



Regulation & the Economy

The Relationship & How to Improve It

*A Policy Statement by the Committee for Economic Development of
The Conference Board*

Regulation and the Economy: The Relationship and How to Improve It

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Introduction:

What Is Regulation—and How Can Regulatory Policies Work to Work Well?

Regulation is a major way in which government influences the U.S. market economy. The scope of government regulations is vast and reaches all sectors of the economy and all aspects of our daily lives. But what exactly is regulation?

The [Merriam-Webster dictionary](#) provides this very general and simple definition of regulation:

an official rule or law that says how something should be done¹

Regulatory policy scholars Susan Dudley² and Jerry Brito elaborate on that definition this way:

Regulations, also called administrative laws or rules, are the primary vehicles by which the federal government implements laws and agency objectives. They are specific standards or instructions concerning what individuals, businesses, and other organizations can or cannot do.

Market economies need clear rules to function efficiently. Without a legal framework establishing and enforcing property rights and the “rules of the game,” our free enterprise system could not exist. Regulations issued by the executive branch affect every aspect of our lives. From the moment you wake up until the time you go to sleep, regulations influence what you do. Yet most people know very little about the impact of regulations or the process by which they are produced.³

Recently, the international [Organisation for Economic Co-operation and Development \(OECD\)](#) has done considerable research on regulatory policy. Their overarching perspective is that regulations are often necessary for a well-functioning, market-based, capitalist society, but they do not always live up to public expectations or achieve their social goals. In other words, regulations in practice do not always make things better:

Regulations are indispensable to the proper function of economies and societies. They create the “rules of the game” for citizens, business, government and civil society. They underpin markets, protect the rights and safety of citizens and ensure the delivery of public goods and services. At the same time, regulations are not costless. Businesses complain that red tape holds back competitiveness while citizens complain about the time that it takes to fill out government paperwork. Moreover, designing and enforcing regulations also requires resources for government and public administrations. Regulations can also have unintended costs, when they become outdated or inconsistent with the achievement of policy objectives. The 2008 financial crisis—which resulted in part from poorly designed regulatory regimes and the uneven enforcement of existing regulations—and the ensuing and ongoing economic downturn starkly illustrate the potential consequences of regulatory failure.⁴

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When CED last spoke on regulatory policy, we, like the OECD, recognized the necessity of regulation but noted how it often fails to serve its role well:

Government regulation of economic and social activities permeates our lives. While regulation in many instances yields important public benefits, regulations often are imposed on individuals and organizations with too little thought or analysis of what is gained in comparison with the losses incurred in time, money, indecision, and productivity...Further, the growth of government involvement in the market system sometimes constrains our ability to achieve fundamental economic and social goals.⁵

Indeed, though government intervention in the marketplace is often justified, it does not always achieve its “first-best” textbook ideal. There is an elegant efficiency in the market price system, allowing resources to flow naturally to their highest-valued uses as signaled by suppliers and demanders; but still there is a role for government where markets fail to price goods and services to reflect social values. Where government intervention can help “correct” prices, whether through regulations or fiscal (tax and spending) policies, government will improve economic and social outcomes. This is not a blanket endorsement of government intervention, however, as public policies are often imperfect “fixes” that can worsen, rather than improve, outcomes. A worthy government role does not mean we should hand over full control of markets to government. The free market may still be superior to government in getting most of the prices and flows of resources right.

It follows that government regulations are more likely to improve rather than impede the performance of the economy when they adhere to broad economic principles rather than impose narrow statutory rules. Principles-based regulatory approaches have the advantage of being

more adaptable to changes in economic conditions and economic opportunities, as new markets develop in the economy and particular businesses rise or fall in response to appropriate price signals. Admittedly, the lack of specificity in principles-based regulations can allow unintended behavior to be characterized as “compliant.” On the other hand, whereas a highly prescriptive rules-based approach makes it harder for businesses and regulators to “fudge” compliance, such brighter-line regulations can become so specific and tailored to the situation of the moment that they can easily become obsolete or even counter-productive—particularly from a public interest or societal perspective—as the economy evolves. They can also be specifically designed to favor incumbent businesses as well (supporting “cronyism”), to the detriment of new business formation and the innovation and productivity growth of the overall economy.

The case for a highly specific rules-based regulatory system is that in our litigious society, laws and rules must fully cover every contingency, lest the clever manipulate the system to take unfair advantage. Even sound and well-intended rules, this perspective would contend, could leave enormous and debilitating uncertainty until all of those contingencies were resolved—perhaps even in court. However, we believe that the benefits of a more concise principles-based approach are substantial enough that the nation should change its collective mentality, including perhaps a dispute-resolution system that could deliver timely judgments, possibly with penalties for attempts at manipulation that are fairly determined to be frivolous. (A summary of recent literature on principles- versus rules-based systems is presented in Appendix 1.)

Government decisions are more susceptible to bias through the influence of special-interest money and politics, whereas free market outcomes are impartial to all the different participants in the marketplace who clearly signal values through the prices they are willing to pay or receive.

Therefore, a well-justified approach to government policy is one in which private market prices are still the primary signal to steer resources, but regulations or other public policies supplement (or “correct”) the signals to more completely reflect public costs and benefits.

Regulation is just one way the government can intervene in the market economy. Two other major ways are through fiscal and monetary policy. These three types of public policy levers interact and overlap and can work toward the same goals—but also (unfortunately) cross purposes. Sadly, government does not plan for and scrutinize the effects of regulatory policy as well as it does for the impact of fiscal and monetary policy. There are several reasons for this discrepancy. First, the effects of regulations are more difficult to measure—on both the benefit and the cost side, but particularly measuring both on common terms (usually in monetary values) so they are comparable. Second, regulations typically do not impact the federal government’s budget (bottom line) as directly or explicitly as fiscal policy does, so it is more difficult and there is less incentive for the federal government itself to measure the costs—which are often shifted to lower-level governments or the private sector—even though the effects on the economy broadly can be just as large or larger. Any cost estimates produced by those very entities that disproportionately bear the costs of regulatory policies are typically viewed by federal policymakers with skepticism and a presumption of exaggeration, given that they come from a self-interested, rather than purely public-interested, perspective. (Regulated entities, not surprisingly, view claims by regulators with analogous skepticism.)

In theory, the major economic justifications for and role of regulation are fairly clear cut:

- To address market failures where true costs and benefits are not reflected correctly in market prices;
- To reduce entry barriers, “level the playing field,” encourage greater competition and

innovation, and combat short-sightedness—all to increase economic growth; and

- To ensure consumer, worker and investor safety, transparency in information about products and services, and a fair distribution of net benefits. This category is often labeled “social regulation,” but these policies also have economic justifications and implications.

In practice, however, “capture” (special interests or “cronyism”) theories compete with the public interest rationale to explain why and how the government actually regulates.

“Regulation policy” refers to how regulations in practice are made, maintained, and evaluated. Worldwide regulation policy over the past few decades has progressed from concepts of regulatory reform or deregulation, to regulation management, and most recently to regulatory governance. In a [2011 report on “Regulatory Policy and Governance,”](#) the OECD describes this progression of concerns and goals:

The OECD model of regulatory policy is founded on the view that ensuring the quality of the regulatory structure is a dynamic and permanent role of government. Governments must be actively engaged in assuring the quality of regulation, not reactively responding to failures in regulation. In advanced countries this concept is evolving into regulatory governance. Regulatory governance is grounded in the principles of democratic governance and engages a wider domain of players including the legislature, the judiciary, sub national and supra national levels of government and standard setting activities of the private sector. The integration of evidence based impact assessment of new and existing regulation, building strong institutions for regulatory management and placing a greater focus on users of regulation are all critical elements.⁶

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A common business perspective on regulatory policy is that regulations can often be helpful to the economy in encouraging competition, leveling the playing field, and promoting vibrant and dynamic markets that can be more responsive to evolving public interests. On the other hand, businesses also complain about regulations being overly burdensome, inefficient, and sometimes inappropriate and unjustified. Of course, individual businesses can find much to complain about in specific regulations that impose new costs on them specifically, and may seek regulations that give their business competitive advantages over others. Ironically, to promote a business-friendly regulatory climate (the “public interest”), large, powerful companies sometimes lobby for what are effectively special-interest regulations that keep potential new, innovative competitors out of the market and thus remove much of the incentive for their own companies to keep innovating.

CED believes that regulations should support (but not necessarily subsidize) business activity in ways that maximize the net benefits to society as a whole. This is why we favor a more principles-based regulatory strategy. Regulations are more likely to promote the public interest, even if they stay on the books for a long time (perhaps without periodic and frequent review), if they are based on broad principles rather than narrow rules. Broad economic principles last forever, but narrow legal rules can become stale over time. Broad principles do not favor specific companies over others, whereas narrow rules easily can and sometimes do.

CED’s Previous Statement on Regulation

The last CED policy statement on regulatory policy, “[Modernizing Government Regulation: The Need for Action](#),” was issued in 1998.⁷ The report concluded that while government regulation is needed to achieve many important economic and social goals, the regulatory system “produces too few benefits at excessive cost”—a shortcoming encouraged by the lack of regular scrutiny and analysis of the justification for and effectiveness of regulations.

The report also observed that “current efforts to effect meaningful regulatory reform are severely hampered by distrust on both sides of the regulatory debate” and stressed the need to reconcile and narrow the gap between the “polar extremes” with “sound science and analysis”—that is, evidence-based guidance, transparency, and accountability.

The CED statement made the following policy recommendations:

1. Require Congressional articulation of expected benefits and costs of regulatory programs when writing a regulatory statute;
2. Eliminate or amend provisions in existing regulatory statutes that prevent or limit regulatory agencies from considering costs and benefits;
3. Congress should establish its own professional, nonpartisan regulatory analysis organization (a part of or separate from CBO);
4. Congress should legislate provisions for regulatory review by the Office of Management and Budget (OMB) Office of Information and Regulatory Affairs (OIRA) similar to the guidance and directives contained in the executive orders of Presidents Reagan and Clinton;
5. Congress should codify requirements for regulatory impact or cost-benefit analyses before regulations are put in place;
6. On a regular timetable of every 5 to 10 years, each regulatory agency should be required to publish the objectives of its significant regulatory programs so that they can be validated and upheld;
7. Greater efforts and resources should be devoted to the information required for effective regulatory analysis;
8. Congress should require that OIRA continue to report annually on the costs and benefits of federal regulations and move toward producing a “regulatory budget.”

Note the repeated theme in these recommendations of getting Congress more involved in implementing, evaluating, and overseeing regulatory policies, and moving away from what is viewed as regulators' *self*-evaluations which are more likely to be biased and invested positions. But given how much things have changed over the past 18 years in terms of the function—or rather *dys*function—of Congress, it is not clear that we can have the same faith in the capability and motivations of Congress (over other parts and levels of government or other stakeholders in the private sector) today.

Beyond that point, regulations established via laws enacted by Congress are actually *imple-*
mented by executive agencies, not by Congress.

If regulations are to be workable at the street level where the “practice” takes place, it will necessarily require expertise in the agencies much more than in the halls of Congress in Washington. As a result, oversight of agency regulations and their implementation now resides in the OIRA in the OMB, within the Executive Office of the President. It is not clear that relocating ultimate authority to the Congress would help improve the quality of regulations, in practice, in the real world. On the other hand, Congress mandates new regulations, and in its decision-making needs to understand whether a new, cost-effective regulation is achievable. Therefore, strengthening Congress's regulatory resources in some measure does make sense.

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An Overview of U.S. Regulatory Policy

Regulations affect all sectors of the U.S. economy. Susan Dudley and Jerry Brito's primer on regulation follows "a day in the life of a regulated American family" to illustrate regulatory policy's influence on many areas, including telemarketing, utilities, consumer product safety, water quality, food nutritional information, the pricing of produce and meat, automobile safety (air bags), high-occupancy vehicle lanes and highways, workplace safety, employee benefits (both health insurance and retirement savings), and television broadcasting. When one realizes how these rules affect every aspect of how we earn and spend our money—and the quantity, quality, and price of all these things we buy and sell—it is clear that we *all* are essentially "stakeholders" in all kinds of regulations.

Some major aspects and sectors of the U.S. economy affected by regulations are:

- Antitrust (or competition) policy and regulation;
- Transportation industries (including airlines, taxis);
- Communications: TV, telephone, internet (including the "net neutrality" issue);
- Utilities (electricity);
- Product quality or consumer safety (including drugs and food);
- Environmental; this is probably the most economically significant category of regulations during the Obama presidency, according to a [Council on Foreign Relations 2015 report](#);⁸
- Labor markets (including minimum wage, overtime pay);

- Healthcare markets (especially mandates via the Affordable Care Act);
- Banking and the financial sector (including Dodd-Frank).

