

# MERCATUS ON POLICY

## Regulatory Impact Analysis: Four Decades of Foibles

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**O**n the eve of its abolition in 1981, the Council on Wage and Price Stability (CWPS) pointed out that regulations were often imposed without a clear understanding of the problem they were supposed to solve, a realistic examination of a range of options for solving the problem, and a benefit-cost analysis of each option.<sup>1</sup>

These deficiencies in agency analysis have persisted despite the best efforts of the Office of Information and Regulatory Affairs (OIRA), which began reviewing regulations in 1981. Regulatory process reform is necessary to ensure that regulations address proven problems, solve a substantial portion of those problems, and do so at an acceptable cost.

### LONGSTANDING AGREEMENT ON ANALYSIS STANDARDS

As table 1 shows, executive orders issued by every president since Jimmy Carter have consistently identified key elements agencies should include in their Regulatory Impact Analyses (RIAs). These elements include:

1. Assessing the nature and significance of the problem the agency is trying to solve, so the agency knows whether there is a problem that could be solved through regulation and, if so, the agency can tailor a solution that will effectively solve it.
2. Identifying a wide variety of alternative solutions.
3. Defining the benefits the agency seeks to achieve in terms of ultimate outcomes that affect citizens' quality of life and assessing each alternative's ability to achieve those outcomes.
4. Identifying the good things that regulated entities, consumers, and other stakeholders must sacrifice in

Table 1: Key elements of regulatory analysis across administrations.

President Carter	President Reagan	President Clinton	President G. W. Bush	President Obama
Executive Order 12044	Executive Order 12291 (replaced E.O. 12044)	Executive Order 12866 (replaced E.O. 12291 and remains in effect today)	Executive Order 13422 (amended E.O. 12866, revoked by President Obama)	Executive Order 13563 (reaffirmed E.O. 12866)
<p>“Each regulatory analysis shall contain a succinct statement of the problem; a description of the major alternative ways of dealing with the problem that were considered by the agency; an analysis of the economic consequences of each of these alternatives and a detailed explanation of the reasons for choosing one alternative over the others.” Sec. 3(b)(1)</p>	<p>“[E]ach preliminary and final Regulatory Impact Analysis shall contain the following information:</p> <p>(1) A description of the potential benefits of the rule, including any beneficial effects that cannot be quantified in monetary terms, and the identification of those likely to receive the benefits;</p> <p>(2) A description of the potential costs of the rule, including any adverse effects that cannot be quantified in monetary terms, and the identification of those likely to bear the costs;</p> <p>(3) A determination of the potential net benefits of the rule, including an evaluation of effects that cannot be quantified in monetary terms; [and]</p> <p>(4) A description of alternative approaches that could substantially achieve the same regulatory goal at lower cost, together with an analysis of this potential benefit and costs and a brief explanation of the legal reasons why such alternatives, if proposed, could not be adopted.” Sec. 3(d)</p>	<p>“Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem. Sec. 1(b)(1)</p> <p>“Each agency shall identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public.” Sec. 1(b)(3)</p> <p>“Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.” Sec. 1(b)(6)</p>	<p>“Each agency shall identify in writing the specific market failure (such as externalities, market power, lack of information) or other specific problem that it intends to address (including, where applicable, the failures of public institutions) that warrant new agency action, as well as assess the significance of that problem, to enable assessment of whether any new regulation is warranted.” Sec. 1(a)</p>	<p>“[E]ach agency must, among other things: propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify) . . . select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity); . . . and identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public.” Sec. 1(b) (1-3,5)</p>

order to achieve the desired outcomes under each alternative. In economics jargon, these sacrifices are known as “costs,” but just like benefits, costs may involve far more than monetary expenditures.<sup>2</sup>

### LONGSTANDING DEFICIENCIES IN ANALYSIS

During the past four decades, agencies have failed to follow the rulemaking standards enunciated in these executive orders.

