



J O I N T C E N T E R
AEI-BROOKINGS JOINT CENTER FOR REGULATORY STUDIES

**Improving Regulation:
Start with the Analysis and Work from There**

Testimony before the
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and Paperwork Reduction
House Committee on Small Business

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J O I N T C E N T E R

In response to growing concerns about understanding the impact of regulation on consumers, business, and government, the American Enterprise Institute and the Brookings Institution have established the AEI-Brookings Joint Center for Regulatory Studies. The primary purpose of the center is to hold lawmakers and regulators more accountable by providing thoughtful, objective analysis of existing regulatory programs and new regulatory proposals. The Joint Center builds on AEI's and Brookings's impressive body of work over the past three decades that has evaluated the economic impact of regulation and offered constructive suggestions for implementing reforms to enhance productivity and consumer welfare. The views in Joint Center publications are those of the authors and do not necessarily reflect the views of the staff, council of academic advisers, or fellows.

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Executive Summary

This testimony reviews research from the Joint Center on regulatory impact analyses and provides five recommendations for improving the regulatory process. These recommendations include: making regulatory impact analyses publicly available on the Internet; providing a regulatory impact summary table for each regulatory impact analysis that includes information on costs, benefits, technical information, and whether the regulation is likely to pass a benefit-cost test; establishing an agency or office outside the executive branch to assess independently existing and proposed federal rules; requiring that the head of a regulatory agency balance the benefits and costs of a proposed regulation; and requiring that all regulatory agencies adhere to established principles of economic analysis when doing a regulatory impact analysis.

Improving Regulation: Start with the Analysis and Work from There

Robert W. Hahn and Robert E. Litan

1. Introduction

We are pleased to appear before this subcommittee to provide our views on improving regulation and the regulatory process. We have studied and written about regulatory institutions for over two decades. Two years ago, we helped organize a cooperative effort between the American Enterprise Institute and the Brookings Institution to study regulation. The result was the AEI-Brookings Joint Center for Regulatory Studies.¹

A primary objective of the center is to hold lawmakers and regulators more accountable by providing thoughtful, objective analysis of existing regulatory programs and new regulatory proposals. The Joint Center has been in the forefront of outlining principles for improving regulation, enhancing economic welfare, and promoting regulatory accountability.²

You have expressed interest in the adequacy of agency compliance with analytical and reporting requirements aimed at providing economic analysis of regulations and ensuring that such analysis is publicly available. The requirements include executive orders, such as President Clinton's Executive Order 12866, which stipulates various analytical requirements and outlines how those requirements shall be enforced; and laws, such as the Administrative Procedures Act, which requires agencies to make the process and results of such an analysis public.

In addition, you have asked for suggestions on changes needed to ensure that agencies comply with economic analysis requirements, particularly those related to assessing the impacts of regulations on the regulated community. An example of one such change is the creation of a congressional agency that would independently assess the quality of regulations.

Our testimony proceeds in three parts. First, we provide a brief overview of regulation and offer a slightly different definition of the problem from that given by the subcommittee. Second, we present some results from research undertaken at the Joint

¹ All publications of the Joint Center can be found at www.aei.brookings.org.

² See Arrow et al. (1996).

Center, which reviews the implications of economic impact analyses of regulation performed by the federal government. Third, we offer some suggestions for reforming regulation to improve both the quality of analysis and the quality of regulatory decisionmaking.