[Susan Dudley's latest \(May 2015\) "regulators' budget"](#)⁹ provides estimates on government spending and staffing for the "social regulation" and "economic regulation" categories (see Figures 1 and 2 and the appendix of [Dudley \(July 2015\)](#)¹⁰). It shows the tremendous growth in time and money spent on administering federal regulations, particularly of the "social" variety, over the past 50 years.

The past decade has been economically tumultuous and challenging, and there is plenty of finger pointing at the government for not doing the right thing in various areas of policy. Both since and as a result of the 2008 financial crisis, there has been increased concern that the burden of regulation is unnecessarily holding back economic activity. There is also recognition that policies must strike the proper balance between the often competing goals of: (i) promoting the stability and longer-term growth of the economy (which suggests avoiding imprudent risk-taking, and addressing the fiscal outlook), and (ii) continuing to support the current cyclical (shorter-term) recovery (which implies policies that may encourage risk taking and deficit spending). This tension between economic goals means that in developing and establishing regulations, policy makers will often need to consider whether imposing a regulation that is believed to have long-term social (and perhaps nonmonetary) benefits is worth its short-term economic risks and costs. This is typically a tradeoff that is both challenging to measure and difficult to make.

Figure 1

Total Spending on Federal Regulatory Activity

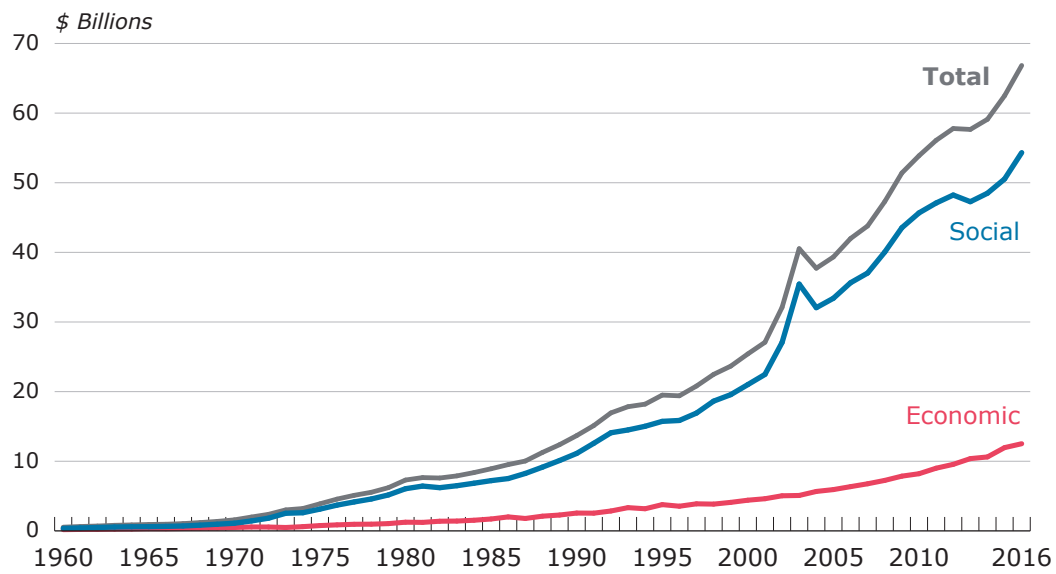
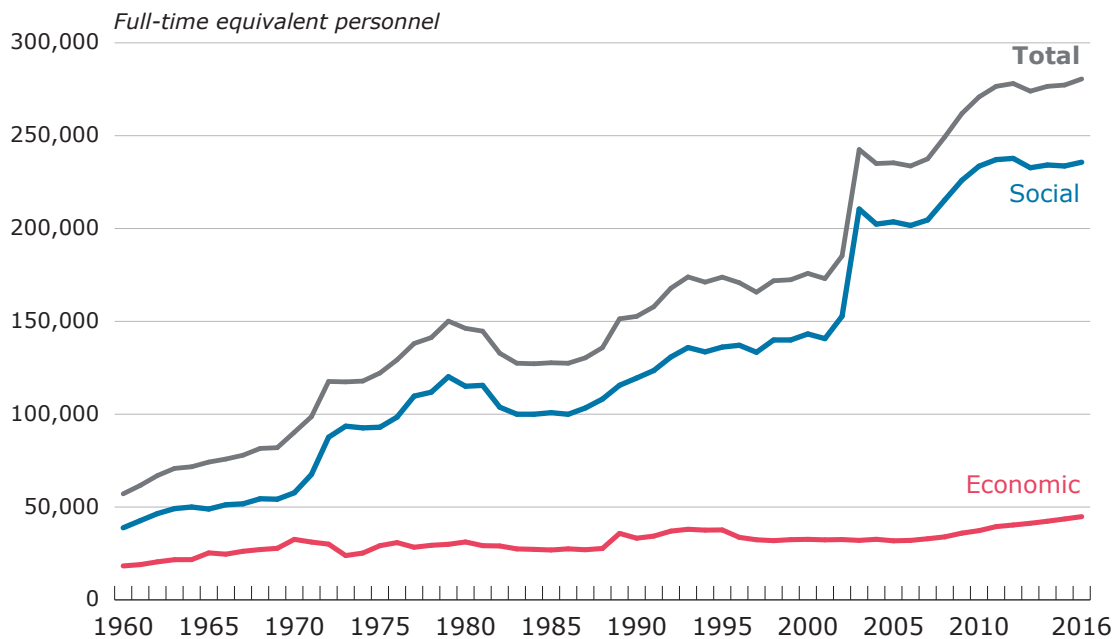


Figure 2

Staffing of Federal Regulatory Agencies



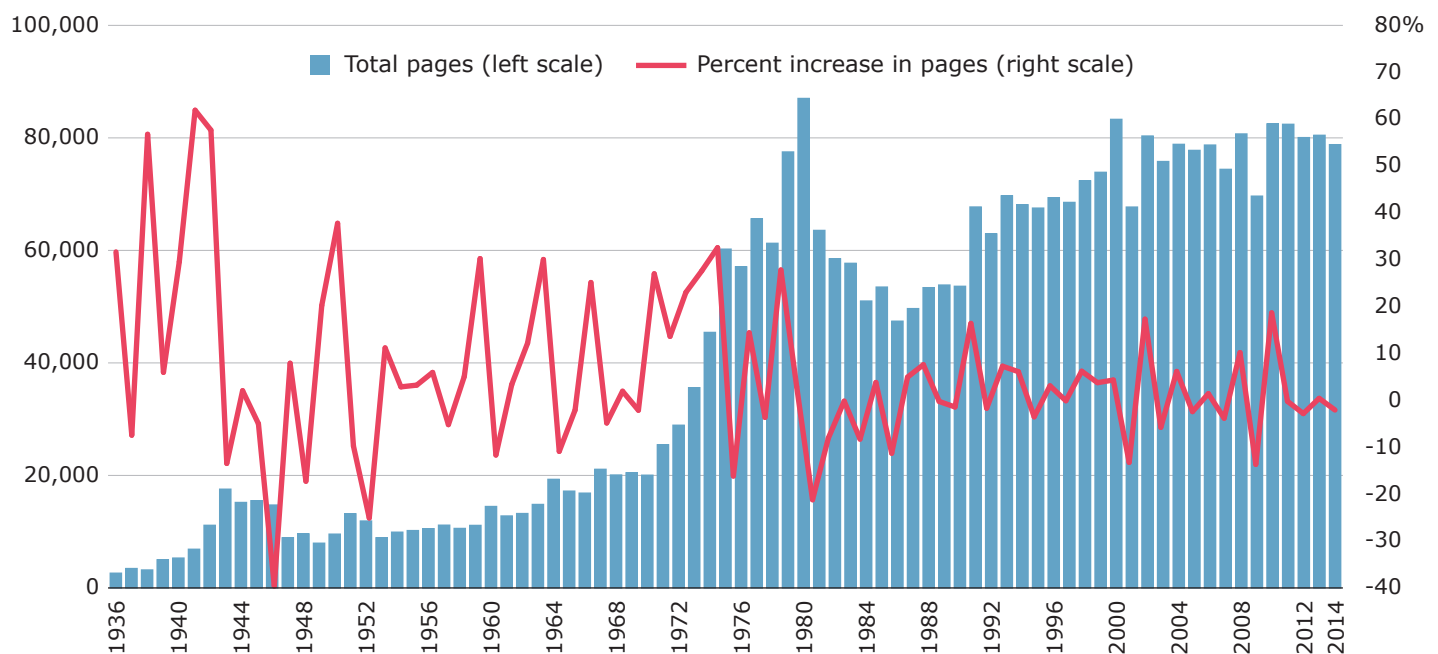
Source: https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/2016_Regulators_Budget.pdf

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The question “Is the United States overregulated?” is difficult to answer because it is difficult to objectively measure how much we are regulated in terms of impacts on economic activity (to be assessed later). The term “regulatory burden” is often used more superficially in reference to paperwork and other administrative costs—the costs of *complying* with regulations. One possible measure of such administrative burden is page counts, as shown in Figure 3.¹¹ Another measure of regulatory burden is the count of “economically significant” rules—deemed to have an effect of \$100 or million or more in a year, as illustrated in Figure 4.¹²

Unfortunately, these count-based measures fail to get to the essence of what makes a regulation truly “economically burdensome.” Are five pages of clear rules worse than one page that is so dense as to be impenetrable? Is a “significant” rule that generates far more benefit than cost bad because its costs breach some arbitrary total-cost cap? Smarter measures of regulatory burden try to account for “regulatory stringency” on business and household economic activity, such as through the international comparisons made by the OECD and World Bank, which will be discussed in the next section.

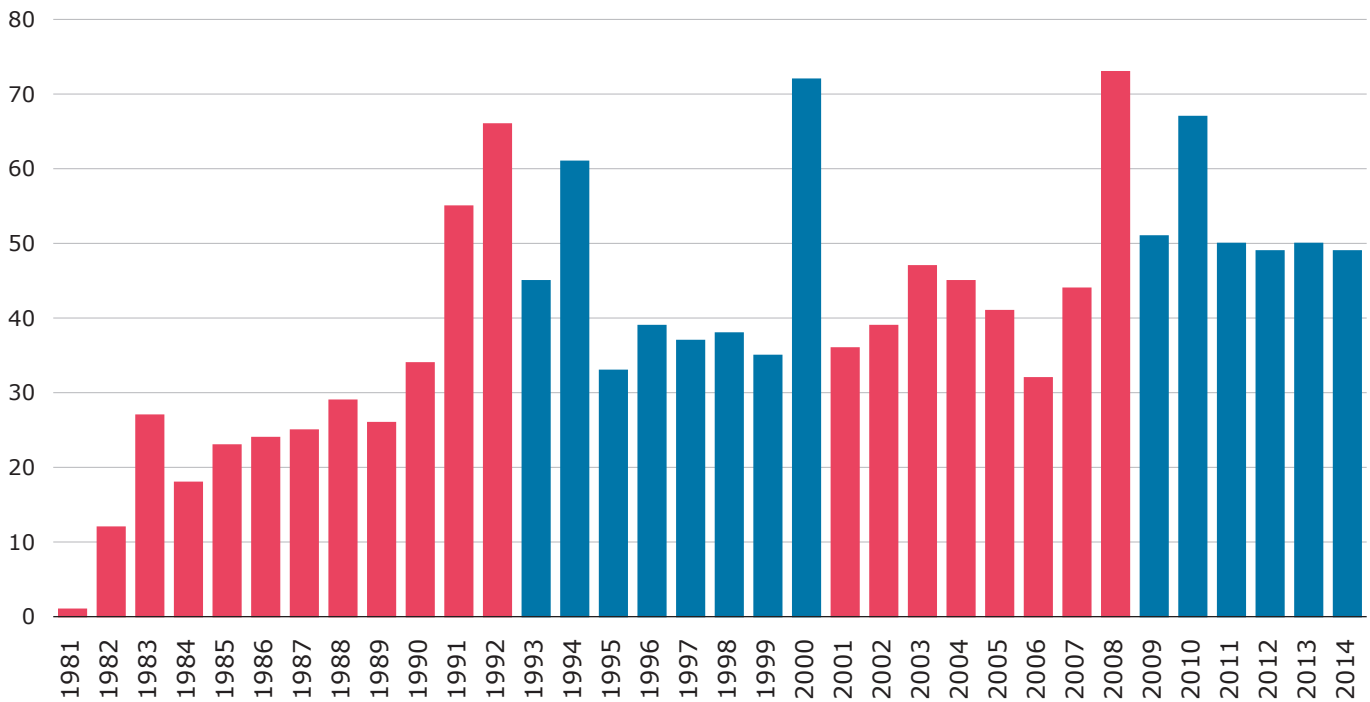
Figure 3
Federal Register Pages Published, 1936–2014



Note: Comparisons between the numbers of pages in early years' issues and those issued since the 1970s are complicated by several factors. Proposed rules were not required to be published until the enactment of the Administrative Procedure Act of 1946. The issue of January 1, 1947 was the first to have a Proposed Rule category. Extensive preambles explaining rule documents were not common until the mid-1960s. The issues from the years 1936 - 1975 are not broken down by category and are not adjusted for blank or skipped pages.

