes to the regulatory analysis and review process. Without experimentation, institutions will not adapt, and progress will eventually stall. However, until concrete proposals emerge and are enacted, it remains to be seen whether changes will have a lasting or beneficial impact on the regulatory process and, by the extension, on the Americans that live under it.

ABOUT THE AUTHOR

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NOTES

1. Exec. Order No. 11821, 3 C.F.R. 926 (1975).
2. Eventually, the original name was dropped, and the name of the 1975 executive order was amended to "Economic Impact Statements." See Exec. Order No. 11949, 3 C.F.R. 161 (1977).
3. Council on Wage and Price Stability Act, Pub. L. 93-387, 88 Stat. 750 (1974).
4. Thomas Hopkins and Laura Stanley, "The Council on Wage and Price Stability: A Retrospective," *Journal of Benefit-Cost Analysis* 6, no. 2 (2015): 400.
5. Exec. Order No. 12291, 46 Fed. Reg. 13193 (February 17, 1981).
6. OIRA was created by the Paperwork Reduction Act of 1980. One main purpose of the act was to reduce the burden of government paperwork on the public.
7. Dima Yazji Shamoun and Bruce Yandle, "Asserting Presidential Preferences in a Regulatory Review Bureaucracy," *Public Choice* 166, no. 1 (2016): 87–111.
8. John Morrall, "Reinvigorating, Strengthening, and Extending OIRA's Powers" (Testimony before the House Committee on the Judiciary, Mercatus Center at George Mason University, Arlington, VA, September 30, 2013).
9. Jim Tozzi, "OIRA's Formative Years: The Historical Record of Centralized Regulatory Review Preceding OIRA's Founding," *Administrative Law Review* 63, no. 27 (2011): 37–69.
10. Exec. Order No. 12866, 58 Fed. Reg. 190 (October 4, 1993).
11. One significant change that happened in recent years is that OIRA worked out an arrangement with the Treasury Department to review IRS regulations, which have traditionally been exempt from OIRA review. See US Department of the Treasury and the Office of Management and Budget, *Review of Tax Regulations under Executive Order 12866*, April 11, 2018. Another change was the Trump administration's creation of the first federal regulatory budget in 2017, which placed limits on the costs that executive agencies can impose with their rules. This regulatory budget was subsequently dismantled by the Biden administration. See Exec. Order No. 13992, 86 Fed. Reg. 7049 (January 25, 2021).
12. Elena Kagan, "Presidential Administration," *Harvard Law Review* 114, no. 8 (2000): 2245–385.
13. Robert W. Hahn, "Regulatory Reform: Assessing the Government's Numbers," in *Reviving Regulatory Reform: A Global Perspective* (Washington, DC: AEI Press, 2000), 32; and Jerry Ellig and Rosemarie Fike, "Regulatory Process, Regulatory Reform, and the Quality of Regulatory Impact Analysis," *Journal of Benefit-Cost Analysis* 7, no. 3 (2016): 523–59.
14. James Broughel, "The Mighty Waves of Regulatory Reform: Regulatory Budgets and the Future of Cost-Benefit Analysis," *Business, Entrepreneurship & Tax Law Review* 3, no. 2 (2019): 206–23.
15. Memorandum on Modernizing Regulatory Review, 86 Fed. Reg. 7223, 7223 (January 26, 2021).
16. Contrary to some claims, opportunity cost is "the value of the next best alternative" to something in only special circumstances. Martin Feldstein sums up this point nicely: "economic textbooks often define opportunity cost as the value of resources in the best alternative use to which those resources could be put. . . . In fact, the actual opportunity cost of any resources is their value in the alternative use to which they would have been put. The two coincide in a perfectly functioning economy: if resources are not used in one activity they would be used in the most valuable alternative in which they could be used. But it is the very essence of the second-best problem that resources that could be invested with greater value are consumed instead." Martin Feldstein, "The Inadequacy of Weighted Discount Rates," in *Cost-Benefit Analysis: Selected Readings*, ed. Richard E. Layard (Baltimore, MD: Penguin, 1972), 319.
17. See, for example, Office of Management and Budget, *Circular A-4*, September 17, 2003; and US Department of Health and Human Services, *Guidelines for Regulatory Impact Analysis*, 2016.
18. James Broughel, "Rehabilitating the Opportunity Cost of Capital in Cost-Benefit Analysis" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, September 2021).

19. Brian Baugus, Feler Bose, and James Broughel, "A 50 State Review of Regulatory Procedures" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, April 2022).

20. "Office of Regulatory Reform," Rhode Island Office of Management and Budget, accessed May 12, 2022, https://omb.ri.gov/regulatory-reform.

21. "Joint Committee on Government and Finance—Division of Fiscal and Regulatory Affairs," West Virginia Legislature, accessed May 12, 2022, https://www.wvlegislature.gov/Joint/fiscal-regulatory.cfm.

22. Donald Arbuckle, "The Role of Analysis on the 17 Most Political Acres on the Face of the Earth," *Risk Analysis* 31, no. 6 (2011): 884–92.