2. Regulation and Oversight

Although regulations often have no direct fiscal impact, they pose real costs to consumers as well as businesses. Regulations aimed at protecting health, safety, and the environment alone cost over \$200 billion annually—about two-thirds as much as outlays for federal, nondefense discretionary programs.³ Yet, the economic impacts of federal regulation receive much less scrutiny than the budget.⁴

To encourage the development of more effective and efficient regulations, Presidents Reagan, Bush, and Clinton have directed agencies to perform analyses on major regulations that show whether a regulation's benefits are likely to exceed the costs, and whether alternatives to that regulation can achieve the same goal for less money. They also have attempted to increase agency accountability for decisions by requiring that the President's Office of Management and Budget review all major regulations. More recently, Congress embraced regulatory reform and inserted accountability provisions and analytical requirements into laws such as the Safe Drinking Water Act Amendments of 1996, the Small Business Enforcement and Fairness Act of 1996, and the Unfunded Mandates Reform Act of 1995.⁵

The most prominent and far-reaching of these regulatory reform efforts are President Reagan's Executive Order 12,291 and President Clinton's Executive Order 12,286. Both require agencies to prepare a Regulatory Impact Analysis ("RIA") for all major federal regulations.⁶ Agencies have prepared RIAs for almost twenty years in

³ See Arrow et al. (1996); OMB (1999). All dollar figures are presented as constant 1999 dollars, adjusted by using the consumer price index.

⁴ See Joint Economic Committee Study (1998).

⁵ Some examples of accountability mechanisms include regulatory oversight, peer review, judicial review, sunset provisions, regulatory budgets, and requirements to provide better information to Congress. Analytical requirements include mandates to balance costs and benefits, consider risk-risk tradeoffs, and evaluate the cost-effectiveness of different regulatory alternatives. See Hahn (2000).

⁶ President Reagan coined the term *regulatory impact analysis* in Executive Order 12,291, see 3 C.F.R. 128 (1981). President Bush also used Executive Order 12,291. President Clinton's Executive Order 12866 changed the term *regulatory impact analysis* to *assessment*, see 3 C.F.R. 638 (1993). Executive Order 12866 maintains most of Reagan's requirements but places greater emphasis on distributional concerns.

accordance with the executive orders and guidelines for economic analysis provided by the President's Office of Management and Budget ("OMB").⁷

The subcommittee is particularly interested in focusing on the impact of regulations on the regulated community and small business.⁸ While we believe it is important to consider such impacts, particularly when they are significant, *we would urge the committee to focus its efforts on having an agency do a good benefit-cost analysis of a regulation, as economists typically define it.*⁹ That analysis would include an evaluation of an agency's preferred option along with relevant alternatives. As we shall argue below, such good analyses tend to be the exception rather than the rule. When done well, such analyses can help provide a general measure of the social impact of regulations. In contrast, measures of industry-specific impacts, while important, do not adequately address whether the overall benefits of a regulation are likely to exceed the costs. In addition, it is often difficult to develop reliable measures of industry-specific impacts of a regulation.

3. What Do the Government's Economic Analyses of Regulations Tell Us?

The Joint Center has been engaged in conducting a systematic review of regulatory impact analysis since its inception. We wish to focus on three different efforts: one provides a comprehensive assessment of the costs and benefits of federal regulatory activities; a second examines the extent to which the costs and benefits of regulations are reported in the *Federal Register*; and a third assesses the quality of regulatory impact analyses.¹⁰

To assess net benefits of final regulations between 1981 and mid-1996 the Joint Center reviewed 168 regulations. On the basis of the government's own numbers, these regulations are estimated to yield net benefits of close to \$2 trillion.¹¹ The analysis also

Executive Order 12866 also directs agencies to show that the benefits of the regulation "justify" the costs, whereas Reagan's executive order required agencies to show that the benefits of the regulation "outweigh" the costs. See Exec. Order No. 12,291, 3 C.F.R. 128 (1981-1993); Exec. Order No. 12866, 3 C.F.R. 638 (1993-2000), *reprinted in* 5 U.S.C. § 601 (1994).

⁷ See OMB (1996).

⁸ Examples include estimates of the impact on employment in a specific industry or the impact on plant closures.

⁹ See Arrow et al. (1996); see OMB (1996).

¹⁰ See Hahn (1999a), Hahn (1999b), and Hahn et al. (2000).

