From the Desk of Richard Williams, Ph.D.

January 5, 2011

Via Staff E-mail (Kristina.Moore@mail.house.gov)
The Honorable Darrell Issa, Chairman
House of Representatives
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Dear Representative Issa:

Thank you for the opportunity to provide the House Committee on Oversight and Government Reform with information regarding the Mercatus Center's research on the relationship between regulations and the U.S. economy and potential improvement to the regulatory process. As a university-based research center, the Mercatus Center works to bridge the gap between academic research and public policy problems. For over 20 years, scholars at the Mercatus Center have been studying regulations, and we continue to pursue research in this area.

The following letter and attachment constitute a brief response to your written request of December 8, 2010. They are based on a review of the economics literature on regulation. My colleagues and I would be happy to provide additional information as you consider the committee's priorities in this important area. The attached review finds that there are several ways in which regulations affect U.S. investments, jobs, and the economy. The three most important areas regulation affects are uncertainty, competitiveness, and the cost of doing business.

- Uncertainty: When there is uncertainty about demand, factor costs, or access to capital, businesses may decide to wait for more certainty before they invest in new projects and employees.

- Competitiveness: To the extent that U.S. regulations are more onerous than those of competing countries, firms may choose to relocate production to those countries thereby eliminating employment in the United States.

- The Cost of Doing Business: Expenditures on regulatory monitoring and compliance reallocate jobs from the production of goods and services demanded by consumers in the marketplace to regulatory compliance and may factor into decisions not to start businesses.

While the above have implications for employment and the overall economy, the economic literature suggests that the effect of regulations is likely small at the macro level. However, at the micro level, the effect of regulations on job creation and sustainability of particular businesses can be great. That is, regulations may not affect the overall quantity of jobs in the economy, but they will make certain jobs too costly to create or sustain.

Given the indisputable cost of regulation and the effect regulation has on international trade, it is essential that proposed regulations achieve meaningful social benefits in excess of the costs of implementing them.

There is much room for improvement in the regulatory process, and effective oversight can help ensure that regulations meet the following standards for sound policy:

- There is evidence, supported by sound science, of a significant and systemic social problem (not just a potential problem) i.e., a market failure, a government failure or an overriding social need, that the regulation will address;
- There is evidence (again, supported by sound science) of at least one solution that will solve a significant part of the problem; and
- The agency has a solution that is worth the costs and will not put the United States at a competitive disadvantage.

Three sources of information can help identify rules that may not satisfy the above criteria and signal possibly problematic rules.

1. The Mercatus Regulatory Report Card analyzes the quality and use of sound economic analysis for proposed rules.

2. Input into Agency Rulemaking by the International Trade Administration (ITA) of the Department of Commerce details ITA's concerns about the potential effect of a rulemaking on jobs and competitiveness.

3. Data Quality Act challenges—administrative challenges to the scientific basis for rules under the Data Quality Act—often indicate when poor science has been used to support regulatory claims.

Bad policy happens for many reasons. Public Choice economics has shown that, where there are problems with rules, regulators may be satisfying the interests of specific actors (e.g., themselves, activists, regulated industry) rather than advancing the welfare of the general public. Despite much progress since the passage of the Administrative Procedures Act more than 60 years ago and subsequent congressional amendments and executive orders, it is still far too easy to advance special interests without satisfying the basic tenets of quality regulation. Effective oversight can challenge regulations that are at odds with the public interest and do not satisfy the minimal criteria necessary for quality regulations, and understanding regulatory incentives is absolutely necessary to the creation of institutions focused on the pursuit of effective regulations.

Sincerely,

Richard A. Williams, Ph.D.
Director of Policy Research