### CWPS Filings

Between 1974 and 1981, CWPS analyzed proposed regulations and submitted its analysis to agencies during the public comment period. A new historical review notes, “The majority of CWPS filings included at least one of the following conclusions: the regulatory agency either failed to estimate benefits or had done so incorrectly, the agency either failed to estimate costs or had done

so incorrectly, and the agency should have examined different regulatory options.”<sup>3</sup>

Consider, for example, the CWPS analysis of a regulation proposed by the Department of Transportation in 1978 that would have changed the maximum duty and driving hours for commercial truck and bus drivers. CWPS noted that, despite Executive Order 12044’s requirement that agencies consider several alternatives, the regulators did not consider whether alternative approaches might produce greater benefits or lower costs.<sup>4</sup> The CWPS comments urged regulators to consider alternatives, such as stricter enforcement of the current rules, increased driver training, improved truck cab safety, more spot safety checks, and highway improvements.<sup>5</sup>

### POST-1981 EVALUATIONS OF RIAs

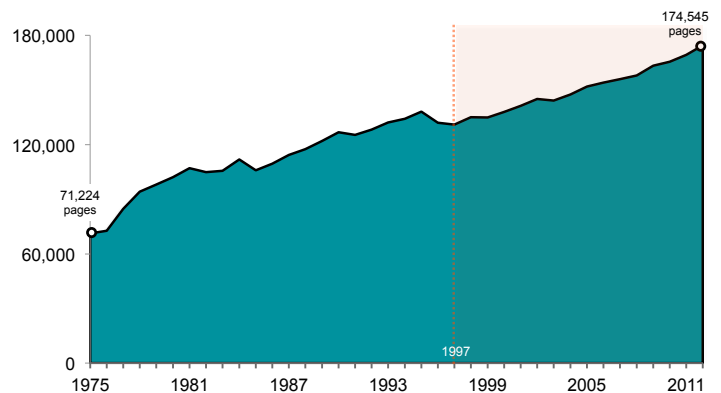
Despite the advent of OIRA review in 1981, Government Accountability Office studies and scholarly research reveal that in many cases, RIAs are not sufficiently complete to guide agency decisions.<sup>6</sup> The most recent evaluations of agency RIAs, from the Mercatus Center’s Regulatory Report Card, confirm those earlier findings.<sup>7</sup> The Report Card project has assessed all RIAs for economically significant, prescriptive regulations proposed between 2008 and 2012.<sup>8</sup> The project found some reasonably good examples of the proper execution of each key aspect of regulatory impact analysis.<sup>9</sup> However, the average RIA did a poor job of assessing the problem the agency sought to solve and a mediocre job of assessing benefits, costs, and alternatives.<sup>10</sup>

Regulations restricting truckers’ service hours again illustrate longstanding problems with RIAs. A proposed 2010 regulation that would have reduced service hours was accompanied by an RIA that estimated the benefits and costs of alternatives, but the alternatives consisted of “no new regulatory action” plus three options that were all narrow variations on the same basic approach. All of the options reduced duty time and required a break but had different limits on driving time.<sup>11</sup> Moreover, the agency identified no market failure that would prevent companies and drivers from internalizing the costs of fatigue. It admitted that the data show prior changes in hours of service regulations have had no effect on highway safety, and indeed, the total number of crashes is declining.<sup>12</sup>

### IMPORTANCE OF REGULATION CONTINUES TO GROW

Although regulatory analysis is often seriously incomplete, the scope of regulation continues to expand. Figure 1 shows that the total number of pages in the *Code of Federal Regulations* has more than doubled during the period of regulatory review that commenced with CWPS and continued under OIRA. Given the extensive effects of regulation on all Americans’ lives, there is no excuse for agencies not to understand the problems they seek to solve and the benefits and costs of alternative solutions.

Figure 1. Total pages in the *Code of Federal Regulations*, 1975–2012.



Source: Government Printing Office, computed by RegData. Patrick A. McLaughlin, Richard Williams, and Rizqi Rachmat, “Why We Need Regulatory Reform in Two Charts” (Mercatus Center, May 27, 2014).

### INSTITUTIONAL REFORM IS THE SOLUTION

Mercatus Center scholars have identified several institutional reforms to prevent future regulatory failures and correct existing regulations that have not produced the desired outcomes.

#### Require Regulatory Impact Analysis by Statute.

Agencies should perform proper analysis on potential regulations, but they frequently fail to meet long-standing quality standards. Too often, agencies misuse analysis as a means to justify predetermined decisions rather than as a tool to inform decision-making.<sup>13</sup> To foster better analysis, Congress should mandate regulatory

analysis by statute, with judicial review to ensure that the analysis meets minimum quality standards and that the agency adequately explained how the analysis affected its decisions.