¹¹ The net benefits estimate does not include two rules on stratospheric ozone that, according to the Environmental Protection Agency, have net benefits in the trillions of dollars. Those rules would have a

shows that the government can significantly increase the net benefits of regulation. Less than half of final regulations pass a neutral economist's benefit-cost test. Net benefits could increase by approximately \$300 billion if agencies rejected such regulations. Net benefits could also increase if agencies replace existing regulations with more efficient alternatives, or if agencies substantially improve regulatory programs. While one could argue with the particular interpretation of the numbers provided in this study, we feel comfortable saying that a significant fraction of the government's final regulations would not pass an economist's benefit-cost test using the government's own numbers. That suggests that the executive orders requiring a careful weighing of costs and benefits have not been taken very seriously.¹²

A second strand of research examined how the government used the *Federal Register* to convey important information on the impacts of regulation. The *Federal Register* was selected because it is a key repository of information on regulation within the government.

Joint Center researchers examined seventy-two final rules promulgated by regulatory agencies from 1996 through February 10, 1998, that were subject to review by the OMB. Each rule was scored on pertinent information related to alternatives considered, costs, cost savings, benefits, and other essential economic information.¹³ Two important conclusions emerge from that analysis. First, *Federal Register* notices that present regulatory analysis currently exhibit a great deal of variation in the kind of information that is presented.¹⁴ Second, with some key changes in the requirements for including and presenting information, the content of those notices could be improved dramatically.

Further insight into the extent to which the government's analyses of regulations provide an adequate basis for decisionmaking can be found in a Joint Center study of

large impact on the overall estimate of net benefits (taking the government numbers as given), but not on the fraction of rules that pass a benefit-cost test.

¹² An alternative interpretation is that those numbers were carefully weighed and then dismissed for other reasons, for example, because they left out important aspects of the problem.

¹³ Once each *Federal Register* notice was reviewed, the data were entered into a database. Each notice was then reviewed a second time to check for accuracy.

¹⁴ For example, there was little consideration of alternatives. For all seventy-two rules, thirty-one (43 percent) considered alternatives; only nineteen (26 percent) discussed specific alternatives; and eight (11 percent) quantified them.

regulatory impact analyses.¹⁵ That study provides the most comprehensive evaluation of the quality of recent economic analyses that agencies conduct before finalizing major regulations.

We construct a new dataset that includes analyses of forty-eight major health, safety, and environmental regulations from mid-1996 to mid-1999. That dataset provides detailed information on a variety of issues, including an agency's treatment of benefits, costs, net benefits, discounting, and uncertainty. We use that dataset to assess the quality of recent economic analyses and to determine the extent to which they are consistent with President Clinton's Executive Order 12866 and the benefit-cost guidelines issued by the OMB.

We find that economic analyses prepared by regulatory agencies typically do not provide enough information to make decisions that will maximize the efficiency or effectiveness of a rule. The study of regulatory impact analyses shows that agencies only quantified net benefits —the dollar value of expected benefits minus expected costs—for 29 percent of the forty-eight rules, even though the executive order directs agencies to show that the benefits of a regulation “justify” the costs. The agencies also did not adequately evaluate alternatives to the proposed regulation, another element of the Executive Order. Agencies failed to discuss alternatives for 27 percent of the rules and quantified the costs and benefits of alternatives for only 31 percent. In addition, the agencies often failed to present the results of their analysis clearly. Agencies provided executive summaries for only 56 percent of the rules.

Taken together, those studies illustrate four key points. First, many major regulations are not likely to pass a standard benefit-cost test using the government's own numbers. Second, the quality of analyses is generally poor, though there is a great deal of variation in quality. Third, the analyses are not readily accessible to the general public. Finally, useful summaries of the analyses are not readily available to the general public.

¹⁵ See Hahn et al. (2000).

