



## Evaluating the benefits and costs of regulatory reforms: What questions need to be asked?

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### ABSTRACT

In 1984, Portney argued that “[w]e should scrutinize proposed reforms of the rulemaking process every bit as carefully as the regulations that process produces.” In the 23 years since then, the regulatory process on the federal level has been continuously reformed by statute, by executive order, and by directives from the OMB. Despite the extensive debate on the need for these reforms, there has been very little analysis of the reforms themselves. This paper updates Portney’s work on analyzing cost–benefit analysis and expands it to evaluate reforms of the regulatory process. I use as my primary example the recent peer-review guidelines issued by OMB. I argue that we may have reached a point of diminishing returns in regulatory reforms, that the peer-review guidelines likely have costs that exceed their benefits, and that further regulatory reforms merit closer evaluation.

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### 1. Introduction

In a 1984 article, Paul Portney argued, “[w]e should scrutinize proposed reforms of the rulemaking process every bit as carefully as the regulations that process produces” (Portney, 1984). In the 23 years that followed, the federal regulatory process has been reformed repeatedly—by statute, executive order, and directives from the Office of Management and Budget (OMB). Reform has proceeded apace on the state level. Portney’s recommendation, however, has largely been ignored: few studies have attempted to evaluate the impact of these reforms.

Certainly, the need for proposed reforms is often debated, but there has been little evaluation of the efficacy of the reforms themselves. This analysis has taken place neither *ex ante*, as the reforms are being debated, nor *ex post*, after we have had the opportunity to measure their impacts. The result is that the regulatory process has become increasingly complicated—one Department of Transportation map of the process stretched out for 30 feet<sup>1</sup>—without anyone understanding whether the added complexity is leading to better regulations.

These reforms often take the form of adding procedural requirements to the process for promulgating regulations. These

procedures have been imposed by the President, by Congress, and by the courts. They date back to the requirement that agencies solicit public input on their regulatory proposals (Kerwin, 2003). In recent decades, such reforms often impose analytical requirements on agencies such as the requirement to conduct cost benefit analysis on some regulations (see Executive Order 12866) and the requirement to analyze the impact of rules on small businesses contained in the Regulatory Flexibility Act. Just this past year, President Bush issued Executive Order 13422, making several modifications to the regulatory process.

Both academic and political supporters of regulatory reforms (see e.g. Hahn, 2004; Viscusi & Gayer, 2002), cite regulations that are excessively costly or burdensome as evidence of the need for regulatory reform. They do little, however, to examine the costs associated with the reforms, and provide little evidence that the reforms will lead to better regulations.

Critics of regulatory reforms express concern about how any reform of the process is intended solely to make regulating more difficult (McGarity, 1992).<sup>2</sup> They often describe such reforms as “paralysis by analysis.” While paralyzing the regulatory process may or may not be the intention of those who advocate the reforms, critics rarely address whether the reforms confer any benefits upon the regulations they impact (other than to occasionally assert that they do not). As a result we are left wondering how much if any delay in the regulatory process is acceptable.

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<sup>1</sup> As shown by Neil Eisner of the Department of Transportation at the March 26, 2005, American University conference on “The State of Rulemaking in the Federal Government.” See for a transcript of the proceedings. <http://www.american.edu/rulemaking/news/pastconference05.htm> (last viewed November 13, 2006).

<sup>2</sup> One can envision regulatory reforms that speed up regulation. Because the vast majority of requirements make writing a regulation more difficult for an agency, I ignore this possibility in my analysis.

A further problem with the debate over particular regulatory reforms is that marginal impacts are rarely considered. Each reform is made to a regulatory process filled with requirements that were originally designed to achieve the same goals as the newer reform. This is particularly relevant when considering the benefits of regulatory reforms. When assessing whether a new procedure in the regulatory process will improve agency decision-making, existing procedures need to be considered. An effort to improve the scientific basis of agency decisions must convincingly demonstrate that it will improve the scientific evidence more than current agency scientific processes and judicial review.

This article attempts to update Portney's work on analyzing cost–benefit analysis. My goal is to highlight the questions that we need to answer when evaluating regulatory reforms. I apply these questions to the recent peer-review guidelines issued by OMB. In doing so, I hope to demonstrate that economic analysis of regulatory reforms can yield useful conclusions about the desirability (or lack thereof) of such reforms. In the specific case of regulatory peer review, I argue that the benefits of the reform are unlikely to outweigh its costs. This is largely because of the costs of delaying regulations as they undergo regulatory peer review. I discuss the implication of this finding to other regulatory reforms and to the existing regulatory process.

The paper is structured as follows: Section 2 reviews Portney's 1984 article and the limited work analyzing regulatory reform since 1984. Section 3, focusing on the peer-review guidelines, discusses the costs of regulatory reforms. Section 4 provides an analogous discussion of the benefits of regulatory reforms. Finally, Section 5 draws conclusions from these analyses and points out directions for further research.