### Apply the Same Analysis Standards to Executive Branch and Independent Agencies.

Executive orders requiring federal regulatory analysis do not apply to independent agencies. Scholarly research has found that many independent agencies conduct even less thorough economic analysis than executive branch agencies.<sup>14</sup> To better serve the public interest, Congress should ensure all agencies are subject to the same requirements for regulatory analysis, including review by OIRA.<sup>15</sup>

### Correct Nonfunctional Rules.

Numerous rules have accumulated that did not undergo thorough analysis at the time they were implemented. Consequently, many regulations are likely “nonfunctional.” A nonfunctional rule is a rule that does not address a current, significant problem; fails to mitigate a significant portion of the problem; or has significant unintended effects or excessive compliance costs relative to its benefits.<sup>16</sup> Presidents have often required agencies to conduct retrospective analysis of existing rules, but requiring agencies to critically examine their own rules has produced meager results.<sup>17</sup>

As a result, congressional action may be required to address the problem of nonfunctional rules.

One promising approach is an expert regulatory review commission, modeled after the Base Realignment and Closure Commission used to consolidate and close military bases since 1988. This independent commission would conduct assessments of regulatory programs based on objective criteria specified in the legislation. Its package of recommendations for modifying or repealing regulations would take effect unless disapproved by Congress.<sup>18</sup>

These three reforms would help ensure that both new and existing rules receive the thorough scrutiny that was promised, but not always achieved, by executive orders.

## NOTES

1. Thomas D. Hopkins, Benjamin Miller, and Laura Stanley, “The Legacy of the Council on Wage and Price Stability” (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, August 26, 2014), <http://mercatus.org/sites/default/files/Hopkins-Wage-Price-Stability.pdf>.

2. For a more extensive explanation, see Jerry Ellig, *Ten Principles for Better Regulation* (Arlington, VA: Mercatus Center at George Mason University, 2013), <http://mercatus.org/publication/ten-principles-better-regulations>.

3. Hopkins et al., “The Legacy of the Council on Wage and Price Stability,” 10.

4. *Ibid.*, 14.

5. Elizabeth Pinkston et al., Council on Wage and Price Stability, “Federal Motor Carrier Safety Regulations, Hours of Service,” Comments Before the Department of Transportation Federal Highway Administration (Nov. 1978), 16, <http://cwps.mercatus.org/wp-content/uploads/110801.pdf>.

6. See Art Fraas and Randall Lutter, “The Challenges of Improving the Economic Analysis of Pending Regulations: The Experience of OMB Circular A-4,” *Annual Review of Resource Economics* 3, no. 1 (2011): 71–85; Jamie Belcore and Jerry Ellig, “Homeland Security and Regulatory Analysis: Are We Safe Yet?,” *Rutgers Law Journal* (Fall 2009): 1–96; Robert W. Hahn, Jason Burnett, Yee-Ho I. Chan, Elizabeth Mader, and Petrea Moyle, “Assessing Regulatory Impact Analyses: The Failure of Agencies to Comply with Executive Order 12,866,” *Harvard Journal of Law and Public Policy* 23, no. 3 (2001): 859–71; Robert W. Hahn and Patrick Dudley, “How Well Does the Government Do Cost–Benefit Analysis?” *Review of Environmental Economics and Policy* 1, no. 2 (2007): 192–211; Robert W. Hahn and Robert Litan, “Counting Regulatory Benefits and Costs: Lessons for the U.S. and Europe,” *Journal of International Economic Law* 8, no. 2 (2005): 473–508; Robert W. Hahn, Randall W. Lutter, and W. Kip Viscusi, *Do Federal Regulations Reduce Mortality?* (Washington, DC: AEI-Brookings Joint Center for Regulatory Studies, 2000); Government Accountability Office, *Regulatory Reform: Agencies Could Improve Development, Documentation, and Clarity of Regulatory Economic Analyses*, Report GAO/RCED-98-142 (May 1998); Government Accountability Office, *Air Pollution: Information Contained in EPA’s Regulatory Impact Analyses Can Be Made Clearer*, Report GAO/RCED 97-38 (April 1997).

7. Jerry Ellig and Patrick McLaughlin, “The Quality and Use of Regulatory Analysis in 2008,” *Risk Analysis* 32, no. 5 (2012): 855–80.