Source: https://regulatorystudies.columbia.gwu.edu/sites/regulatorystudies.columbia.gwu.edu/files/downloads/SDudley_Can-Fiscal-Budget-Concepts-Improve-Regulation2015_0.pdf

Figure 4
Economically Significant Rules Published by "Presidential" Year



Source: <https://regulatorystudies.columbian.gwu.edu/files/downloads/West-%20Pace%20of%20E.S.%20Rule%20Increased-2.pdf>

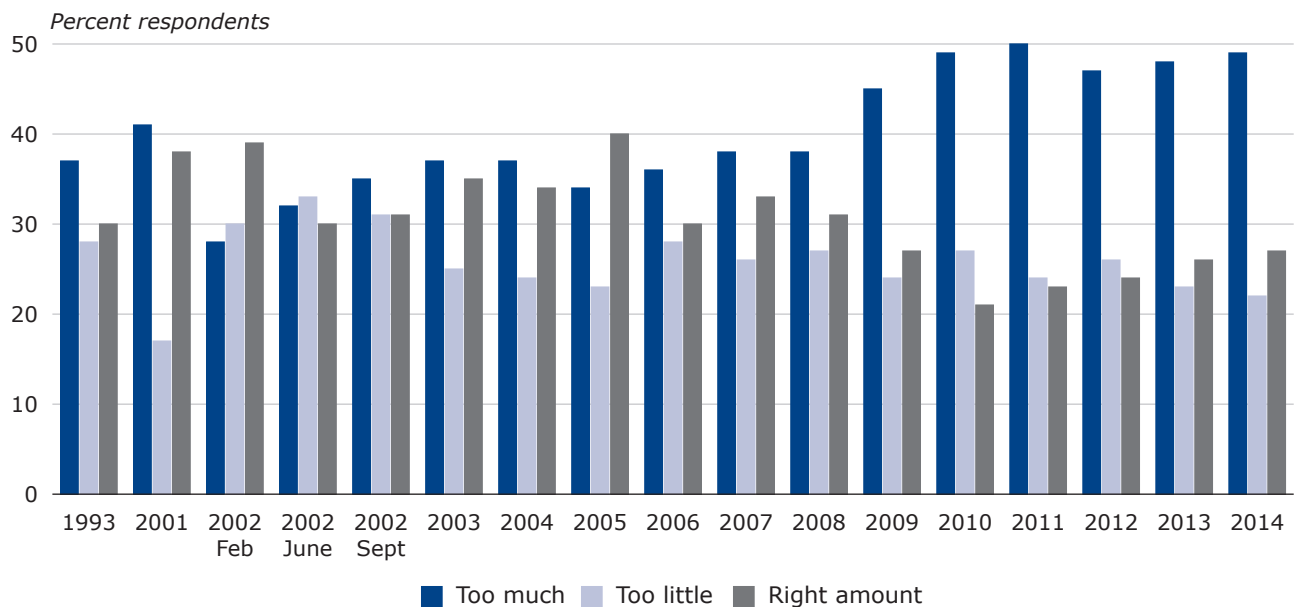
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Public attitudes about the burden of regulation may be flawed through reliance on opinions of persons not directly involved in the process.¹³ (See Figure 5.) Negative sentiment has risen over the past decade, but it is unclear how much of this is informed through real-life experiences of the

burdens of regulation on economic activity, versus blaming regulations for the general difficulties of the economy since the last recession, versus people's more general philosophical positions informed by hearsay (or otherwise from less-than-relevant personal experience).

Figure 5

Do you think there is too much, too little, or about the right amount of government regulation of business and industry?



Source: <http://www.gallup.com/poll/176015/few-americans-gov-regulation-business.aspx>

How Does Regulation Affect the Economy?

The effects of regulation on economic activity are difficult to measure and thus too often are neglected in the debates over economic policy. The World Bank's senior vice president and chief economist, Kaushik Basu, explains this is because regulations affect the “nuts and bolts” and “plumbing” in the economy—the fundamental moving parts that are often too deep for us to see or notice. He continues to explain that:

The public discourse on economic policy is overwhelmingly focused on fiscal measures, monetary interventions, welfare programs and other such highly visible instruments of government action. Thus when an economy does poorly, a disproportionate amount of our debate centers on whether or not it needs a fiscal stimulus, whether there should be liquidity easing or tightening, whether its welfare programs have been too profligate or too paltry and so on. What gets much less attention but is equally—and, in some situations, even more—important for an economy's success or failure is the nuts and bolts that hold the economy together and the plumbing that underlies the economy.

The laws that determine how easily a business can be started and closed, the efficiency with which contracts are enforced, the rules of administration pertaining to a variety of activities—such as getting permits for electricity and doing the paperwork for exports and imports—are all examples of the nuts and bolts that are rarely visible and in the limelight but play a critical role. Their malfunctioning can thwart an economy's progress and render the more visible policy instruments, such as good fiscal and monetary policies, less effective.¹⁴

Main Economic Effects of Regulation

The ways in which regulatory policies affect the economy fall into these main categories:

- **Allocative or economic efficiency across sectors of the economy:** How our nation's resources (labor, capital, natural) are used in the production of different goods and services, and whether those inputs are distributed to their truly highest-valued uses;
- **Vibrancy and competitiveness within industries:** How easy it is for new businesses to form and for the most successful businesses to grow and thrive; and (less often recognized) how easy it is for unsuccessful firms to leave or close down;
- **Costs vs. benefits in promoting the public interest, public goods:** For regulations justified by a public good, social benefit perspective, whether those regulations consider the benefits achieved versus the economic costs, or the cost-effectiveness of alternative approaches;
- **Macroeconomic and employment effects:** The effects on both the short-term, cyclical movements of the economy (such as on employment during a recession) and the longer-term growth of the economy (such as via investment and innovation); and
- **Distributional effects:** Which businesses—and more fundamentally and meaningfully, which types of real people—end up bearing the burden of the economic cost of regulations.

On the macroeconomic effects, [Coglianese](#), [Finkel](#), and [Carrigan](#) conclude that although there has been substantial progress in researchers' ability to understand and better measure the economic effects of regulation, “neither regulatory analysts nor academic researchers have yet to develop the kind of evidentiary foundation needed to provide solid answers” to the question “Are regulations job killers or job creators?”¹⁵

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Keith Hall, current director of the Congressional Budget Office, [wrote for the Mercatus Center](#) that agencies have failed to examine the economic cost of job displacement, “not based on any empirical evidence that job displacement is costless. ... Although the lack of effective methodologies for forecasting the macroeconomic and dynamic impacts of regulation may be the biggest problem facing regulators, the intentional dismissal of the cost of job displacement remains a real shortcoming of agency efforts to promote only those regulations where the benefits are worth their costs.”¹⁶

Regulating for “safety” reasons is an especially tricky proposition in terms of acknowledging economic side effects or unintended consequences and appropriately weighing benefits against costs. [Diana Thomas](#) concludes that regulation of health and safety in consumer products ends up a regressive policy—placing disproportionate burden on lower-income households by driving up the prices of consumer goods and driving down wages.¹⁷ Greg Ip of the *Wall Street Journal* warns that safety regulation can encourage even riskier behavior, as we are essentially lulled by a false sense of regulatory security. Ip also emphasizes that regulations designed to tamp down risky behaviors (widely deemed to be bad) can often tamp down economic activity (universally considered to be good).¹⁸

How to Analyze a Regulation (Before It’s Born)

To judge whether a regulation will be good or bad for the economy, first one has to identify the purpose or goal of the regulation. Is it to achieve a more optimal outcome for the economy and society that the private market cannot deliver on its own because of a fundamental “market failure?”

If so, what is the nature of the failure, and is a regulatory approach (and if so, what type) the best way to address (correct or adjust for) the failure, considering both the benefits and costs of the strategy? What kinds of evidence can and should be gathered and considered to evaluate the likelihood of success before a regulation is established?

Dudley and Brito’s regulation primer suggests the following steps in describing “How to Analyze a Regulation” (chapter 8):

1. Identify a significant market failure or systemic problem;
2. Identify alternative approaches;
3. Choose the regulatory action that maximizes net benefits;
4. Base the proposal on strong scientific or technical grounds;
5. Understand the effects of the regulation on different populations;
6. Respect individual choice and property rights.

In other words, justify a role for government, find the approach (regulatory or otherwise) most likely to improve the economic outcome and maximize *net* benefit to society, and then consider (and address and adjust if needed) any undesirable distributional effects. These would be the steps an impartial economist would take in building a smart regulation, but of course, impartial economists are not the ones who propose, vote on, or implement regulations. Economists are on the sidelines, ready to analyze (when asked) the economic effects of regulations already in motion or in place.

Challenges to Assessing the Economic Effects of Regulations

In asking “how could regulatory policy do better for the economy?” we must first acknowledge the current resource constraints that make very challenging the adequate evaluation of regulations in terms of all these types of economic effects. There are both data and analytical limitations: Federal agencies currently do not do a good job of monitoring and measuring the effects of regulations and collecting data along the way for later analyses. Having to compare effects at different points in time (involving discount rates), place values on human life, and deal with uncertain outcomes is technically complicated. Robert Hahn has argued that not enough progress has been made in the actual, evolving practice of regulatory assessment in terms of the rigor and quality of economic analysis and its potential to improve regulatory policy.¹⁹ Yet Hahn also acknowledges that there are understandable and persistent political obstacles to strengthening the role of economic assessments in regulatory decision making.

Although all regulations must at least implicitly pass a society-wide cost-benefit test, measurement (especially of benefits and especially in the case of social regulations) can be extremely difficult. Given the limits of available knowledge, benefits can be highly uncertain. Furthermore, it is in the nature of many regulations to require investment-type activities, which provide their uncertain payoffs years in the future. Thus, even if those benefits were known with certainty (which they are not) decision makers still could disagree over how many future dollars of benefit are required to justify one dollar of current cost. Still further, because those remote and uncertain benefits often include claims of the saving of human lives, those decision-makers are caught in the analytical and ethical quagmire of valuing a human life, under various combinations of controversial circumstances. (The same of course can be true of the valuing of avoidance of injury or illness.) Environmental regulation is a good (and large) example: the economic costs of environmentally

motivated regulatory policies in terms of reduced economic output (activities that explicitly enter GDP) are much easier to put dollar values on than are the environmental benefits. Thus, although approving or rejecting a proposed regulation is inevitably and implicitly passing judgment on a cost-benefit test, in many instances that judgment will of necessity be highly controversial.

[Hassett and Shapiro explain](#) that the economic effects of regulations are fundamentally challenging to evaluate compared with assessing the effects of other types of government policies that are more easily “parameterized” (such as tax policy’s effects depending on the breadth and uniformity of the tax base and level of marginal and average tax rates).²⁰ Regulations are varied and hard to generalize because every case is unique and it is difficult to find directly relevant empirical evidence. Hassett and Shapiro conclude that “policymakers must draw inferences concerning the likely impact of regulations from analogies”—and based on international comparisons reflecting differences in regulatory climates and stringency. (Note that this also supports a “principles-based” approach to regulation, as broader economic principles typically are applicable and relevant across countries, whereas specific rules usually are not.)

International comparisons can help researchers assess the overall, country- or at least industry-wide stringency and burden of regulations on broad measures of business and household economic activity, but they do not really help us evaluate the effectiveness of *particular* regulations on the particular (more specific) activities of particular businesses and households. To do that, we need more *micro*-level data. Here the case for more adequate funding for statistical agencies and programs must be made: All stakeholders in regulatory policy should collect adequately detailed data to measure these *micro* effects so that regulations do what they are supposed to, in economically sensible, optimal ways. Assessing the economic costs and benefits of particular types of regulations cannot be done using macro-level data.

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Given that aggregate or average, economy-wide effects are typically very small, the most significant effects are the allocative and distributional effects (across geographies, industries, companies within industries, and different types of people), which require micro-level data to measure.²¹ It is also true that regulatory policies are not imposed in a vacuum, so without the more detailed data it is extremely problematic to attribute changes in business or household behavior entirely to the regulatory policy.

Micro-level data are needed to control for other factors affecting decisions and outcomes.

