

February 3, 2016

Senator Michael B. Enzi
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

Dear Chairman Enzi:

Thank you for the opportunity to testify at the Senate Budget Committee's December 9, 2015, hearing on the regulatory budget. Below are my responses to the four questions for the record:

Chairman Enzi Question 1:

As you know OMB provides Congress annually with a report of The Costs and Benefits of Federal Regulations as required by the Regulatory Right to Know Act. Over the years that report has varied in its timeliness and quality. You have also seen various agency budgets showing the dollars spent on writing and enforcing regulations as well as studies on the cost of compliance with regulation in the private sector.

How then would you recommend that Congress establish an initial regulatory baseline for a regulatory budget?

Answer: The initial baseline should be an estimate of the actual costs of existing regulations. To be useful in congressional decision-making about individual agencies, authorizing statutes, and appropriations, the baseline needs to identify the costs of individual regulations, regulatory programs, or authorizing statutes.

Figures in the annual OMB report to Congress are inadequate for this task. The annual OMB report is a compendium of agencies' prospective estimates of the costs of regulation, not a retrospective assessment of actual costs. The report covers only the small minority of federal regulations classified as "major," includes only the regulations issued during the previous 10 years, and is based on agency regulatory impact analyses that are often seriously incomplete.¹

Figures from studies on the aggregate cost of regulation are also inadequate for this task. Such studies may be helpful in identifying some cumulative costs of regulation, but they do not attribute costs to individual regulations, regulatory programs, or authorizing statutes.

¹ Jerry Ellig, Letter to Senator Ron Johnson, Chairman, Senate Committee on Homeland Security and Governmental Affairs (April 2, 2015), <http://mercatus.org/sites/default/files/Ellig-Senate--HSGA-hearing-followup.pdf>.

As my Mercatus Center colleagues Jason Fichtner and Patrick McLaughlin noted in a study published in 2015, measuring regulatory costs is more difficult than counting federal outlays. Congress could consider using a proxy for total regulatory costs, such as paperwork costs or net costs to regulated entities, as has been done in other countries.² As I noted in my oral response to a question during the hearing, a disadvantage of this approach is that it ignores significant social opportunity costs created by regulation, such as the increase in waiting time for passengers and increased highway deaths attributable to airport security regulation.³ Correct estimation of the social cost of a regulation can require assessments of cause-and-effect relationships and monetary valuation challenges that are every bit as difficult as those involved in estimating benefits.⁴

Given the difficulties, it may be most practicable for Congress to take an incremental approach, selecting certain agencies or regulatory programs for a pilot study to explore different ways of establishing a baseline.⁵ Since the GPRA Modernization Act requires the federal government to identify the programs, tax expenditures, and regulations that contribute toward its high-priority goals, another option would be to conduct a pilot study using the regulations that agencies say are intended to advance high-priority goals.⁶ The pilot study should include provisions to disclose the methodology to the public and seek comment from experts to fine-tune a method that could be used across the federal government.

Chairman Enzi Question 2:

You have worked on two projects, the Performance Report Scorecard and the Regulatory Report Scorecard that have underscored the need for Congress to use and incentivize high-quality analysis. That involves knowing how to obtain, understand and analyze the information needed in decision making. Over the past three decades, legislation has been proposed to establish a separate Congressional Office of Regulatory Analysis.

Do you support the establishment of such an office?

Answer: Establishment of a Congressional Office of Regulatory Analysis—either as a separate entity or as a division of the Congressional Budget Office or Government Accountability Office—could provide Congress with the systematic assessment of the effects of regulation that Congress currently lacks.

² Jason J. Fichtner and Patrick A. McLaughlin, “Legislative Impact Accounting: Rethinking How to Account for Policies’ Economic Costs in the Federal Budget Process,” Mercatus Working Paper, Mercatus Center at George Mason University (June 2015), 24–25, <http://mercatus.org/publication/legislative-impact-accounting-rethinking-how-account-policies-economic-costs-federal>.

³ Jerry Ellig, Amos Guiora, and Kyle McKenzie, *A Framework for Evaluating Counterterrorism Regulations*, Mercatus Policy Series No. 3, Mercatus Center at George Mason University (Sept. 2006), 32–36; Garrick Blalock, Vrinda Kadiyali, and Daniel H. Simon, “The Impact of Post-9/11 Airline Security Measures on the Demand for Air Travel,” *Journal of Law & Economics* 50, no. 4 (November 2007), 731–56.

⁴ The Mercatus Center has developed a survey instrument called the Regulatory Cost Calculator that agencies and stakeholders can use to gather more accurate information about costs. For more information, see <http://mercatus.org/publication/regulatory-cost-calculator>.

⁵ Fichtner and McLaughlin, “Legislative Impact Accounting,” 33–34.

⁶ 31 USC 11, §115(a)(2).

Under the Government Performance and Results Act, the executive branch has a monopoly on the production of information about the performance of federal programs. Under Executive Order 12866, which governs regulatory analysis and review by the Office of Information and Regulatory Affairs, the executive branch has a monopoly on the production of information about the prospective and retrospective results of regulations. Mercatus Center research projects have found that GPRA and the executive orders on regulatory analysis have improved decision-makers' knowledge about the results of programs and regulations. But as I noted in my testimony, we have also found that such analysis is often seriously incomplete.