4. Recommendations for Improving Regulation

A complete discussion of improving regulation is beyond the scope of this testimony.¹⁶ Here, we wish to focus on a few key policies that will either promote economic welfare (broadly understood) or promote greater regulatory accountability. We believe the subsequent recommendations are modest in the sense that they could be implemented with bipartisan support. We also believe that proposals that are viewed as more far-reaching, such as requiring that a regulation pass a broadly defined benefit-cost test, are unlikely to be implemented in the near future because the political support will not be there.

We begin from the presumption that neither Congress nor the next administration (whether Democratic or Republican) is likely to put regulatory reform or regulatory improvement at the top of its political agenda.

Recommendation 1: Congress should require that agencies make each regulatory impact analysis and supporting documents available on the Internet before a proposed or final regulation can be considered in the regulatory review process.

Discussion: If the RIA is expected to inform the decision process, the analysis must precede the decisions themselves. Making such analyses widely available is an important first step in holding lawmakers and regulators more accountable for proposed and final regulations. Some agencies, such as the Department of Health and Human Services and, increasingly, the Environmental Protection Agency, are moving in that direction by eventually putting the regulatory impact analysis on the Internet. Requiring that an analysis and supporting documents be made available on the Internet before the regulatory review process starts at OMB provides an agency with an additional incentive to make it available to the public.

Recommendation 2: Each regulatory impact analysis should include an executive summary with a standardized regulatory impact summary table that contains information on costs, benefits, technical information, and whether the regulation is likely to pass a benefit-cost test based on the best estimate of quantifiable benefits and costs.

¹⁶ See, e.g., Breyer (1993), Breyer (1984), and Litan et al. (1983).

Discussion: The executive summary, regulatory impact summary table, and the requirement of standardization would all promote greater regulatory accountability. The standardization and summary will make it easier for the public, interest groups, and academics to obtain information on the government's views of the benefits and costs of regulation.

The information identified in the regulatory impact summary table is similar to that required by Executive Order 12866, the Unfunded Mandates Reform Act, and the Regulatory Flexibility Act. Congress should simply consider passing an amendment requiring that the information be summarized and produced in the form suggested here. The cost would be trivial, and the benefits could be potentially quite large.

We present an example of a regulatory impact summary table in table 1. That information should be standardized across agencies to enable Congress and stakeholders to make comparisons when setting regulatory priorities.

Recommendation 3: Congress should create a congressional office of regulatory analysis (CORA) (e.g., within CBO) or a separate agency outside of the executive branch to assess independently existing and proposed federal rules.

Discussion: CORA is sound for three reasons. First, because it is likely to serve as an independent check on the analysis done in the executive branch by OMB and the agencies. Second, it will help to make the regulatory process more transparent. Third, Congress can use the independent analysis to help improve regulation and the regulatory process.

OMB's Office of Regulatory and Information Affairs (OIRA) faces inherent limits in the scope of its review of individual regulatory proposals. OIRA is headed by a political appointee chosen by the same administration that appoints the heads of the regulatory agencies. There is likely, therefore, to be some implicit understanding that the head of OIRA is not to press the agencies excessively hard because he or she is on the same team as the agency heads. Even if the head of OIRA were given authority to challenge regulations, the basis for those challenges is rarely made public; and the scope of those challenges is likely to be limited. The constraints on the OMB are manifested in its annual report, in which it has, so far, simply accepted the benefits and cost estimates compiled by the agencies instead of providing any of its own assessments. CORA would

not face those constraints but instead would be able to provide its independent analysis, much as CBO has done in the budget arena.

CORA could help Congress implement its recent legislation, such as the Small Business Regulatory Enforcement Fairness Act. CORA could also aid Congress in periodically assessing the need to modify its own regulatory statutes. As it is now, if and when Congress chooses to do so, it will have to rely on the agency's own estimates of the impacts of a rule and on any other data that interested parties may or may not have submitted in the rulemaking record. Significantly, Congress now has no *credible, independent source of information* upon which to base such decisions. That is analogous to the pre-CBO Congress, which had to make budget and appropriations decisions based solely on the information developed by the executive branch.