A great example of the kind of microdata needed to study the effects of regulations on the very activities that are being regulated (and hence whether regulations are achieving their public interest goals) is found in a [paper by economists Joseph Shapiro and Reed Walker](#), which uses factory-level records from the Census Bureau and the Environmental Protection Agency (EPA) to isolate the effects of environmental regulations from other factors that affect pollution emissions (trade, productivity, and consumer preferences).²² Using a “model-driven decomposition” of the causes of the observed pollution changes, the researchers find that environmental regulation explains 75 percent or more of the observed reduction in pollution emissions from U.S. manufacturing over 1990–2008.

Consideration of Alternative Policy Approaches

One of the “four broad principles” emphasized in CED’s 1998 policy statement was that:

Where feasible and effective, regulations should be applied with a “soft touch” that allows flexibility of response, including the use of market incentives, in lieu of command-and-control directives.²³

The report went on to explain a full range of regulatory policy approaches in terms of the degree of control the regulation attempts to impose on markets. The reporting of information lies at the minimum end, and traditional directive rulemaking at the maximum. Intermediate positions include a variety of mechanisms that affect economic incentives through the price system, such as (in the case of environmental policy) through pollution taxes or tradable permits. Economists of all political persuasions tend to favor regulation via market-based adjustment of prices (to account for differences between social costs or benefits and private costs or benefits) over regulation based on requiring changes to quantities of specific inputs or outputs (which would override, rather than simply adjust, the natural market-based price incentives). Using the price system allows markets to “self-correct” in response to government-adjusted social costs and benefits while preserving the market-fluctuating signals contained in the private component of prices, in contrast to the latter “command and control” approach where the government essentially sets *quantities* and thus pre-determines (full) prices. Such market-based forms of regulatory policy are also more in keeping with a principles-based as opposed to a rules-based approach.

Another advantage of using more market-based approaches to regulation is that such practices facilitate the collection of “real-time,” objective information on the behavioral effects of these programs. Randall Lutter writes that the permit trading approach to environmental regulation has several advantages. In addition to promoting the lowest-cost means of meeting a specified emissions target, environmental regulation also generates emissions permit prices, which are “unsurpassed at measuring one important aspect of the effects of regulations on regulated entities—the current marginal cost of controls, averaged across the industry,” and futures markets for permits can “also provide information about current expectations of future control costs.”²⁴

The Bootleggers and Baptists Phenomenon: Crony Capitalism in Action

To widen the market and to narrow the competition, is always the interest of the dealers...The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.²⁵

Approximately 240 years ago, Adam Smith cautioned the readers of his *Wealth of Nations* that policy actions touted by businesses and politicians as being in the public interest might actually be positions promoting their own, particular and very special interests. Fast forward to modern times and crony capitalism: the pursuit of private gain through influence in the public sector, which is a frequent topic of discussion and debate among the citizenry.²⁶ In the field of regulation, such manipulation can potentially have a serious cost. Influence over the regulatory process could be used to stifle competition, allowing existing businesses to charge higher prices. To a degree perhaps beyond even what Adam Smith appreciated, regulations could be used to preclude innovation that would challenge incumbent businesses. Stifling innovation could, in the longer run, slow U.S. productivity growth, and advantage other nations that would allow the same innovation to achieve more-dynamic economies to challenge ours. For that reason, building regulatory governance structures that maintain a level playing field and encourage competition is essential.

Such an attempted manipulation of the regulatory process could be a quite straightforward one-on-one struggle between a particular private interest and the relevant governmental authorities. However, there have been occasional alliances between seemingly unlikely private collaborators in attempts to compound their political influence on regulation. Economist Bruce Yandle has dubbed such phenomena the “Bootleggers and Baptists” theory of regulatory policy. He first introduced the concept in a [short paper in *Regulation* magazine in 1983](#)²⁷ and [revisited it in 1999](#).²⁸ He recently made a short video on the theory.²⁹ His latest, more extensive take is in a [2014 book with the same title](#), coauthored with his economist grandson named, by the most extreme coincidence, Adam Smith.³⁰ As the two authors explain in the book’s preface:

The [Bootleggers and Baptists] theory takes its name from the classic example of laws requiring liquor stores to close on Sundays, which were supported by both alcohol bootleggers and anti-alcohol Baptists—with both groups willing to spend valuable resources in pursuit of such laws. The happy bootleggers eliminated competition one day a week, and the devoted Baptists could feel better knowing that demon rum would not be sold openly on their Sabbath day. Of course, no one will ever see bootleggers carrying signs in front of a state house seeking political support when closing laws are up for reauthorization. The point of the theory is precisely that they don’t have to: the Baptists lobby state house members for them. For success to occur, according to the theory, a respectable public-spirited group seeking the same result must wrap a self-interested lobbying effort in a cloak of respectability. Both members of the politicking coalition are necessary to win. The Baptists enable accommodating politicians to say the action is the “right” thing to do and have folks believe them. The bootleggers laugh all the way to the bank—and may occasionally share their gains with helpful politicians.³¹

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These “Bootleggers” and “Baptists” are indeed strange bedfellows, but the problem for society is not the oddity of these relationships, but rather the disparate and perverse motivations that are thus brought together to shape regulatory policy. Instead of the partnership allowing policymakers to better account for a broad and diverse set of viewpoints in their making of government regulations as good public policy, this collaboration between Bootlegger- and Baptist-types produces economic outcomes that are, ironically, bad for society and the public interest. Instead of appropriately correcting or improving situations where the private market on its own would fail to generate an efficient and strong economy, regulatory policies that are tailored to “bootlegger” special interests (but cloaked in public-interest “Baptist” costumes) end up distorting markets further away from what would be best for society as a whole.³²

Smith and Yandle explain:

...we are convinced that the rising tide of crony capitalism, or what we would call Bootlegger/Baptist capitalism, is drawing some seriously critical attention to capitalism itself. Capitalism has taken lots of hits recently. Everything from bailed-out banks and auto companies to subsidized solar product firms that fail spectacularly leaves the public with the feeling that the marketplace is seriously flawed. Anti-capitalism messages seem ubiquitous. Yet the proposed remedies for the system’s failings all seem to involve more government regulation, which means more opportunities for Bootleggers and Baptists to line their purses with transferred rather than newly produced wealth.³³

In their book, Smith and Yandle provide additional modern-day examples of “Bootleggers and Baptists” (B&B) in action, with one chapter covering regulation of “sinful substances”—including (the original) alcoholic beverages, tobacco products, and marijuana—and another discussing the large field of environmental regulation. In the next two chapters they relate the B&B theory to two more

recent and politically charged public policies: the Troubled Asset Relief Program (TARP) following the financial crisis of 2008, and the Patient Protection and Affordable Care Act of 2010 (popularly known as “Obamacare”). In each case the authors identify Baptist-type lobbying that yields Bootlegger-type benefits—“cronyism” in action.

The B&B scenario is well illustrated in two more recent examples taken from some of the most innovative parts of our economy: (i) taxicabs and (ii) internet service providers. In both cases we can see Bootlegger-type special interests trying to pass off their positions as protecting Baptist-type public interests.

New “Ride-Hailing” Companies as Alternatives to Traditional Taxicabs

- Public interest (“Baptist”) claim: We need to regulate new ride-hailing companies like Uber and Lyft for public safety reasons. As a [New York Times editorial argued](#), “Consumers have a right to expect proper vetting [background checks on drivers] whether they are hailing a cab or summoning a car from an app on their cell phone.”³⁴
- “Bootleggers” who would benefit from the “Baptist” claim: (i) existing taxi companies who do not want the competition, and (ii) status-quo state regulators who rely on license and permit (“medallion”) revenue.

Stories about the new ride-hailing companies suggest there are some true public interests well served by the newcomers’ entry into the industry: improved access to transportation (in areas where it isn’t profitable for taxis to wait for passengers—as explained in [Oglethorpe University president Lawrence Schall’s experience](#) as an Uber driver),³⁵ better tailoring of supply to demand (in real time via the app system), and more efficient “peak-load” pricing where fares rise when demand does to ensure cars are available where and when they are most needed or valued. Traditional taxi companies already subject to regulations naturally find it unfair that companies such as Uber do not have to play by the same rules.³⁶

But instead of leveling the playing field by *raising* regulatory burdens on Uber, governments could take Uber's success as evidence that their local economies would likely benefit from *reducing* existing regulatory burdens on the rest of the taxi cab industry. On the other hand, as [Eric Posner cautions](#), the “platform technology” that Uber and Lyft use is one factor that suggests some regulatory attention will be needed, as each company's own platform (dedicated to purchasing ride services from that company alone) may create monopoly-like pricing opportunities.³⁷

“Net Neutrality” in the Pricing of Internet Services

- Public interest (“Baptist”) claim: We want “net neutrality” to provide free or cheap internet access for all, and internet service providers should not price-discriminate across different types of consumers.
- “Bootleggers” who would benefit from the “Baptist” claim: application (“app”) developers and other businesses that use internet service as an intermediate input or part of their “supply chain” of services and whose profits would rise if ISP costs were lower.

Ironically, as [Kevin Hassett and Robert Shapiro have explained in a recent paper](#), the imposition of a single price whereby ISP companies are prohibited from charging higher prices for higher quality services will lower investment, reduce supply, and hence raise average costs charged to consumers.³⁸ [Hahn, Litan, and Singer \(2010\)](#) explain that “net neutrality” takes a legitimate concern that internet services be provided without unjust price “discrimination” (where different prices are charged for the exact same service) and takes it to the unjustified extreme where a firm is prohibited from charging different prices for different levels of service—reducing economic efficiency by preventing firms and consumers from entering into mutually beneficial agreements.³⁹ A [CED blog post focused on](#) what seems to be the general public's misunderstanding of the economics of “net neutrality.”⁴⁰

In the end, even the “bootleggers” in this case would not actually benefit from a pure, unadulterated, fully-implemented

and enforced version of “net neutrality” the way they think they would. But as [Roslyn Layton explains](#), there will be plenty of external legal challenges and internal hand-wringing over the FCC's new “open Internet” rules before any such rules become a reality.⁴¹

Occupational Licensing

Similar to the “bootlegger” position of the taxi cab industry, another current example of regulatory policy supported by incumbents in the industry is occupational licensing. A [2015 report by President Obama's Council of Economic Advisers](#) finds that the licensing requirements for certain occupations (most commonly in the health and education fields, for example, physical therapist, personal trainer, dental hygienist or assistant, yoga teacher) are typically mandated through state-level regulations.⁴² While ostensibly designed to protect the health and safety of consumers (a “Baptist” goal), they also create obstacles to either entering such employment or being geographically mobile in such work—thus reducing competition for those who already hold such licenses within their state (the “bootlegger” interests). Again, the benefits of the “bootlegger” or “crony” behavior here (in favor of restrictive licensing requirements) are clearly focused and easily recognized, while the costs of the regulatory burden (to the would-be competitors who are kept out of the industry, and to the consumers who pay more for such services because of the burden passed onto them) are much more diffuse.

In general it seems that cronyism and capture of regulatory policy by special interests is easier when regulations are narrow (special, tailor-made) and complex (difficult for new business to qualify or comply). This means that not only are narrow, rules-based regulations likely to favor incumbent businesses over new businesses, but they are likely to hurt the overall economy's level of innovation and productivity by allowing less-productive older businesses to survive and be protected by regulatory hurdles that prevent more-productive new businesses from entering the competitive market in the first place.

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Regulatory Burdens in the United States Compared with Other Countries

The [Council on Foreign Relations' 2015 report, "Quality Control: Federal Regulation Policy,"](#) reviews the literature and makes international comparisons.⁴³ Their bottom-line conclusion is that the United States needs *smarter* regulations, not fewer. From their report:

Research on the economic effects of regulation is underdeveloped, though available evidence suggests most regulations have brought benefits that are worth the economic costs. [But] the federal government could do more to lower burdens on business without compromising the objectives of regulation [, and] the U.S. regulatory management system...has changed little since the early 1980s and focuses almost exclusively on cost-benefit analysis before regulations are put into place, instead of in hindsight when it is clearer whether a regulation is working...The United States used to be the trailblazer in regulatory reform. But the rest of the rich world has caught up.

Survey data show that regulatory burden “does not put U.S. business at a competitive disadvantage”—see [World Bank's "Ease of Doing Business"](#) index (and [Timothy Besley's paper](#) on it); but the United States does a poorer job of “getting rid of regulations that no longer work.”⁴⁴

From the World Bank's overview of their *Doing Business* report:

Doing Business 2015: Going Beyond Efficiency, a World Bank Group flagship publication, is the 12th in a series of annual reports measuring the regulations that enhance business activity and those that constrain it. **Doing Business** presents quantitative indicators on business regulations and the protection of property rights that can be compared across

189 economies—from Afghanistan to Zimbabwe—and over time.

