

# MERCATUS ON POLICY

## Colorado's Expiring Benefit-Cost Analysis Requirements for Regulations

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### **COLORADO IS A STATE WITH AN EXTENSIVE**

sunset review process. Sunset provisions are expiration dates attached to specific provisions of law. In Colorado, the sunset review process, first established in 1976,<sup>1</sup> attaches expiration dates to various regulatory programs and boards and requires a review of the effectiveness of expiring entities so that the legislature can make informed decisions as to whether those entities should be reauthorized. The Department of Regulatory Agencies (DORA) is an executive branch agency in the state that plays a critical role in this process,<sup>2</sup> reviewing sunset programs and writing reports that include recommendations to the legislature as to whether the sunset program or board should be continued.

One example of a provision in Colorado law that is about to expire is the benefit-cost analysis (BCA) requirement for regulations,<sup>3</sup> set to expire on September 1, 2018.<sup>4</sup> BCA is an analytic tool that regulators use to lay out the various policy options that are available to them. As part of this process, regulators organize the best available information—scientific, economic, and legal—about different ways to solve a problem, and then quantify the pros and cons of each possible solution. This decision-making process helps regulators identify the solution with the best results for society.

This short policy paper reviews the Colorado benefit-cost analysis requirements and makes recommendations as to how to improve the system going forward. A key takeaway is that, while Colorado is ahead of many states when it comes to its use of technical analysis to shape regulations, problems remain. Certain institutional features of the current system make it unlikely that analysis is being used effectively. Given the resources already being invested in

this area, the state can do more to improve the well-being of state residents through evidence-based policy.

### BACKGROUND ON COLORADO REGULATORY PROCEDURES AND ANALYSIS REQUIREMENTS

Like most states, Colorado has an Administrative Procedure Act (APA) that outlines the process by which state regulatory agencies promulgate—or write and put into effect—rules.<sup>5</sup> That process is fairly straightforward. When an agency first proposes a regulation, it must file the proposal with the Secretary of State’s office. The relevant agency also has to submit the proposed regulation, along with a plain-language explanation of the regulation, to DORA for review.<sup>6</sup> Shortly thereafter, the proposed regulation is published in the *Colorado Register*, a publication of state government activities, and comments are solicited from the public. A public hearing is scheduled as well.

Up to five days after the publication of the proposed rule in the *Colorado Register*, any person can request that DORA require the agency to produce a BCA.<sup>7</sup> The executive director of DORA, or a designee, makes a final determination as to whether the regulating agency has to produce the BCA. If required, the agency must complete the BCA at least 10 days before the hearing and make it public. In theory, the agency can delay the hearing indefinitely in order to have adequate time to produce a quality BCA,<sup>8</sup> but in practice it appears that delays rarely happen.<sup>9</sup>

A BCA, according to Colorado statute,<sup>10</sup> must include the following elements:

- The reason for the rule or amendment
- Anticipated costs and economic benefits of the rule (including costs to the government and benefits to economic growth, among other factors)
- A description of any adverse effects on the economy, consumers, private markets, small businesses, competitiveness, or job creation
- At least two alternatives to the proposed rule, including costs and benefits of those alternatives

Once the analysis is completed, DORA reviews it and can urge the agency to revise the rule based on the findings presented.<sup>11</sup> Economic factors, especially small business impacts, are a central focus of Colorado BCAs. The initial statutory requirement for BCA, put in place in 2003, was partly inspired by a concern over the impact of state regulation on small businesses.<sup>12</sup> The emphasis on growth, job creation, and competition suggests that economic growth and efficiency are also of general concern.

Since 1988,<sup>13</sup> any member of the public also has the opportunity to request a document known as a “regulatory analysis.” This document must be requested at least 15 days before the public hearing for a new regulation, and the analysis must be completed and made public by the agency at least 5 days before the hearing.<sup>14</sup> This provision, unlike the BCA provision, does not have a sunset clause.<sup>15</sup> The regulatory analysis document, by statute, must include items such as the following:<sup>16</sup>

- A description of who will be affected by the proposed rule, including who will bear the costs and reap the benefits
- A quantitative or qualitative description of the impacts on affected classes of persons
- The costs to the agency in implementing and enforcing the rule, plus any impacts on state revenues
- A description of alternative methods that were considered by the agency, including less costly alternatives, and a description of why they were rejected