8. “Economically significant” regulations adversely affect the economy or have an annual effect on the economy of \$100 million or more. “Prescriptive” regulations are what most people think of when they think of regulations: they mandate or prohibit certain activities. This is distinct from budget regulations, which implement federal spending programs or revenue collection measures. See Patrick A. McLaughlin and Jerry Ellig, “Does OIRA Review Improve the Quality of Regulatory Impact Analysis? Evidence from the Bush II Administration,” *Administrative Law Review* 63 (2011): 179–202.

9. Mercatus Center researchers have described these best practices in a series of prior publications. See Jerry Ellig and James Broughel, “Regulation: What’s the Problem?” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, Nov. 2011); Jerry Ellig and James Broughel, “Regulation: What’s the Alternative?” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, Feb. 2012); Jerry Ellig and James Broughel, “Baselines: A Fundamental Element of Regulatory Impact Analysis” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, June 2012); Jerry Ellig and James Broughel, “How Well Do Federal Agencies Use Regulatory

Impact Analysis?" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, July 2013).

10. See Report Card scores and accompanying discussion in Jerry Ellig, "Improving Regulatory Impact Analysis through Process Reform," Testimony before the U.S. Congress Joint Economic Committee (2013), [http://www.jec.senate.gov/public//index.cfm?a=Files.Serve&File\\_id=4ab151c8-c772-4da7-93b2-048a848ec613](http://www.jec.senate.gov/public//index.cfm?a=Files.Serve&File_id=4ab151c8-c772-4da7-93b2-048a848ec613).

11. See the Report Card assessment for this regulation at "Commercial Motor Vehicle Hours of Service" (Mercatus Center Report Card, Mercatus Center at George Mason University, Arlington, VA), <http://mercatus.org/reportcards/commercial-motor-vehicle-hours-service>.

12. Department of Transportation, Federal Motor Carrier Safety Administration, "Hours of Service of Drivers: Notice of Proposed Rulemaking," 75 Fed. Reg. 249 (Dec. 29, 2010): 82171.

13. Richard Williams, "The Influence of Regulatory Economists in Federal Health and Safety Agencies" (Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2008), [http://mercatus.org/sites/default/files/publication/WP0815\\_Regulatory%20Economists.pdf](http://mercatus.org/sites/default/files/publication/WP0815_Regulatory%20Economists.pdf); Wendy E. Wagner, "The CAIR RIA: Advocacy Dressed up as Policy Analysis," in Winston Harrington et. al., *Reforming Regulatory Impact Analysis* (Washington, DC: Resources for the Future, 2009), 57.

14. Arthur Fraas and Randall L. Lutter, "On the Economic Analysis of Regulations at Independent Regulatory Commissions," *Administrative Law Review* 63 (2011): 213-41; Jerry Ellig and Hester Peirce, "SEC Regulatory Analysis: A Long Way to Go and a Short Time to Get There," *Brooklyn Journal of Corporate, Financial & Commercial Law* 8, no. 2 (Spring 2014): 361-437.

15. Research finds that OIRA review is associated with higher-quality regulatory analysis. See Jerry Ellig and Rosemarie Fike, "Regulatory Process, Regulatory Reform, and the Quality of Regulatory Impact Analysis," (Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2013); and Stuart Shapiro and John F. Morrall III, "Does Haste Make Waste? How Long Does it Take to Do a Good Regulatory Impact Analysis," *Administration & Society* 20, no. 1 (2013).

16. Patrick A. McLaughlin and Richard Williams, "The Consequences of Regulatory Accumulation and a Proposed Solution" (Working Paper, Mercatus Center at George Mason University, Arlington, VA, Feb. 2014), [http://mercatus.org/sites/default/files/McLaughlin\\_RegulatoryAccumulation\\_v2.pdf](http://mercatus.org/sites/default/files/McLaughlin_RegulatoryAccumulation_v2.pdf).

17. US Government Accountability Office, *Re-Examining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* (Washington, DC: July 2007); Randall Lutter, "The Role of Retrospective Analysis and Review in Regulatory Policy" (Working Paper, Mercatus Center at George Mason University, Arlington, VA, April 2012).

18. McLaughlin and Williams, "The Consequences of Regulatory Accumulation."

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