Doing Business measures regulations affecting 11 areas of the life of a business. Ten of these areas are included in this year's ranking on the ease of doing business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. **Doing Business** also measures labor market regulation, which is not included in this year's ranking.

Data in **Doing Business 2015** are current as of June 1, 2014. The indicators are used to analyze economic outcomes and identify what reforms of business regulation have worked, where and why. This year's report introduces a notable expansion of several indicator sets and a change in the calculation of rankings.

The United States ranks 7th out of 189 countries in this year's *Doing Business* report (ranking particularly high in the financial market areas of ease of “getting credit” (2) and “resolving insolvency” (4)). As the report explains (page 3, emphasis added):

The 20 economies at the top of the ease of doing business ranking perform well not only on the *Doing Business* indicators but also in other international data sets capturing dimensions of competitiveness. **The economies performing best in the *Doing Business* rankings therefore are not those with no regulation but those whose governments have managed to create rules that facilitate interactions in the marketplace without needlessly hindering the development of the private sector.**

The OECD's recent "Future of Productivity" report also suggests that regulatory burden (in terms of stifling entry of new businesses, harming innovation and productivity) is relatively low in the United States compared with other countries.⁴⁵ The United States is not included in the latest (2013) updates to the OECD's [indicators on product market regulation](#), but the 2008 data show the United States ranked second only to the Netherlands in terms of having the most market-friendly (least stringent or burdensome) regulatory stance.⁴⁶ In a recent article on the woes of the U.S. labor market [in the Financial Times](#), [Martin Wolf contends](#) that the troubles are *not* due to regulatory burden—that the United States still has the least-regulated labor market among all of the OECD countries, including having a relatively low minimum wage (20 percent below UK levels in real terms in 2014).⁴⁷

[Hassett and Shapiro](#) refer to these "regulatory stringency" measures as providing "relevant analogy" in that they correlate with economic outcomes (economic growth and investment).⁴⁸ They describe the OECD's survey of individual governments asking approximately 1,400 questions, the answers to which are combined and coded into a single quantitative score ranging from zero (most market friendly) to six (least) as a "complicated procedure" that "might appear to have questionable empirical relevance to the macroeconomic differences among countries." However, the evidence shows they do have relevance. They cite a paper by [Alesina et al. \(2003\)](#) that found a statistically and economically significant negative relationship between the OECD measure of regulatory stringency and investment.⁴⁹ Hassett and Shapiro explain the "analogy" strategy as follows:

It is our view that since the analysis of regulatory policy necessarily will require that an analyst draw from a large set of empirical analogies, these macro-econometric estimates can help researchers infer the likely direction and scale of a change in regulation. In an ideal setting, one could estimate how a given change in policy would change the

index and then infer the likely impact on investment by drawing on the empirical literature. Alternatively, one could assemble micro analogies to the policy under consideration and then collect evidence on the plausibility of the scale of these effects by performing a thought experiment based on the OECD index.⁵⁰

Hassett and Shapiro also stress that regulatory policies often negatively impact economic activity, particularly investment, not so much because of the level of stringency of the rules per se, but because of uncertainty about the nature and scope of the rules as they are anticipated to be (finally) written, implemented, and enforced. They explain that:

...[A] new regulation can have an especially destructive, negative effect if it involves a threshold event that creates large incentives for investors to wait until an uncertainty is resolved. Such a threshold event could occur, for example, when a regulator's actions are not consistent with his or her past actions, and likely to be challenged in court. Between the initial regulatory decision and the final resolution, firms may radically reduce their affected investments.⁵¹

This also explains Hassett and Shapiro's worry about "net neutrality" regulations discussed previously—given the tremendous uncertainty about what the rules will finally be after all legal challenges have been resolved.

All of this suggests that although U.S. regulatory policies are not a huge burden on the U.S. economy in general and compared with other countries, we could be doing better—particularly in the execution and maintenance of regulations. In theory, we may know a lot about what makes for good regulations, but in practice, we are not optimizing. Our regulations could be better designed and maintained to promote a more vibrant, innovative, and productive economy.

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How to Build (and Maintain) Better Regulation

How can our nation do a better job at constructing and implementing sound regulation policies and avoiding cronyism (including the “Bootleggers & Baptists” problem) and otherwise unwise or misguided policies? Many researchers and research organizations (U.S. and international) have formulated guidelines for better regulatory policy. All these recommendations focus on: (i) **better information**, that is, the data and economic analysis, the “tools” in the regulatory tool box, that are used in the planning and evaluation of regulations; (ii) **better oversight and monitoring** of the regulatory policy process and the institutions and people involved—the regulators, or “the carpenters” who build and maintain the regulations; and (iii) **better collaboration** between and input from regulators and all stakeholders (including businesses and the general public).

OECD Guidance

The 2012 OECD Regulatory Policy Committee recommendations⁵² of the Council On Regulatory Policy and Governance 2012, which built upon 2005 OECD Guiding Principles for Regulatory Quality and Performance,⁵³ provide overarching recommendations on how to improve the quality of regulatory policy. Those 12 recommendations are (quoting, with emphasis added):

1. **Commit at the highest political level to an explicit whole-of-government policy for regulatory quality.** The policy should have **clear objectives and frameworks** for implementation to ensure that, if regulation is used, **the economic, social and environmental benefits justify the costs, distributional effects are considered and the net benefits are maximised.**
2. **Adhere to principles of open government, including transparency and participation in the regulatory process to ensure that regulation serves the public interest and is**

informed by the legitimate needs of those interested in and affected by regulation. This includes providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals and to the quality of the supporting analysis. Governments should ensure that regulations are comprehensible and clear and that parties can easily understand their rights and obligations.

3. **Establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality.**
4. **Integrate Regulatory Impact Assessment (RIA) into the early stages of the policy process for the formulation of new regulatory proposals.** Clearly identify policy goals, and evaluate **if regulation is necessary and how it can be most effective and efficient** in achieving those goals. **Consider means other than regulation** and identify the tradeoffs of the different approaches analysed to identify the best approach.
5. **Conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals,** including consideration of costs and benefits, to ensure that regulations **remain up to date, cost-justified, cost-effective and consistent** and [deliver] the intended policy objectives.
6. **Regularly publish reports on the performance of regulatory policy and reform programmes and the public authorities applying the regulations.** Such reports should also include information on how regulatory tools such as Regulatory Impact Assessment (RIA), public consultation practices and reviews of existing regulations are functioning in practice.

7. **Develop a consistent policy covering the role and functions of regulatory agencies** in order to provide greater confidence that regulatory decisions are made on an **objective, impartial and consistent basis, without conflict of interest, bias or improper influence.**
8. **Ensure the effectiveness of systems for the review of the legality and procedural fairness of regulations, and of decisions made by bodies empowered to issue regulatory sanctions.** Ensure that **citizens and businesses have access to these systems** of review at reasonable cost and receive decisions in a timely manner.
9. **As appropriate apply risk assessment, risk management, and risk communication strategies** to the design and implementation of regulations to **ensure that regulation is targeted and effective.** Regulators should assess how regulations will be given effect and should design responsive implementation and enforcement strategies.
10. **Where appropriate promote regulatory coherence through co-ordination mechanisms between the supra national, the national and sub-national levels of government.** Identify cross cutting regulatory issues at all levels of government, to promote coherence between regulatory approaches and avoid duplication or conflict of regulations.
11. **Foster the development of regulatory management capacity and performance at sub national levels of government.**
12. In developing regulatory measures, **give consideration to all relevant international standards and frameworks for co-operation** in the same field and, where appropriate, their likely effects on parties outside the jurisdiction.

The [OECD's \(2014\) Framework for Regulatory Policy Evaluation](#) focuses on evaluation practices in OECD countries and concrete examples of best practices.⁵⁴ Chapter 1 provides insights from three expert papers, chapter 2 describes the OECD framework for regulatory policy evaluation, chapter 3 documents practices in regulatory policy evaluation across the OECD, and chapter 4 describes the results of “pilots” for the framework in the Netherlands and Canada.

In their most recent (October 2015) reports on regulatory policy (Regulatory Policy in Perspective⁵⁵ and OECD Regulatory Policy Outlook 2015⁵⁶), the OECD catalogs the knowledge to date on best regulatory practices and continued challenges, with special focus on the use of regulatory impact assessment, stakeholder engagement, and ex-post (or retrospective) evaluation. They conclude that the ex-ante evaluation of regulatory costs and benefits is well developed in the United States, with the degree of evaluation efforts proportional to the anticipated impacts of the regulatory proposals. They also note that the United States has institutionalized ex-post evaluation via executive order (discussed below), but in terms of stakeholder engagement, there is “no mandatory requirement...for consultation with the general public in the development or maintenance of **primary laws** [calling for regulations] **initiated by Congress**” (emphasis added; a deeper discussion of the issues associated with retrospective review is presented in Appendix 2). (The OECD indicators distinguish between “primary laws” and “subordinate regulations -- statute can be changed only by another statute, whereas regulations are subject to OMB OIRA (executive) review and a required public comment process.) In chapter 1 of the “in Perspective” volume, written by Martin Lodge of the London School of Economics, four main “deficits” in the current state of regulatory policy in OECD nations—oversight, participation, incentive, and adaptation—are identified.

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Current U.S. Regulatory Policy Rules and Guidance

The scope of current U.S. regulatory policy rules and guidance, and recent and current proposals for regulatory process reform, are described in the Congressional Research Service report, [Cost-Benefit and Other Analysis Requirements in the Rulemaking Process](#).⁵⁷

The federal government guidance on U.S. regulation policy writ large comes mostly from the U.S. [Office of Management and Budget's Office of Information and Regulatory Affairs \(OIRA\)](#).⁵⁸

- [Executive Order \(E.O.\) 12866](#)⁵⁹ by President Bill Clinton in 1993 expresses the philosophy that regulations should:
 1. address a “compelling public need, such as material failures of private markets;”
 2. be based on an assessment of “all costs and benefits of available regulatory alternatives, including the alternative of not regulating;” and
 3. “maximize net benefits” to society unless otherwise constrained by law.
- This guidance requires that regulatory analysis be performed on all rules deemed to be of “significant economic impact” of \$100 million or more in a year, and that agencies submit such significant regulations for review by OIRA before publication in the Federal Register in proposed or final form.
- [OMB Circular A-4](#)⁶⁰ whose most recent version was issued in September 2003 (during the George W. Bush Administration), is essentially OMB's guidebook for federal agencies on how to do regulatory analysis—i.e., what are “best practices.” The 2003 version refined a prior guide developed in 1996 and published in 2000.
- The Obama Administration's [E.O. 13563](#)⁶¹ (“Improving Regulation and Regulatory Review,” January 18, 2011), [E.O. 13579](#)⁶² (“Regulation and Independent Regulatory Agencies,” July 11, 2011), and the latest [E.O. 13610](#)⁶³ (“Identifying and Reducing Regulatory Burdens,” May 10, 2012), all placed heavy emphasis on ex-post (retrospective) analyses—but only requested that regulatory agencies (starting in 2011) develop a preliminary plan and then (in 2012) take further steps to institutionalize regular assessments and promote public participation in retrospective review.
- The Trump Administration's [E.O. 13771](#)⁶⁴ (“Reducing Regulation and Controlling Regulatory Costs,” January 30, 2017) specifies that to limit the costs associated with regulation, at least two regulations must be eliminated for every one that is imposed. For the current fiscal year (2017), each agency recommending a new regulation must identify at least two to be repealed. Furthermore, the total incremental cost of all new regulations for this fiscal year must be no more than zero (including the reduction of cost from regulations that are repealed), as determined by guidance issued by the Director of OMB. Beginning next fiscal year (2018), the OMB Director shall create a regulatory cost budget to limit each agency's incremental net cost (again taking into account regulations that are eliminated). The Executive Order makes no reference to the benefits that accrue from any regulations, including those that are recommended for imposition or repeal. Logically, if only costs are considered, than every existing regulation should be eliminated, and no new regulations should be imposed. Presumably, this logical inconsistency will somehow be dealt with in the guidance issued by the OMB Director.