### DRAWBACKS OF THE CURRENT SYSTEM

Colorado should generally be commended for its commitment to evidence-based policy. A 2017 report from the Pew-MacArthur Foundation noted that

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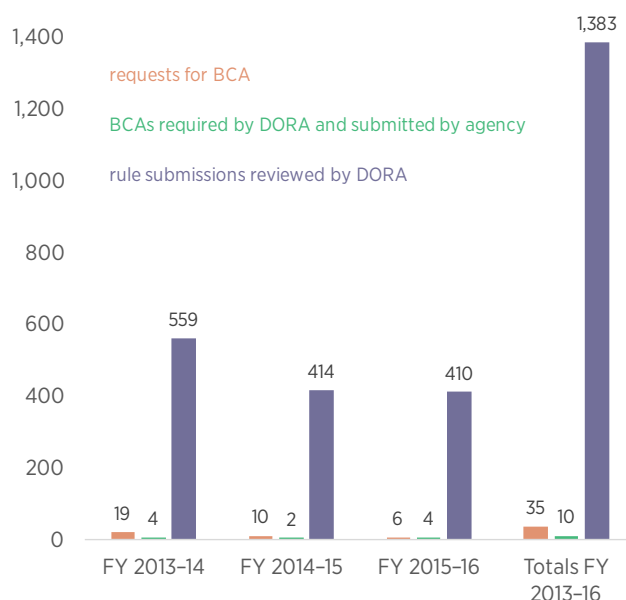
Colorado is one of 11 states “established” in its use of evidence-based policy making, meaning the state pursues more evidence-based actions than most other states (but either not as frequently or not in as advanced a manner as in some “leading” states).<sup>17</sup> Pew puts particular emphasis on Colorado’s use of data to inform policy.<sup>18</sup> However, some limited use of data does not ensure sound public policy, and the current Colorado regulatory system (which creates a narrower subset of law than Pew’s evaluation of state policy more generally) is less than ideal in some important respects.

First, only a tiny fraction of Colorado regulations ever receives the scrutiny of a BCA. For fiscal years 2013 through 2016, just 35 BCA requests were made for 24 regulations (some regulations received multiple requests).<sup>19</sup> In response, DORA required an analysis for only 10 rules. By comparison, during this same period, 1,383 rule submissions were reviewed by DORA, suggesting that less than 1 percent of rule reviews have corresponding BCAs associated with them. Figure 1 illustrates this trend.

Even those rules that receive a request may not be the most important, as requests will tend to come from groups that have a particular stake in the outcome of a regulation. A 2010 study from New York University’s Institute for Policy Integrity found that “Colorado’s analytical requirements are at best inconsistently applied, and at worst may be simultaneously too broad and too narrow, imposing analytical burdens on some minor rules while not covering all major rules.”<sup>20</sup>

It is also unclear whether analysis, when produced, even gets used. A 2012 DORA report—published before Colorado BCA requirements were set to sunset the last time around—included information

**Figure 1. BCA Reports for Colorado Regulations, FY 2013–2016**



Source: Colorado Department of Regulatory Agencies, Office of Policy, Research, and Regulatory Reform, 2017 Sunset Review: Requirements and Procedures Regarding the Preparation of a Cost-Benefit Analysis of Proposed Rules, 2017, 12.

from a survey of state regulators. That survey revealed that a majority of responding agencies said that “rarely, if ever, is a rule changed as a result of information contained in the [BCA].”<sup>21</sup>

A more recent 2017 report from DORA included a similar survey with slightly more optimistic findings. It found that “29 percent of respondents stated that their agency has revised its rules based on a completed [BCA].” An even larger percentage of respondents, 45 percent, noted having made changes to rules in response to a regulatory analysis.<sup>22</sup>

These findings may not be inconsistent if analysis does result in some significant changes, even if only infrequently. A core reason why the analysis does not influence decision-making more—aside from

the fact that very few rules even receive a BCA—is likely because analysis comes too late to inform decisions. It makes little sense for a BCA to be produced after a regulation is proposed because the purpose of analysis is to inform regulatory decisions. Proposing a regulation and then crafting an analysis is putting the cart before the horse. DORA even acknowledges this issue, stating that “the [BCA] may come too late in the process to inform decision-making.”<sup>23</sup>

It is also troubling that regulatory agencies in Colorado typically have only a short time to complete a BCA or a regulatory analysis. Analysis appears to be produced in a matter of days, between the time when a regulation is proposed and when a public hearing takes place. The survey in DORA’s 2017 report revealed that 22.9 percent of respondents said BCAs are completed in 20 hours or less.<sup>24</sup> Furthermore, the public in Colorado has only 10 days to review the BCA (and 5 days for the regulatory analysis) before a public hearing, which is not very much time. At the federal level, a thorough analysis will take months or sometimes even a year to produce, depending on the complexity of the issue. The public usually gets 30 to 60 days to review an analysis as part of the notice and comment process. In short, the process in Colorado appears to be rushed.