## 2. Efforts to evaluate regulatory reforms

Portney's article examined the costs and benefits of requiring agencies to analyze the costs and benefits of major rules.<sup>3</sup> Portney's analysis of costs was restricted to direct costs, which included the costs of agency contracts with consultants to conduct the analyses, the costs of agency salaries for those who would have to monitor the contracts, and the salaries of the Office of Information and Regulatory Affairs (OIRA) personnel who would review the analyses. These direct costs, according to Portney's research, amounted to \$17–25 million annually in 1984 dollars.<sup>4</sup>

Portney's study did not consider the indirect costs of a cost–benefit analysis requirement, as he believed that quantifying those costs would be impossible:

What can be said about the indirect costs associated with regulatory analysis? Only that they can take several different forms. Unfortunately it is not possible to be more quantitative than that.

Indirect costs, as Portney conceived of them, include the costs of delays in the issuance of regulations; the costs of uncertainty; and other, even less tangible costs.<sup>5</sup> As the regulatory process has become more procedurally complex, these indirect costs—

particularly the cost of delay—have received increased attention from critics of regulatory reforms (McGarity, 1992). Any contemporary analysis of regulatory reforms needs to address these costs in order to be credible.<sup>6</sup>

As for the benefits of the cost–benefit analysis requirement, Portney argues that they are even more difficult to quantify than indirect costs. He concludes, nonetheless, that benefits likely outweigh costs. As an example of the difficulty in calculating benefits, he cites the case of a particular EPA rule<sup>7</sup> in which a change to the initially proposed standard saved \$1–3.8 billion, but in which it is impossible to tell whether the procedural requirement of cost–benefit analysis motivated the change. Despite this uncertainty, however, numerical conclusions are possible. If the cost of cost–benefit analysis is \$25 million (the upper bound of Portney's range and if rules cost \$2.5 billion annually, also from Portney's data), then even a 1% savings resulting from cost–benefit analysis will outweigh the direct costs of the cost–benefit analysis requirement.

As noted above, the work done on evaluating the costs and benefits of regulatory procedures has been quite limited since Portney's article.<sup>8</sup> What work has been done, has focused, like Portney's, on one specific procedural control<sup>9</sup>—the cost–benefit analysis requirement—rather than on the many other reforms to the regulatory process.<sup>10</sup> And this work has looked primarily at its costs or benefits. Effectiveness is an important component of the benefits of such a requirement, because if the requirement is not effective, then it will not produce any benefits. However, it is only a piece of the larger question.

This literature on the effectiveness of cost–benefit analysis has produced mixed results. The most prominent researcher in this field has been Robert Hahn. He has been a prominent critic of the analyses conducted by federal agencies to comply with the cost–benefit analysis requirement. One of his studies argued that the reason for poor analyses was agencies' failure actually to follow the analysis requirement contained in the executive orders requiring cost–benefit analysis. He notes that “[t]he RIA's [regulatory impact analyses] typically do not provide enough information to enable regulatory agencies to make decisions that will maximize the efficiency or effectiveness of a rule” (Hahn, Burnett, Chan, Mader, & Moyle, 2000). Elsewhere, Hahn argues that as many as 50% of cost–benefit analyses do not meet the requirements for such analyses laid out in the OMB guidance that specifies their content.

Other literature has examined the results of specific cost–benefit analyses years after they were conducted in order to assess how well they predicted the costs and benefits of various regulations. OMB (2005) summarized some of this literature in its 2005 report to Congress on the costs and benefits of regulations. It reported that of 47 analyses studied, 11 were found to have been roughly accurate, 22 to have overestimated the

<sup>6</sup> Dreisen (1997) and Asimow (1994) itemize these costs but do not attempt to quantify them.

<sup>7</sup> The 1978 National Ambient Air Quality Standard for Ozone.

<sup>8</sup> In response to a comment from this author, the Office of Management and Budget did attempt to describe the costs and benefits of their requirement that agencies subject the science supporting significant regulations to peer review.

<sup>9</sup> I use the phrases regulatory reforms, regulatory procedures, and procedural controls interchangeably since regulatory reforms typically add procedures to the regulatory process.

<sup>10</sup> GAO (2005) has issued a series of reports on regulatory reforms at the federal level. While none of these are economic analyses, they provide useful perspectives on reforms such as the Unfunded Mandates Reform Act and the Paperwork Reduction Act.

<sup>3</sup> Executive Order 12291, issued by President Reagan and in effect at the time of Portney's article, required that agencies analyze the costs and benefits of all rules with an impact of more than \$100 million in any given year. Such rules were defined as “major” rules.

<sup>4</sup> Adjusted for inflation this would be between \$31 and \$46 million in 2005 dollars.

<sup>5</sup> These less tangible costs include the potential devaluation of objects that occurs if they are assigned monetary values (Kelman, 1980) and the cynicism that may result from cost–benefit analysis done to justify decisions already made.

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