Legislation relating to oversight of regulatory policy (as described on pages 46–47 in the Dudley primer) that has passed since CED’s 1998 report includes the following:

1. The **Congressional Review Act of 1996** (CRA, contained in the Small Business Regulatory Enforcement Fairness Act of 1996) allows the Congress to overturn regulations within a specified time through a resolution of disapproval. Because such a resolution would be subject to a presidential veto, and with a presumption that a president would support his own regulation with a veto, the CRA garnered little attention. However, the CRA also requires each agency issuing a regulation to submit a report to the Congress, and the deadline for a resolution of disapproval occurs after the report is filed. Because the requirement for a report may have been ignored in some instances, a new administration hostile to such a regulation could file a report on a regulation issued at any time after the CRA was enacted, and thereby empower the Congress to pass a resolution of disapproval.
2. The **Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999** (section 638(a)) requires OMB to report to Congress yearly on the costs and benefits of regulations and to provide recommendations for reform.
3. The **Truth in Regulating Act of 2000** gives Congress authority to request that the GAO conduct an independent evaluation of economically significant rules at the proposed or final stages.
4. The **Information Quality Act of 2000** requires OMB to develop government-wide standards for ensuring and maximizing the quality of information disseminated by federal agencies.

Recent legislative proposals (from the 114th Congress, calendar years 2015 and 2016) for better regulatory policy practice fall into two

general categories (as sorted in [Susan Dudley’s September 2015 testimony](#)).⁶⁵ Proposals before the Senate Homeland Security and Governmental Affairs Committee either: (i) improve analysis for decision-making *before* regulations are issued, and (ii) institutionalize “retrospective review” of regulations *after* they are put in place (discussed in detail later). On the former:

- **S. 1818, the “Principled Rulemaking Act,”** would codify the language of President Clinton’s Executive Order 12866 and President Obama’s Executive Order 13563.⁶⁶ This would give congressional support to the EO’s nonpartisan principles, could be applied to independent agencies, and would make compliance with legislative requirements subject to judicial review.
- **S. 1820, the “Early Participation in Regulation Act of 2015,”** would require agencies to publish an advance notice of proposed rulemaking (ANPR) at least 90 days before publishing a proposed major rule.⁶⁷ This would be valuable to solicit input from stakeholders *before* decisions are made.
- **S. 1607, the “Independent Agency Regulatory Analysis Act,”** would explicitly authorize the president to require that independent regulatory agencies (such as the Securities and Exchange Commission, the Federal Communications Commission, and the Consumer Product Safety Commission) comply with regulatory analysis requirements.⁶⁸ Currently, the analyses supporting regulations issued by independent agencies tend to be less robust. The [Administrative Conference of the United States recommended in 2013](#) “Benefit-Cost Analysis at independent Regulatory Agencies” that independent regulatory agencies adopt more transparent and rigorous regulatory analysis practices for major rules;⁶⁹ according to government data cited in the Dudley testimony, “more than 40 percent of the rules developed by independent agencies over the past 10 years provided no information on either the costs or the benefits expected from their implementation.”⁷⁰

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Additionally, the recently House-passed (pending in Senate) H.R. 26 and S. 21, “Regulations from the Executive In Need of Scrutiny (REINS) Act” also focuses on documenting and considering the economic costs of regulations before they are put in place. The legislation:

Revises provisions relating to congressional review of agency rulemaking to require a federal agency promulgating a rule to publish information about the rule in the Federal Register and include in its report to Congress and to the Government Accountability Office (GAO) a classification of the rule as a major or non-major rule and a complete copy of the cost-benefit analysis of the rule, including an analysis of any jobs added or lost, differentiating between public and private sector jobs. Defines “major rule” as any rule that is made under the Patient Protection and Affordable Care Act or that the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in: (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of U.S.-based enterprises to compete with foreign-based enterprises.

But we conclude that there has been disproportionate emphasis on greater scrutiny of new regulations (based on the common presumption that there is too much regulation overall), at perhaps the price of too little effort toward expanding the practice of retrospective review (and too little recognition that regulations may be suboptimal in a variety of ways in the variety of cases that evolve over time). As the world changes (including, but not limited to, advances in technology), regulations, even those based on

principles rather than narrow, specific rules, can become obsolete and even counterproductive. It is not surprising that scholars of regulation around the world have cited retrospective review as one of the areas where other nations have made advances, and the United States, while still a world leader, has lost some of its comparative edge. We believe that our nation must invest more in continuing review of its stock of regulations, and in the data and other resources to support it.

That does not determine precisely what organization should perform such review. We are skeptical that an analytical body of a sufficient size and strength could be created within the Congress. Retrospective review must rely heavily on the street-level body of knowledge and information already resident within the executive agencies, and with the associated leadership resources in OIRA. However, we also are concerned that the instincts of self-justification within those agencies—the reflex to defend the judgments taken by those same executive offices in the past—could prevent objective retrospective review. Still, the success of self-review at the National Highway Traffic Safety Administration (documented below) demonstrates that open-minded self-criticism can be achieved (even more so with the expertise and leadership at OIRA), with the President’s own authority (and the persuasive power of his budget office) behind it.

One way to circumvent any tendencies of agencies to be closed-mindedly defensive about their own regulations in any review process would be either to expand the resources of OIRA so that it could have a separate shop that focuses on retrospective review. Alternatively, a new and independent office could take on that responsibility. What would not work is requiring existing staff at OIRA or the agencies, already required to assure the quality of new regulations, also to take on the responsibility for retrospective review. Both functions would suffer, beyond any self-protective instinct in the retrospective review function.

The office charged with retrospective review could select existing regulations for the earliest review, guided by priorities set by the Congress. Those priorities could include the “significance” of the regulations as measured by the cost impact in dollar terms, and the length of time that the regulations have been in force, as well as the degree of public demand solicited through the current comment process. We see this function as an ongoing challenge of regulation, so we do not see the government institution to fulfill the function as a one-time, temporary “commission” with unpaid citizen members.

The Congress must play a stronger role in regulation. There is always the potential for a costly Catch-22 dilemma for the executive, should a less-than-fully-informed Congress mandate the creation of a new

regulation that must pass a cost-benefit test, while imposing conditions such that the creation of such a regulation is impossible. The Congress does need more expertise to ensure that the legal foundations that it builds for future regulations are sound.

So, better creation and ex-post review of regulation will cost money. It is important that the nation not swallow whole the fallacy that more resources for regulators mean more regulation. It must be made to mean better regulation. It can mean better data to facilitate stronger and more-frequent review, and therefore the cleaning-out or improvement of obsolete or deficient regulations that otherwise would evade scrutiny. All that is needed is the leadership and the understanding to make that happen. It is imperative for a dynamic, prosperous economy.

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FEDERALISM IN REGULATORY POLICY

Coordination with (and Lessons from) State and Local Regulatory Policies

What can the federal government do to improve state and local regulatory policies?

State and local governments lack capacity (even more than the federal government) to collect and analyze data on regulation merits and effectiveness. Federal government analysts can inform and support regulatory policy practices at the state level—particularly as some recompense for mandates on state and local governments that get passed along from federal government via federal regulations and fiscal policies. (An example is the [Obama Administration’s paper on “best practices” state-level occupational licensing](#) mentioned earlier in the section on crony capitalism.)

On the other hand, states and localities have better ground-level, hands-on information and familiarity about the activities and industries they are regulating. The federal government can “learn” from state experiences, too.

Are there also opportunities to learn from the great variety of state-level regulatory policies and practices—as natural experiments?

Variation in state- and local-level regulatory policies and practices can

provide an opportunity to learn about the economic effects of alternative strategies. [NYU/Schwartz’s study \(2010\)](#) provides a comprehensive look across the states in terms of regulatory review practices. Where little federal-level variation in regulatory policies has taken place over time, making the gathering of an evidence base challenging, state- and local-level variation provides a natural way of controlling for other identifiable and measurable factors and estimating the effects of alternative policy specifications. Researchers should be circumspect, however, about lessons that might not be so transferable and applicable going from one level of government to another.

Can regulatory policies be better coordinated across states?

For companies that do business in all 50 states plus DC (the 52nd referenced by Schwartz is Puerto Rico), the variety of state-level regulations makes regulatory burden and red-tape all the more costly. How well aligned are regulations across states? Or should they be aligned at all? What makes certain types of regulatory policy more appropriately administered at the federal versus the state level?

CED's Interpretation of Progress and Challenges Remaining

How much progress has been made in regulatory policy and governance since CED's 1998 statement? The one recommendation where some progress has been made is the earlier statement's recommendation number 6—more retrospective review of regulations—but only in that more executive orders calling for it (but not quite demanding it) have been issued, not because of any marked improvement in actual practice. We largely agree with the recent conclusions of the Council on Foreign Relations: proposals for regulatory reform should continue to emphasize better ongoing evaluation and oversight of regulatory policy that might be directed, guided, and even conducted outside the executive-branch regulatory agencies themselves. (A deeper discussion of regulatory governance is included in Appendix 3.) But today it is also important to consider whether the “cronyism” (including “Bootleggers and Baptists”) problem is more or less likely in the legislative versus executive branches—recognizing that unelected bureaucrats are perhaps less likely to be so influenced by “money in politics” issues (including campaign contributions) than elected members of Congress are. Who in the executive branch and who in the legislative branch would best be given the responsibility for unbiased evaluations of regulations, and how can we best keep cronyism and special interests away from regulatory analyses and decision-making? At the same time, policymakers will need to devote adequate resources to whichever entities are charged with conducting these impartial analyses, to make sure that such evaluations can be done in a comprehensive, systematic, effective, and yet timely and cost-efficient manner.

CED Reaction to Policy Recommendations

There is no question—from our own observation, as well as the judgments of the OECD and the World Bank—that U.S. regulatory processes and practices could be improved. We find some of the ideas in the literature highly promising, others less so. At the headline level, we have already noted that approval of any regulation is at least an implicit assertion that its benefits exceed its costs. We believe that to the greatest possible degree, comparison of costs and benefits should be explicit. We recognize that cost-benefit analysis can be extraordinarily challenging and believe that sound cost-benefit analysis in a world of uncertainty should make all of its assumptions explicit and should provide alternative upper- and lower-bound estimates of its key components. We also believe that our proposed retrospective review should allow reconsideration on the basis of those sensitivity analyses.

We believe that such cost-benefit analysis is the gold standard of the regulatory process. We fear that some alternative decision rules, however well meaning, might yield inferior outcomes. For example, an aggregate regulatory budget or regulatory cost cap could yield perverse results. A new regulation with benefits exceeding costs could be rejected by an aggregate regulatory cost cap or budget. But at the same time, old regulations whose costs exceeded their benefits would be protected against a cost cap or budget solely because of their incumbency. Similarly, a regulatory “pay-as-you-go” rule, which required repealing one regulation before imposing another, could delay a fully justified regulation.

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Another global approach to regulation is a “sunset” requirement, such that all regulations would automatically expire unless reaffirmed through some formal process. We fear that a well-meaning mandatory sunset requirement would soak up considerable resources to reimpose justified and uncontroversial regulations—resources that would better be devoted to the difficult and more important issues.

In short, a regulatory cost cap or budget, a “cut-as-you-go” requirement, or mandatory sunset rules all seem to be second- or third-best alternatives to a basic, fundamental policy of rigorous cost-benefit analysis and retrospective review. If we were assured

that those basics were unattainable, we would consider falling back on the second-best alternatives. But we see no reason to declare pre-emptive surrender on the most-sound options available to our regulatory system.

There are other recommendations that we find highly appealing. We believe that even statutorily independent regulatory agencies should be subject to the same process and review requirements as the line executive regulatory agencies. “Independent” does not mean “alien.” We believe that early public input should be solicited, and given careful consideration. We also align ourselves with the governance principles in the 2014 OECD report.⁷¹

Conclusion:

Key Takeaways and Summary of CED Recommendations

This CED review of U.S. regulatory policy leads to the following key takeaways and recommendations:

1. Economically wise regulation policy is easier in theory than in practice.
2. The problem of biased, inefficient, and outdated regulations could be better avoided if policymakers would pursue an overarching strategy of favoring principles-based over rules-based regulation which would be more immune to special interest hijacking and manipulation.
3. Measurement challenges and resource constraints continue to prevent adequate levels and quality of both ex-ante and ex-post (retrospective) evaluation of regulations to ensure that policies are beneficial and optimal.
4. The United States is doing better at ex-ante justification but could and should strive to do more monitoring and evaluation of regulations after they are put in place. Some other countries have surpassed the United States in regulatory management in this regard.
5. Federal regulations go on “auto-pilot” without regular scrutiny, a lot like mandatory spending and tax expenditures (and in contrast to discretionary, annually-appropriated spending). Charging an agency with retrospectively evaluating regulations might be one way to better reevaluate regulations, ensure regulations continue to serve their intended purpose, and monitor regulations to catch any sub-optimal “drift” in their performance over time.
6. The independent body in charge of reevaluation of regulations could be charged with criteria to order the existing stock of regulations for review. But we believe this to be a permanent function of looking for regulations that have fallen behind the changing times—not a once-for-all housecleaning.
7. Toward the goal of more regular scrutiny of regulations, a reinvigoration of the congressional reauthorization process is needed. Legislators need more resources so that they can develop realistic standards for new regulations, and can pay better attention to the function and performance of regulations after they are put in place, too.
8. More and better data on the effects of regulatory policies are needed. This has been recommended for decades, but we really should be doing better now that the costs of collecting, maintaining, and analyzing data in real time have come down and will continue to decline rapidly. At the same time, funding for the statistical agencies should be preserved and enhanced to take advantage of the increasing productivity of investments in data.
9. More sharing and disclosure of information with stakeholders and the public—more transparency—is needed. Regulatory policy making should involve other parts and levels of government and the public, not just the federal executive agencies. Increased stakeholder participation will shed light on and help avoid inefficient regulations that benefit special interests over the public interest.