In the Budget Act of 1974, Congress created the Congressional Budget Office because lawmakers recognized that they needed an objective source of spending and revenue estimates independent of the executive branch. In contrast, Congress has no independent source of information on the effects of regulations. The current system provides Congress with a flood of information but little structured means to produce high-quality analysis of the problems that regulatory legislation seeks to solve and the benefits and costs of alternative solutions. For this reason, Congress needs to develop a system for obtaining impartial legislative impact analysis when it authorizes new regulation or reauthorizes existing regulation.

Ranking Member Sanders:

Much of today's hearing concerned the costs of regulation. However, as we've seen in recent years, there are massive costs associated with deregulation. The Wall Street crash in 2008 was precipitated by the deregulation of the financial sector. The costs associated with the Great Recession that resulted were massive, and we're still paying the price with high unemployment and a huge deficit. Similarly, the Deepwater Horizon oil spill in 2010 – in which an explosion killed 11 people and almost 5 million barrels of oil spilled over an area estimated to be as large as 68,000 square miles – was also caused, in part, by what the Houston Chronicle called “a lax regulatory climate.”

With these facts in mind, how would a regulatory budget account for the unforeseen economic and environmental costs of deregulation?

Answer: Like a family budget or the federal budget, a regulatory budget is a plan for the allocation of resources. The purpose of a budget is to place an overall limit on spending, based on the family's or the government's projected income, then divide that spending among competing priorities based on the expected benefits. No one would seriously suggest that the federal government operate without a budget; that would mean individual agencies could spend federal money as they parochially see fit, with no consideration of the government's ability to pay or the implications such spending could have on other programs.

Unfortunately, the current regulatory system creates an analogous dysfunctional situation. Regulatory agencies can direct individuals, businesses, and state, local, and tribal governments to sacrifice money, time, privacy, and other values with no consideration of the total cost to society of all regulations, as long as the regulation is intended to accomplish the agency's goals.

As with a family budget or the federal budget, cost is not the only factor relevant to resource allocation decisions in a regulatory budget. When dividing the total of regulatory costs among competing priorities, Congress should take account of the benefits expected from various regulations and regulatory programs. The expected benefit of regulations intended to prevent a financial crisis is the social cost of the crisis multiplied by the reduction in risk (of a crisis) created by the regulations. Similarly, the expected benefit of regulations intended to prevent oil spills is the social cost of the spill multiplied by the reduction in risk (of spills) created by the regulations. Given the high costs of financial crises and oil spills, regulations that significantly reduce the risk of their occurrence would likely be high priorities to retain. Regulations that are *intended* to reduce the risk but *in reality create little or no reduction in risk* should not be high priorities.

Extensive research by my colleagues at the Mercatus Center has documented the phenomenon of regulatory accumulation: the tendency of the federal government to continually add new regulations without reexamining existing regulations to see if they are actually accomplishing their intended goals at a reasonable cost.⁷ By constraining the total social cost of regulation, a regulatory budget creates incentives for agencies and Congress to examine the actual results of regulations, eliminate the nonfunctional regulations, and retain the regulations that solve real problems at a reasonable cost.⁸

Senator Whitehouse:

Does the Mercatus Center accept donations from donors with financial interests in regulated pollutants, regulated chemicals, regulated financial products, and/or regulated consumer products? Please describe any such entities, and the amount of the support of each to the Mercatus Center.

Answer: To preserve the academic freedom of our researchers, the Mercatus Center has an explicit policy regarding independence of research (<http://mercatus.org/content/policy-regarding-independence-research>). Accordingly, I am not involved in requesting or accepting donations.

⁷ Patrick A. McLaughlin and Richard Williams, “The Consequences of Regulatory Accumulation and a Proposed Solution,” Mercatus Working Paper, Mercatus Center at George Mason University (February 2014), <http://mercatus.org/publication/consequences-regulatory-accumulation-and-proposed-solution>; Patrick A. McLaughlin, “The Searching for and Cutting Regulations That Are Unnecessarily Burdensome Act of 2014,” Testimony before the House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial, and Antitrust Law, Mercatus Center at George Mason University (February 11, 2014), <http://mercatus.org/publication/searching-and-cutting-regulations-are-unnecessarily-burdensome-act-2014>; Patrick A. McLaughlin and Robert Greene, “The Unintended Consequences of Federal Regulatory Accumulation,” Economic Perspectives, Mercatus Center at George Mason University (May 8, 2014), <http://mercatus.org/publication/unintended-consequences-federal-regulatory-accumulation>.

⁸ “Functional rules address current, significant risks; mitigate some amount of those risks through compliance with the regulations; and do not have significant unintended effects or excessive compliance costs relative to their benefits. Nonfunctional rules are missing one or more of these features. The key to achieving significant amelioration of the problem of regulatory accumulation is first identifying as many nonfunctional rules as possible and then either eliminating them or changing them so that they become functional.” Patrick A. McLaughlin, “Regulatory Reform Can Amount to a Progressive Tax Cut, If Done Right,” Testimony before the Senate Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law, Mercatus Center at George Mason University (March 2, 2015), <http://mercatus.org/publication/regulatory-reform-can-amount-progressive-tax-refund-if-done-right>.

Thank you again for the opportunity to testify. These answers are being provided in a good faith effort to answer your questions. I nevertheless reserve the right to supplement these answers with any information that should be brought to my attention subsequent to this submission. Please let me know if I can be of further assistance to the committee on this or other topics related to federal regulatory process reform.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jerry Ellig", with a large, sweeping flourish extending to the right.

Jerry Ellig
Senior Research Fellow