Recommendation 4: Congress should require agencies to balance the benefits and costs of major regulations.

Discussion: While the Reagan and Clinton Executive Orders have encouraged agencies to consider the benefits and costs of regulations, executive orders do not have the authority of statutes. Executive orders are difficult to enforce in part because they are not judicially reviewable, and agencies cannot be sued for noncompliance. Congress should therefore require agencies by statute to comply with requirements similar to those in the executive orders and in the OMB's implementation guidance for the executive orders. Although some statutes already require agencies to balance the benefits and costs of regulation, these statutes apply to only a small number of major regulations and agencies often do not comply with the requirement. Other statutes either do not require benefit-cost analysis or actually restrict its use. The Clean Air Act, for example, precludes the consideration of costs for certain regulatory decisions. A congressional requirement to balance benefits and costs will increase the transparency of the regulatory process by forcing agencies to provide high-quality analyses that the courts could review in the event of significant controversy.¹⁷

¹⁷ If a balancing requirement is seen as problematic, then Congress should consider passing an amendment that does not preclude agency heads from explicitly considering costs and benefits in regulatory decision making.

Recommendation 5: Congress should require that all regulatory agencies adhere to established principles of economic analysis when undertaking a regulatory impact analysis.

Discussion: It is clear from a careful review of regulatory impact analysis that agencies are currently not taking the guidelines imposed by the executive branch very seriously in carrying out regulatory analyses. To add political weight to those guidelines, Congress should consider adopting the kinds of principles contained in the OMB guidelines. It should also consider requiring that an agency, such as OMB, enforce those guidelines. It, too, could help to enforce those guidelines by holding hearings. An obvious question is how far Congress would be willing to go in providing methods for enforcement. One possible mechanism that deserves consideration is not allowing agencies to move forward on regulations unless an oversight agency, such as OMB, determines that the guidelines are met.

If Congress and the White House are serious about regulatory reform, they must cooperate to enforce the regulatory impact analysis requirement. Successful enforcement requires high-level political support, statutory language requiring all agencies to adhere to established principles of economic analysis, and rigorous review of agency analyses by an independent entity. If lawmakers are willing to exert the political muscle, real reform could be achieved.

Table 1

| Regulatory Impact Summary | |
|--|--|
| I. BACKGROUND ON RULE AND AGENCY | |
| AGENCY AND DEPARTMENT/OFFICE NAME | |
| CONTACT PERSON | TELEPHONE NUMBER |
| TITLE OF THE RULE | |
| RIN NUMBER | DOCKET NUMBER |
| TYPE OF RULEMAKING (FINAL/INTERIM/PROPOSED/NOTICE) | TYPE OF RULE (REGULATORY/BUDGET IMPACT) |
| STATUTORY AUTHORITY FOR THE RULE | RULEMAKING IMPETUS |
| BRIEF DESCRIPTION OF THE RULE | |
| II. OVERALL IMPACT | |
| <p>1. Will the rule have an impact on the economy of \$100 million or more? <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>2. Best estimate of the present value of quantifiable benefits of the rule. \$ _____</p> <p>3. Best estimate of the present value of quantifiable costs of the rule.¹⁸ \$ _____</p> <p>4. Do the quantifiable benefits outweigh the quantifiable costs? <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>5. Report the dollar year of costs and benefits. _____</p> <p>6. Report the discount rate used in the calculations for costs and benefits. _____ If more than one discount rate was used in calculations, please explain why. _____</p> <p>7. Discuss level of confidence in the benefit-cost estimates and key uncertainties. Include a range for costs and benefits. _____ _____ _____ _____</p> <p>8. Identify benefits or costs that were not quantified. _____ _____ _____ _____</p> | |

¹⁸ Costs are defined as costs minus cost savings.

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