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REGULATORY ANALYSIS AND REGULATORY REFORM

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Congress and the executive branch have attempted to improve the quality of regulatory decisions by adopting several laws and executive orders. These laws and orders require agencies to identify the problem they are trying to address and assess its significance, examine a wide range of alternatives to solve the problem, assess the costs and benefits of the alternatives, and regulate only when the benefits justify the costs.

To see whether these laws and executive orders have had the desired effects, a research team from the Mercatus Center at George Mason University evaluated the quality and use of the regulatory analysis accompanying every economically significant regulation proposed by executive branch regulatory agencies in 2008 and 2009. The team found that, while it varied widely, the quality of regulatory analysis was generally low and did not alter much with the change of administrations. It also found that budget regulations, which define how the federal government spends money or collects revenues, have much lower quality analysis than other regulations. Improving the quality and use of regulatory analysis will require institutional reforms—not just new executive orders—to ensure that regulatory impact analysis is required, objective, and used to inform decisions about whether and how to regulate.

WHAT IS REGULATORY IMPACT ANALYSIS?

Somewhere along the line in our schooling, most of us learn a few basic steps to take before making a major decision. Call this "Decisionmaking 101." These steps include:

1. Understand the root causes of the problem,
2. Define the goal we want to achieve,
3. Develop a list of alternative ways to solve the problem, and
4. Assess the pros and cons of each alternative.

For nearly four decades, presidential administrations have required executive branch agencies to follow these steps when they issue major regulations. In 1993, President Clinton's Executive Order 12866 laid out the fundamental requirements that have governed regulatory analysis and review ever since.[1] In January 2011, President Obama's Executive Order 13563 reaffirmed the principles and processes of the Clinton executive order:

> Our regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation. It must be based on the best available science. It must allow for public participation and an open exchange of ideas. It must promote predictability and reduce uncertainty. It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements.[2]

Analytical requirements are especially rigorous for economically significant regulations—regulations that adversely affect the economy or have an annual effect on the economy of $100 million or more.

ASSESSING THE QUALITY AND USE OF REGULATORY ANALYSIS

The Mercatus Center at George Mason University has developed a qualitative framework to assess both the quality and use of regulatory analysis in federal agencies.[3] The scoring process evaluates the quality of regulatory analysis using twelve criteria grouped into three categories:

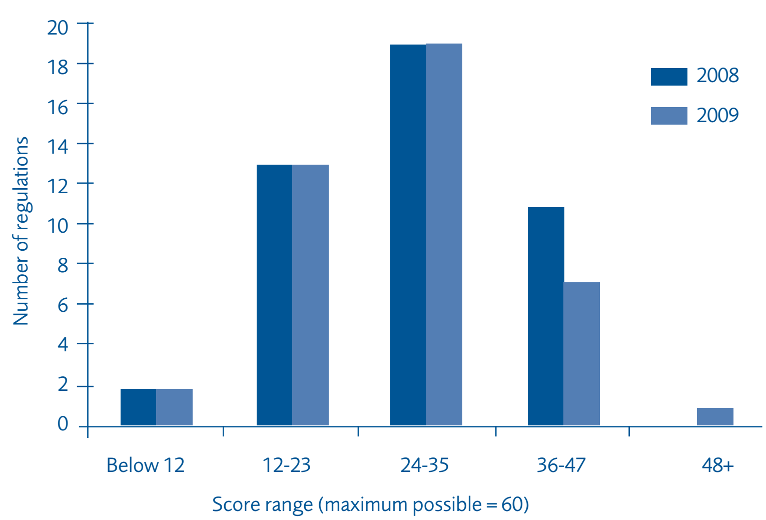
1. Openness—How easily can a reasonably informed, interested citizen find the analysis, understand it, and verify its underlying assumptions and data?

2. Analysis—How well does the analysis define and measure the outcomes or benefits the regulation seeks to provide, define the systemic problem the regulation seeks to solve, identify and assess alternatives, and evaluate costs and benefits?

3. 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?

A research team evaluated each economically significant rule issued in 2008 and 2009.[4] The team chose these years in order to assess whether the change of presidential administrations had any effect on the quality or use of regulatory analysis. For each criterion, the evaluators assigned a score ranging from 0 (no useful content) to 5 (comprehensive analysis with potential best practices). Thus, each analysis has the opportunity to earn between 0 and 60 points.

FIGURE 1: DISTRIBUTION OF SCORES



QUALITY IS LOW, UNCHANGED IN 2009

The average score for regulations proposed in 2008 and 2009 was virtually the same—about 27 points out of a possible 60 (See Figure 1). There were no examples of all-around excellent regulatory analysis; the highest-scoring regulation in 2008 earned merely 43 out of 60 possible points, equivalent to a grade of C, while the highest-scoring regulation in 2009—a joint Department of Transportation and Environmental Protection Agency regulation on Corporate Average Fuel Economy Standards—earned 48 out of 60 possible points, equivalent to a B-. Although several more regulations in 2008 received scores in the 36 to 47 range, the distribution of scores was roughly the same in both years.