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These recommendations continue the spirit of our 1998 recommendations. Unlike our recommendations in 1998, however, we now put less emphasis on Congress doing the heavy lifting. We also conclude that no matter who is in charge of developing and maintaining regulations, the regulations will be more supportive of the economy and the public interest—as well as more sustainable over time—if based on broadly defined, commonly agreed-upon economic principles rather than narrowly defined technical rules. If we are to improve the regulatory policymaking process

and the ultimate quality and effectiveness of the regulations themselves, we will need to determine which entities are best able to consider, construct, administer, and review regulations in ways that help businesses, the economy, and our society. (See a more detailed discussion of issues of stakeholder involvement in Appendix 4.) Reorienting our approach to regulation in this way will help to achieve our goal of regulations that are better justified and regularly monitored, reevaluated, and scrutinized to be economically smarter, not just administratively simpler.

Appendices

Appendix 1:

Rules- vs. Principles-Based Regulation

“Principles-based regulation” is not an original idea. Following are some valuable contributions from the recent literature.

Frantz and Instefjord (2014)⁷² present an academic, theoretical paper on rules- versus principles-based financial regulation. They explain that with regulatory competition and “race to the bottom” (where regulators compete for businesses by watering down principles to nothing), principles-based strategies can essentially be captured by special interests (and thus preferred by firms). Without regulatory competition, however, special interests (“firms”) prefer rules-based systems “where the cost of ambiguity is borne by society.” They go on to explain that:

We study the relative strengths and weaknesses of principles based and rules based systems of regulation. In the principles based systems there is clarity about the regulatory objectives but the process of reverse-engineer[ing] these objectives into meaningful compliance at the firm level is ambiguous, whereas in the rules based systems there is clarity about the compliance process but the process of forward-engineer this into regulatory objectives is also ambiguous. The ambiguity leads to social costs, the level of which is influenced by regulatory competition. Regulatory competition leads to a race to the bottom effect which is more harmful under the principles based systems. Regulators applying principles based systems make dramatic changes in the way they regulate faced with regulatory competition, whereas regulators applying rules based systems make less dramatic changes, making principles based regulation less robust than rules

based regulation. Firms prefer a rules based system where the cost of ambiguity is borne by society rather than the firms, however, when faced with regulatory competition they are better off in principles based systems if the direct costs to firms is sufficiently small. We discuss these effects in the light of recent observations.

Arnold Kling’s (2012) AEI piece, “Why We Need Principles-Based Regulation”⁷³ argues:

When we think of regulation, we think of specific rules that spell out the boundaries between what is approved and what is forbidden. For example, requiring credit card issuers to give 45 days’ notice prior to a rate increase. I call this bright-line regulation (BLR).

What I want to propose is an alternative approach, called principles-based regulation (PBR). With PBR, legislation would lay out broad but well-defined principles that businesses are expected to follow. Administrative agencies would audit businesses to identify strengths and weaknesses in their systems for applying those principles, and they would punish weaknesses by imposing fines. Finally, the Department of Justice would prosecute corporate leaders who flagrantly violate principles or who are negligent in ensuring compliance with those principles.

The banks will always be savvier than the consumers and nimbler than the regulators, so bright-line regulation is bound to fail.

James Surowiecki⁷⁴ wrote skeptically about the approach as advocated in April 2008 by Henry Paulson, then Treasury Secretary, with Surowiecki sniffing, “But the best principles in the world won’t help much if those in charge aren’t willing to enforce them.”

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They go on to say:

...As with any regulatory approach, principles-based regulation must be well executed in order to work. A key element is that the principles should have clear meaning. They cannot be vague, as in the United Kingdom, where one finds principles like “A firm must observe proper standards of market conduct” or “A firm must conduct its business with integrity.” To me, those are not principles. They are just glittering generalities that offer no concrete guidance to a firm.

Businesses often use internal mission statements and lists of principles as a tool to align employees with the goals of top management. However, in many instances, the statements are so general that they have no implications for any particular way of conducting business. The truly meaningful statements of corporate philosophy are those that provide strong signals of what type of business directions the firm will and will not take. Similarly, for PBR to work, the principles have to clarify rather than obfuscate. Legislative commentary should include specific examples of conduct that falls outside of the principles, in order to provide further guidance...

...Principles-based regulation is not a cure-all. There are many regulatory problems that are better addressed with bright-line regulation. For example, the algorithm for calculating the Annual Percentage Rate of interest should be standardized and clearly specified by regulators. And any regulatory system will have gaps and flaws. After all, those who design and implement regulations are as human as the people who run the businesses that they regulate. But in an increasingly complex and fast-paced market environment, there are likely to be many

regulatory issues where principles-based regulation will prove to be more robust.

Burgemeestre et al. (2009)⁷⁵ “Rule-based versus Principle-based Regulatory Compliance” is a thorough analysis of the different approaches, and points out that for the case of customs regulations the United States tends to follow the rules-based approach, while the EU practices the principles-based approach.

There is an ongoing debate in law and accounting about the relative merits of principle-based versus rule-based regulatory systems. In this paper we characterize what kind of reasoning underlies the two styles of regulation. We adapt an original account of Verheij et al. (1998) to take aspects of the implementation context into account, such as the process of adoption of a new norm and the roles of the participants. The model is validated by a comparison between EU and US customs regulations intended to enhance safety and security in international trade. The EU regulations (AEO self-assessment) are essentially principle-based, whereas the American system (C-TPAT) is rule-based.

Black et al. (2007) in Law and Financial Markets Review⁷⁶ (Black is with London School of Economics), “Making a success of Principles-based regulation” explain:

The UK Financial Services Authority (FSA) leads the way in the development of Principles-based regulation of the financial services industry. It is proposing a significant shift towards reliance on broadly stated Principles rather than more detailed rules. The implications of a more Principles-based approach for regulators, those regulated by the FSA and those whose interests the regulatory regime is designed to protect are the subject of ongoing dialogue...

...The potential benefits claimed of using Principles are that they provide flexibility, are more likely to produce behavior which fulfils the regulatory objectives, and are easier to comply with. Detailed rules, it is often claimed, provide certainty, a clear standard of behavior and are easier to apply consistently and without retrospectivity. However, they can lead to gaps, inconsistencies, rigidity and are prone to “creative compliance”, to the need for constant adjustment to new situations and to the ratchet syndrome, as more rules are created to address new problems or close new gaps, creating more gaps and so on.

Blog by Northwestern University law professor Harlan Loeb (2015)⁷⁷ on “Principles-Based Regulation and Compliance: A Framework for Sustainable Integrity” provides a useful illustration of the problem of absence of principles-based regulation and the General Motors (GM) ignition switch recall. They explain:

...Because most global companies concentrate on making their systems operate as efficiently and functional as possible, they can lack the agility and appropriate mindset to navigate and manage reputational risk and its underlying drivers with alacrity. Compounding the challenge can be corporate dependence on rules-based compliance systems to manage risk. These are situations in which agents are motivated by incentives that reflect legal, regulatory and political constraints rather than (and frequently at the expense of) moral and ethical imperatives. Professor Caroline Kaeb at the University Connecticut Business School concludes that rules-based compliance systems possess far greater hidden costs that prevent maximum compliance at a level of economic efficiency. In addition, rules-based systems often pose design challenges. Their rules are over- or under-inclusive. Therefore, they are unsustainable since global risk has become

fragmented and increasingly qualitative, simultaneously...

They go on to describe the recent problems experienced by General Motors.

The recent compliance crisis surrounding GM’s ignition-switch recall failure... underscores the implications from the organizational absence of a principles-based regulation culture...

A *Wall Street Journal*⁷⁸ commentator points to the root cause of this high-profile compliance failure as “a culture of silence at GM... GM’s compliance system defied well-established behavioral insights by not relying on the individual as the agent for principles-based compliance and integrity, but rather ignoring and allegedly even silencing the individual in the organization....”

Appendix 2:

Retrospective Review—The Care and Feeding of a Regulation After Birth

Many regulatory policy experts across the political spectrum call for better review of regulations after they are put in place to get rid of stale, outdated, and inefficient regulations. The findings from ex-post, retrospective reviews could also serve to validate ex-ante assessments. Susan Dudley provides a concise “retrospective review of retrospective review” in a [May 2013 brief](#) for George Washington University’s Regulatory Studies Center, with an overview of the history and current status of the practice, as well as arguments for more of it.

[Michael Mandel and Diana Carew of the Progressive Policy Institute](#), in a May 2013 report, wrote of the adverse effects of “regulatory accumulation” (“the natural buildup of regulations over time”) on economic growth and its disproportionate burden on small businesses in terms of the hurdles to business formation, hiring of workers, and expansion of product markets.

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They describe three types of regulatory accumulation: (i) “pebbles in a stream” where too many regulations in the aggregate cause a blockage effect that increases costs and slows innovation; (ii) interaction between small numbers of existing regulations (intended or not, obvious or not) that raise costs for businesses; and (iii) “behavioral overload” that forces management to prioritize compliance with regulations over growth and innovation.

Multiple presidents (from both parties and with increasing emphasis over time) have pushed for greater retrospective review of regulations via executive orders. Yet “retrospective review” of the “cumulative effects” of regulation is not commonly practiced because it is time consuming, analytically challenging, expensive (staff- and data-intensive), and difficult to operationalize in an effective and impartial manner.

In a working paper for George Mason University’s Mercatus Center (“The Role of Retrospective Analysis and Review in Regulatory Policy”), [Randall Lutter \(2012\)](#) observed that the “most prominent practitioner of retrospective analyses is apparently the National Highway Traffic Safety Administration (NHTSA), which has completed [at the time of his writing] 92 separate evaluations of the costs and the effectiveness of various facets of its regulatory program since 1973” and describes examples of specific retrospective analyses and the insights that were gained. Lutter praises the NHTSA for the “unusual” rigor of their analyses and their “apparent comfort with self-criticism” which “sets the agency apart.” He speculates that this may stem from the NHTSA’s “engineering culture” and “unparalleled access” to timely and high-quality data—both not the case in most other regulatory agencies—which encourages the practice of data-driven decision making (rather than ex-post data-supported policy advocacy).

Lutter’s paper also describes how the data-driven NHTSA practices the most rigorous forms of analyses of their own regulations, both prospectively and retrospectively. He mentions a 1998 detailed reappraisal (a quintessential retrospective review) of

the cost and effectiveness of the 1983 rule mandating center high-mounted stop lamps on cars and light trucks, and the original prospective study that had randomly assigned vehicles to have the special stop lamps under consideration. Such use of “randomized controlled trials” as a means of informing regulatory policymaking and retrospective review is championed by former OIRA Administrator Cass Sunstein in a [2014 paper on “The Regulatory Lookback”](#) (Harvard Kennedy School).

But for the vast majority of regulatory agencies that aren’t naturally so “data-driven” in the development and administration of their regulations, further efforts to emphasize and institutionalize retrospective review are needed. Recently, several legislative proposals for regulatory reform have been introduced, as discussed in [Susan Dudley’s testimony before the Senate Homeland Security and Governmental Affairs Committee on 9/16/15](#):

- **S. 708, the “Regulatory Improvement Act of 2015”** (sponsored by Sen. Angus King, Independent from Maine) would establish a Regulatory Improvement Commission responsible for evaluating regulations that have been in effect for at least 10 years and making recommendations for their “modification, consolidation, or repeal.” Congress would vote up or down on a full package of recommendations, and federal agencies would have 180 days to implement the approved set of actions.
- **S. 1683, the “SCRUB (Searching for and Cutting Regulations that are Unnecessarily Burdensome) Act of 2015”** (sponsored by Sen. Orrin Hatch, Republican from Utah) would establish a Retrospective Regulatory Review Commission to review and make recommendations to repeal rules or sets of rules that have been in effect more than 15 years. Congress would approve the full package of recommendations via joint resolution. The Commission’s report would include estimated costs of the reviewed rules and would sort the most burdensome rules into two categories (cut immediately or save for later cuts).