A further issue with the analytic requirements in Colorado is the blurred distinction between a BCA and a regulatory analysis. The BCA and the regulatory analysis documents in Colorado share some requirements—for example, both must include alternative forms of regulation considered, and both must consider impacts on the government’s budget. In the context of federal regulation, BCA is typically thought of as *a component* of regulatory impact analysis rather than as a standalone type of analysis.<sup>25</sup> The Colorado regulatory analysis, with its emphasis on *who* benefits and *who* bears the cost, sounds more like a distributional analysis, which is also typically considered to be a component of a regulatory impact analysis.<sup>26</sup>

A final problem is the objectivity of analysis produced in Colorado, or rather, the possible lack thereof. The 2017 DORA report notes that “there

are legitimate concerns with the [BCA] process as it stands now. . . . The same personnel who drafted the proposed rule, rather than a disinterested third party, conduct the [BCA].”<sup>27</sup> Because regulatory agencies have a stake in the outcome of a regulation, and because they wish to show that their choice of regulatory options is optimal, they are unlikely to be fair evaluators of their own rules. Establishing a more independent and objective system of rule evaluation is almost certainly desirable.

## RECOMMENDATIONS

Given the problems identified above, I recommend several ways to streamline the Colorado administrative process, improve the allocation of resources being invested in Colorado regulation, and enhance the usefulness and objectivity of regulatory impact analysis in the state.

1. *The two types of regulatory analysis in Colorado should be combined.*

It makes little sense to have both a regulatory analysis requirement and a BCA requirement for regulations. The two kinds of analysis ask for similar information from agencies. Traditionally, a BCA is a part of a regulatory impact analysis, and what is currently called regulatory analysis in Colorado could instead be viewed as a distributional analysis, which is also traditionally a component of a regulatory impact analysis. Agencies in Colorado should be required to produce a comprehensive “regulatory impact analysis” that includes an analysis of the problem being addressed through regulation, consideration of various policy and nonpolicy alternatives, a BCA for those alternatives, and a distributional analysis.

2. *Regulatory impact analysis should happen earlier in the process, giving analysts more time to prepare it and the public more time to review it.*

The purpose of an analysis is to organize pertinent information so that decision makers can make informed policy decisions and stakeholders can be

informed about the likely consequences of those decisions. If analysis comes after a decision to regulate has already been made, then it comes too late to be useful and the resources invested in analysis are wasted. Regulators in Colorado could be required in some cases to issue “advanced notices of proposed rulemaking” (ANPRMs) that would occur before the issuance of a proposed rule. Alongside an ANPRM, the regulating agency could be tasked with producing an analysis. The agency would then seek comments from the public on the ANPRM and the corresponding analysis. Only after the agency has considered these comments would it formally propose a regulation. The benefit of this approach is that it puts decision-making in the right order. Rather than *ready, fire, aim*—which describes the current system in Colorado—the process would be *ready, aim, fire*.<sup>28</sup> This approach would also give the regulating agency more time to craft an analysis before a rule is proposed and more time for the public to review and comment on the analysis.

3. *The General Assembly should define the factors that trigger when an analysis is produced, even when no public request for one has been made.*

In DORA’s 2012 review of the Colorado benefit-cost analysis requirement, the department argued that when rules are deemed to have a significant impact, the BCA requirement should be triggered. DORA argued that “significant” should be defined by the General Assembly in statute.<sup>29</sup> The legislature, however, appears not to have followed this recommendation.

At the federal level, the definition of a significant regulation is outlined in section 3(f) of Executive Order 12866, which was signed by President Bill Clinton in 1993.<sup>30</sup> In that order, significance broadly means that a regulation

- is expected to have a certain economic impact,<sup>31</sup>
- will materially impact the government’s budget,
- raises novel legal issues, or
- requires coordination across multiple agencies.