GREATEST WEAKNESSES: IDENTIFICATION OF SYSTEMIC PROBLEM AND RETROSPECTIVE ANALYSIS

Table 1 shows the average score for each criterion in 2008 and 2009. Two types of criteria score particularly low:

TABLE 1: SCORES BY CRITERION

Criterion	2008 Average score	2008 # Earning highest score	2009 Average score	2009 # Earning highest score
1. Accessibility	3.53	12	4.06	14
2. Data documentation	2.24	1	2.50	5
3. Model documentation	2.33	3	2.62	1
4. Clarity	2.93	3	2.83	10
5. Outcome definition	2.36	2	2.38	1
6. Systemic problem	1.80	1	1.60	4
7. Alternatives	2.29	1	2.21	1
8. Benefit-cost analysis	2.09	3	2.19	1
9. Some use of analysis	2.44	2	2.24	1
10. Considered net benefits	2.20	2	1.62	4
11. Measures and goals	1.36	1	1.29	1
12. Retrospective data	1.73	1	1.50	2
Total	27.31		27.02	

- Systemic Problem (Criterion 6): Few analyses provide a coherent theory and empirical evidence of a market failure, government failure, or other systemic problem the regulation is supposed to solve.

- Retrospective Analysis (Criteria 11 and 12): Few regulations or analyses set goals, establish measures, or establish protocols to gather data so that the effects of the regulation may be evaluated after implementation.

For each criterion, at least one regulation earned the highest possible score of 5 in most cases. Best practices, however, are not widely shared within or across departments.

WORSE ANALYSIS FOR BUDGET REGULATIONS

Agencies sometimes issue regulations to implement spending or revenue collection programs, such as Medicare, Medicaid, or federal loan programs. Several previous studies find that the quality and use of analysis for these "budget" regulations is well below the quality and use of analysis for "prescriptive" regulations that mandate what individuals, businesses, states, or other regulated entities must or must not do.[5] Indeed, the Office of Management and Budget observes that, although budget regulations generate social costs via mandates, prohibitions, and price distortions, agencies do not usually estimate the social benefits and costs of budget regulations.[6]

Our research confirms that the quality and use of analysis for budget regulations is much lower in both years. In 2008, for example, the average total score for budget regulations (17 points) is 47 percent below the average score for prescriptive regulations (32 points). Similarly, in 2009 the average total score for budget regulations (21 points) is 40 percent below the average total score for prescriptive regulations (34 points). These differences occur for Openness (Criteria 1–4), Analysis (Criteria 5–8), and Use (Criteria 9–12). Openness has the smallest gap, but even there, budget regulations score 20 to 30 percent below prescriptive regulations.

IMPROVING THE QUALITY OF REGULATORY ANALYSIS

Even after removing budget regulations from the sample, average scores for prescriptive regulations are relatively low, earning slightly more than 50 percent of the total possible points.

Clearly, agency regulatory analysis is often incomplete and seldom used in decisions. This pattern persists across administrations, indicating that the source of the problem is institutional, not political. Fundamental institutional reforms are necessary to ensure that agencies conduct high-quality regulatory impact analysis and use it in decisions. In short, regulatory impact analysis should be:

- Required—Regulatory analysis must be legislatively required for all federal agencies, including independent agencies.

- Objective—All too often, regulatory analyses read as an afterthought. Agencies should publish regulatory analysis, along with all underlying data and research, before making decisions about proposed regulations. Agency economists should have the independence to conduct objective analysis instead of simply justifying decisions that have already been made. Independent review outside of the executive branch can help to ensure this.

- Used—Congress should require all agencies to explain, when proposing regulations, how the major elements of regulatory analysis affected decisions about the regulation. Consistent with the Government Performance and Results Modernization Act of 2010, agencies should also be required to explain how major regulations advance their high-priority goals and establish measures to track the regulation's actual results.

CONCLUSION

Regulatory impact analysis assesses the need for, alternatives to, and benefits and costs of proposed regulations. Although administrations of both political parties have required regulatory impact analysis, the quality of that analysis has generally been low. This is especially the case with budget regulations. The most significant deficiency occurs in analysis of the systemic problem the proposed regulation is supposed to solve; often the problem is not even well-defined. To be genuinely effective, regulatory impact analysis should be required, objective, and used by federal agencies.

ENDNOTES

1. Executive Office of the President, Executive Order 12866. *Federal Register* 58:190 (1993), 51735–44, http://www.whitehouse.gov/sites/default/files/omb/inforeg/eo12866/eo12866_10041993.pdf.

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3. Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), http://mercatus.org/publication/quality-and-use-regulatory-analysis-2008.

4. Jerry Ellig and John Morrall, "Assessing the Quality of Regulatory Analysis: A New Evaluation and Data Set for Policy Research" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), http://mercatus.org/sites/default/files/publication/wp1075-assessing-the-quality-of-regulatory-analysis.pdf.

5. Jerry Ellig and Patrick McLaughlin, "The Quality and Use of Regulatory Analysis in 2008;" Patrick McLaughlin and Jerry Ellig, "Does OIRA Review Improve the Quality of Regulatory Impact Analysis? Evidence from the Final Year of the Bush II Administration," *Administrative Law Review* (forthcoming, 2011); and Eric A. Posner, "Transfer Regulations and Cost-Effectiveness Analysis," *Duke Law Journal* 53 (2003): 1067–110.

6. Office of Management and Budget, 2008 *Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on States, Local, and Tribal Entities* (Washington, DC: Government Printing Office, 2008), 12–8.

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