Agencies would be required to repeal rules in the first category within 60 days of the joint resolution's approval, and as new regulations are issued, agencies would be required to "cut as they go" (or "cut-go") and repeal rules in the second category to offset the costs of new regulations.

- **S. 1817, the "Smarter Regulations through Advance Planning and Review Act of 2015"** (sponsored by Sen. Heidi Heitkamp, Democrat from North Dakota) would promote "an evaluation mindset" and require agencies to be forward looking and include in proposed major regulations a framework for measuring effectiveness, benefits and costs, and plans for gathering the information necessary to do so. It would require assessment to take place within 10 years of a rule's promulgation, to measure benefits and costs, evaluate how well the rule accomplishes its objectives, and determine whether the rule could be modified to achieve better outcomes.

These proposals are explicitly supported by former OIRA Administrator Susan Dudley and implicitly achieve policy goals laid out by many other regulatory policy experts. The regulatory commission idea is modeled by Mandel & Carew (2013) after the Base Realignment and Closing (BRAC) Commission. Their conception is that:

The [Regulatory Improvement] [C]ommission would consist of eight members appointed by the President and Congress who, after a formal regulatory review, would submit a list of 15-20 regulatory changes to Congress for an up or down vote. Congressional approval would be required for the changes to take effect, but Congress would only be able to vote on the package as a whole without making any adjustments.⁸⁰

The current practice for retrospective review is regulatory agency "self-review" which Mandel and Carew state is problematic because it is costly and time consuming for the agencies to review

regulations already in place, and agencies have little incentive to be self-critical. The [Government Accountability Office \(GAO\) in April 2014 \(GAO-14-268\)](#) reported on the progress of agency retrospective reviews (conducted over the 2011-13 period). GAO found that agencies had made some progress in the practice of retrospective review, and that the reviews often made a difference in bringing about improvements to the clarity and effectiveness of regulations, and in reducing the "burden" on regulated entities (probably taken as referring to compliance costs). This is illustrated in Figure 6. But GAO also concluded that more guidance from OIRA was needed to improve the transparency and usefulness of the information to policymakers and the general public, and to strengthen the links between retrospective analyses and the regulatory agencies' performance and priority goals.

The GAO report identified the major strategies and barriers that affect agency implementation of retrospective analyses:

Figure 6

Breakdown of the types of reported retrospective analysis outcomes for executive agencies that implemented the final actions from January 2011 through August 2013

Agency:

Improved effectiveness of the regulation

112

Reduced burden of the regulation

99

Provided clarity or made another administrative change

93

Amended regulation to respond to statutory charge

44

Results represent 19 agencies and 246 completed retrospective analyses. The outcome categories are not mutually exclusive. Agencies reported outcomes in multiple categories for 76 of the completed analyses.

Source: <http://www.gao.gov/assets/670/662517.pdf>

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Strategies: (i) establish a centrally coordinated review process to develop review plans; (ii) leverage existing regulatory activities to identify needed changes; (iii) use existing feedback mechanisms to identify and evaluate regulatory reforms; and (iv) facilitate tracking of reviews and interagency discussion and collaboration on best practices.

Barriers: (i) competing priorities hinder agencies' ability to conduct retrospective analyses; (ii) agencies reported difficulty obtaining sufficient data to identify improvements attributed to regulations; and (iii) deciphering and analyzing data to be able to attribute effects to regulations vs. other factors is difficult.

In his testimony that dissents from Susan Dudley's positions on the merits of current legislative proposals for retrospective review, [Sidney Shapiro states](#) that "the regulatory system has become out of balance" with a hugely cumbersome and time-consuming rulemaking process (taking five years or longer), and that the "one-size-fits-all requirements that would be imposed by the proposed bills discussed threaten to exacerbate the problem." He argues that what is needed to make the regulatory policy process function more efficiently is to provide more resources and legal authority to the regulatory agencies themselves and to free them from "unnecessary analytical requirements."

So, some approaches that would help put retrospective review into better practice are:

- Data need to be collected as regulations go along, not long after the fact;
- Agencies need to be forced to or more strongly encouraged to analyze data at regular intervals and in an impartial manner;
- The regulatory system needs to better provide and align resources and incentives to undertake and enforce retrospective review.

Appendix 3:

The Importance of "Good Governance" of Regulators

Who is responsible for designing and implementing regulations, and can that person or entity be trusted to pursue and enforce economically beneficial regulatory policy? Can we better avoid "regulatory capture" and cronyism and the strange bedfellows of "Bootleggers and Baptists?" Regulation policy experts including former OIRA Administrator Susan Dudley (such as in her [2015 Case Western Reserve Law Review](#) article) and the OECD have some recommendations on improving regulatory process to keep it impartial, transparent (to stakeholders and the public), comprehensive (broadly applicable, without special exemptions), and free of "cronyism" or "capture" of regulators by special interests.

The OECD's (2014) [The Governance of Regulators: OECD Best Practice Principles for Regulatory Policy](#) established "seven principles for the governance of regulators" (emphasis is added where the principles most align with CED's objectives and role):

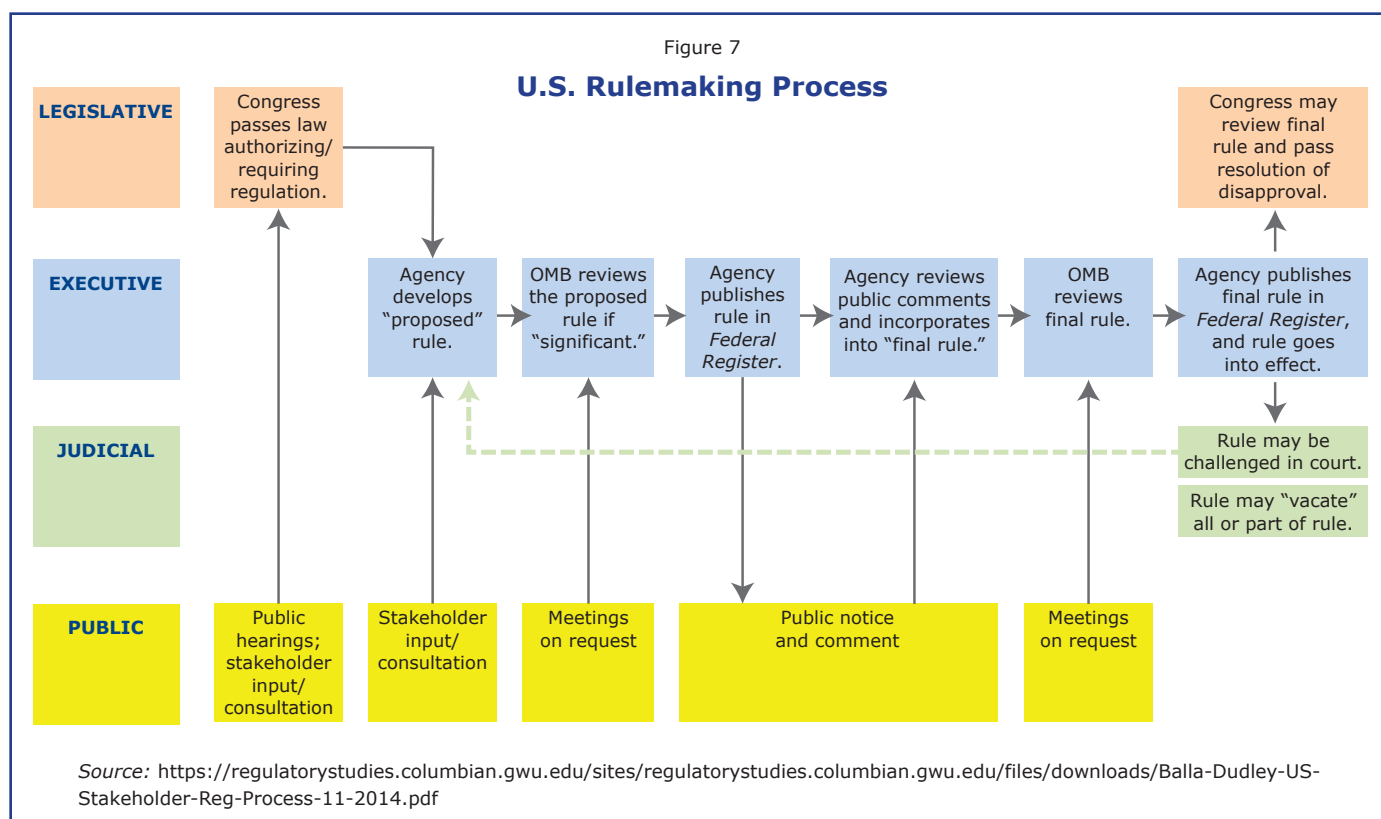
1. **Role clarity:** An effective regulator must have clear objectives, with clear and linked functions and the mechanisms to coordinate with other relevant bodies to achieve the desired regulatory outcomes;
2. **Preventing undue influence and maintaining trust:** It is important that regulatory decisions and functions are conducted with the upmost integrity to ensure that there is confidence in the regulatory regime. *This is even more important for ensuring the rule of law, encouraging investment and having an enabling environment for inclusive growth built on trust;*
3. **Decision making and governing body structure for independent regulators:** Regulators require governance arrangements that ensure their effective functioning, preserve its regulatory integrity and deliver the regulatory objectives of its mandate;

4. **Accountability and transparency:** Businesses and citizens expect the delivery of regulatory outcomes from government and regulatory agencies, and the *proper use of public authority and resources to achieve them. Regulators are generally accountable to three groups of stakeholders: (i) ministers and the legislature; (ii) regulated entities; and (iii) the public;*
5. **Engagement:** Good regulators have established mechanisms for engagement with stakeholders as part of achieving their objectives. *The knowledge of regulated sectors and the businesses and citizens affected by regulatory schemes assists to regulate effectively;*
6. **Funding:** The amount and source of funding for a regulator will determine its organization and operations. *It should not influence the regulatory decisions and the regulator should be enabled to be impartial and efficient to achieve its objectives;*

7. **Performance evaluation:** It is important that regulators are aware of the impacts of their regulatory actions and decisions. This helps *drive improvements and enhance systems and processes internally. It also demonstrates the effectiveness of the regulator to whom it is accountable and helps to build confidence in the regulatory system.*

Appendix 4: Stakeholder Engagement in the Regulatory Process

Stakeholder engagement is an important ingredient in the good governance of regulators. Steven J. Balla and Susan E. Dudley (2014), in a report for the OECD on “[Stakeholder Participation and Regulatory Policymaking in the United States](#),”⁸¹ (a [summary graphic is provided in Figure 7](#)), identify the different ways stakeholders can participate in the regulatory policymaking process:



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Advances in online technology have certainly allowed more of the general public to become aware of regulations (both proposed and in place) and submit comments about them, via the “[regulations.gov](#)” website. Managed by the “eRulemaking Program Management Office” (in partnership with regulatory agencies and the OMB),

Regulations.gov is your source for information on the development of Federal regulations and other related documents issued by the U.S. government. Through this site, you can find, read, and comment on regulatory issues that are important to you.

Balla and Dudley also describe how advances in internet technology and access have inspired some non-profit and academic institutions to develop their own innovative approaches to interfacing with stakeholders and the general public regarding regulatory policy.

But despite the recent progress, Balla and Dudley conclude that the current state of stakeholder participation in rulemaking is mostly a one-way street. Descriptions of regulatory policies in the pipeline are provided to the public and comments are solicited, but there is little evidence that feedback collected via public comment is systematically accounted for in actual decision making:

Our review demonstrates that there are extensive opportunities for stakeholder participation at all stages of the regulatory process. These opportunities, however, are

typically oriented toward facilitating the provision of information on the part of stakeholders. Instruments of participation, in other words, do not generally advance stakeholder engagement in deliberative decision making, where deliberation is characterized by reflection on positions held by others and the possibility of changes in one’s own preferences as a result of such reflection.

The [Administrative Conference of the United States’ “Petitions for Rulemaking”](#) “identifies agency procedures and best practices for accepting, processing, and responding to petitions for rulemaking. It seeks to ensure that the public’s right to petition is meaningful, while still respecting the need for agencies to retain decisional autonomy. Building upon ACUS’ previous work on the subject, it provides additional guidance that may make the petitioning process more useful for agencies, petitioners, and the public.” The ACUS made these final [recommendations](#) on improving communication and engagement between regulatory policymakers and general-public stakeholders, informed by New York University’s [Institute for Policy Integrity’s recommendations to the ACUS](#) which included “...the enhanced use of online platforms to educate the public; the facilitation of consultations with petitioners before and after submission; the creation of public comment periods for all petitions; the collection of statistics on agency petitions; and the establishment of default timelines for responses.”

Endnotes

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Policy Statement

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