The simplest form of trigger would be to set an economic threshold (e.g., \$1 million in financial costs). If a regulation is expected to have an impact over the threshold in a year, then a BCA would be required. Some public entity will have to make a determination as to whether a regulation hits this threshold. The agency writing the regulation could first produce a rough estimate of the impact, and an oversight body like DORA could provide the final determination as to whether the impact estimate is credible. This process should happen early in the process. For example, under state law, regulatory departments are required to submit a regulatory agenda to the legislature each year and to post the agenda on their website.<sup>32</sup> Included in these agendas could be the agency’s initial determination of whether rules in process are significant. DORA could then certify these determinations.

4. *Colorado should either create an independent regulatory analysis agency to conduct analysis, or the state should enhance third-party review of regulatory analysis.*

As DORA itself has pointed out, analysis conducted by agencies in Colorado may not be objective. There is considerable evidence at the federal level, based on interviews with agency economists, that analysts are often asked to produce analysis to justify regulations rather than to inform how regulations are designed.<sup>33</sup> This problem may also be relevant to Colorado analysis.

One way to address this issue is to separate analytic responsibilities from regulator responsibilities. This could be done by removing analysts at regulatory agencies and placing them in a separate analysis agency. Such a body could be modeled after the Planning, Evaluation, and Regulatory Division of the Virginia Department of Planning and Budget, an executive branch office which produces economic and regulatory analysis.<sup>34</sup> This role could also be housed in a legislative agency like the Congressional Budget Office at the federal level. Another possible model is the Washington Institute for Public Policy,



a quasi-governmental body that conducts analysis at the request of the Washington State legislature (or at the request of its board of directors, which includes members from academia and the public sector).<sup>35</sup>

An alternative to having independently conducted analysis is to strengthen third-party oversight of agency analysis. A model for such a system is the review that takes place at the federal level by the Office of Information and Regulatory Affairs (OIRA). OIRA analysts review new agency regulations and their corresponding analyses, recommending alternative solutions that an agency may have failed to consider and identifying ways in which analysis could be strengthened to improve the design and effectiveness of regulations. While DORA currently reviews new regulations and can urge changes to rules in some cases,<sup>36</sup> it has been criticized on the ground that its “review lacks teeth and mostly focuses on minimizing small business impacts.”<sup>37</sup>

Colorado’s legislature could do two things to strengthen third-party oversight: (1) make ensuring the quality of economic analysis part of DORA’s statutory mission, and (2) ensure that analysis is used to inform rulemaking. DORA should be able to return rules to the promulgating agency if the accompanying analysis is deemed poor or does not appear to have influenced the decision of how and whether to regulate. Proceeding with incomplete analysis could also be grounds for courts to strike down regulations.<sup>38</sup>

## CONCLUSION

BCA in Colorado is in need of reform. Analysis is conducted for only a tiny fraction of rules, the rules for which it is conducted may not be those that are the most important, and the analysis generally comes too late to be useful anyway. Furthermore, analysis may not be objective, and the current third-party review process for rules and accompanying analysis is probably too weak to be effective.

As the General Assembly in Colorado considers whether to renew the sunseting BCA requirement, it should also consider whether other changes to the

administrative procedures in Colorado are necessary. DORA itself notes that “meaningful solutions might require a comprehensive overhaul of the [Administrative Procedure Act].”<sup>39</sup> This report has offered several ways to improve the administrative procedures in Colorado to ensure that better analysis is produced and that analysis is actually used to inform public policy.

When it comes to engaging in evidence-based policy, Colorado is actually ahead of most states. Colorado’s analytic capabilities might even one day be extended to analyzing the impact of federal rules on the state. But given Colorado’s analytic capabilities and the resources it already invests in them, hard evidence should play a more important role in rulemaking.

Colorado lawmakers should use this opportunity to make lasting changes to their state’s rulemaking procedures, setting a higher bar for regulation that could serve as a model for other states.

## NOTES

1. Colorado Department of Regulatory Agencies, Office of Policy, Research, and Regulatory Reform, *2017 Sunset Review: Requirements and Procedures Regarding the Preparation of a Cost-Benefit Analysis of Proposed Rules*, 2017, 1.
2. The sunset review process and DORA’s role in it are spelled out in the *Colorado Revised Statutes* § 24-34-104.
3. This kind of analysis is referred to as “cost-benefit analysis” or “CBA” throughout the Colorado government. The terminology used in this report is “benefit-cost analysis” or “BCA,” which is the more common parlance used by practitioners of the analysis. See, for example, the *Journal of Benefit-Cost Analysis*.
4. Colo. Rev. Stat. § 24-4-103(2.5)(f)(I).
5. Colo. Rev. Stat. § 24-4-101 through 108.
6. Colo. Rev. Stat. § 24-4-103.
7. Colo. Rev. Stat. § 24-4-103(2.5)(a).
8. The agency is only required to promulgate a rule within 180 days of the last hearing.
9. Personal communication with an employee at DORA revealed that only one or two hearings had been delayed in the previous 18 months owing to a BCA request. In one of these cases, the rule was withdrawn after receiving the request.
10. Colo. Rev. Stat. § 24-4-103(2.5)(a)(I-V).
11. Colo. Rev. Stat. § 24-4-103(2.5)(b).
12. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 8.

13. Colorado Department of Regulatory Agencies, 8.
14. Colo. Rev. Stat. § 24-4-103(4.5).
15. Nor is there any mention in the Colorado Revised Statutes of delaying hearings to produce an analysis, implying that regulatory analysis is generally produced in a 10-day timeframe. A further difference between the regulatory analysis requirement and the BCA requirement is that DORA plays no role in determining whether a regulatory analysis gets produced. A request from the public is sufficient to trigger the analysis.
16. Colo. Rev. Stat. § 24-4-103(4.5)(I through VI).
17. Pew Charitable Trusts, “How States Engage in Evidence-Based Policymaking: A National Assessment” (Pew-MacArthur Results First Initiative, Philadelphia, PA, January 26, 2017).
18. Sarah Dube and Kristen Pendergrass, “In Colorado, the Use of Data Is Changing the Way Government Operates” (Pew-MacArthur Results First Initiative, Philadelphia, PA, May 9, 2017).
19. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 12.
20. Jason A. Schwartz, *52 Experiments with Regulatory Review: The Political and Economic Inputs into State Rulemaking* (New York: Institute for Policy Integrity at NYU School of Law, 2010), 181.
21. Colorado Department of Regulatory Agencies, Office of Policy, Research, and Regulatory Reform, *2012 Sunset Review: Requirements and Procedures Regarding the Preparation of a Cost-Benefit Analysis of Proposed Rules*, 2012, 18.
22. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 7.
23. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 16.
24. Of the respondents, 65.7 percent were “not sure” how long it takes, and 11.4 percent said it takes “more than 20 hours.” So there is considerable uncertainty surrounding the length of time it takes to produce an analysis. Nonetheless, it is telling that the question involved hours, not weeks or months. See Colorado Department of Regulatory Agencies, *2012 Sunset Review*, 18.
25. John Morrall and James Broughel, *The Role of Regulatory Impact Analysis in Federal Rulemaking* (Arlington, VA: Mercatus Center at George Mason University, 2014).
26. Richard Williams and James Broughel, “Principles for Analyzing Distribution in Regulatory Impact Analysis” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, May 2015).
27. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 16.
28. Jerry Ellig, “‘Ready, Fire, Aim!’: A Foundational Problem with Regulations,” *Economic Perspectives*, Mercatus Center at George Mason University, November 6, 2015.
29. Colorado Department of Regulatory Agencies, *2012 Sunset Review*, 20.
30. Exec. Order No. 12866, 58 Fed. Reg. 51735 (October 4, 1993).
31. At the federal level, this impact level is \$100 million in a single year, but a lower threshold probably makes sense for state rules.
32. Department regulatory agendas are required pursuant to Colo. Rev. Stat. § 2-7-203(4).
33. See Stuart Shapiro, *Analysis and Public Policy Successes, Failures and Directions for Reform* (Northampton, MA: Edward Elgar, 2016); Richard Williams, “The Influence of Regulatory Economists in Federal Health and Safety Agencies” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2008).
34. Virginia Department of Planning and Budget, “Economic and Regulatory Review,” *Virginia.gov*, accessed December 19, 2017, <http://dpb.virginia.gov/regs/regs.cfm>.
35. Washington State Institute for Public Policy, “About WSIPP,” accessed December 19, 2017, <http://www.wsipp.wa.gov/About>.
36. Colo. Rev. Stat. § 24-4-103(2.5)(b).
37. Schwartz, *52 Experiments*, 181.
38. Jerry Ellig and Reeve Bull, “Judicial Review of Regulatory Impact Analysis: Why Not the Best?” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, March 2017).
39. Colorado Department of Regulatory Agencies, *2017 Sunset Review*, 16.

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