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Dear John,

I am pleased to submit my comments on OMB's "Draft Report to Congress on the Costs and Benefits of Federal Regulations." Let me say from the outset that this unique series of annual reports provides tremendous value for US economic and social policy. No other country in the world has a picture of its regulatory practices and results that is as clear and comprehensive as that provided in this report. It provides a sound and thoughtful basis for efforts to improve the social benefits of federal regulations.

The report makes'clear that significant regulatory problems continue to exist at the federal level of the US government, despite over 20 years of investment in improving the quality of regulations by OMB and line departments. The opportunities for improvement are substantial. Yet I note the conclusion of the OECD in its 1999 report, "Regulatory Reform in the United States," that regulatory quality improvements in the United States had contributed to the "construction of one of the most innovative, flexible, and open economies in the OECD, while maintaining health, safety, and environmental standards at relatively high levels." The competitiveness of the US economy has benefited from various regulatory quality tools – including regulatory impact analysis, public consultation, and oversight from OMB experts – that have been refined over the years.[1]

And US regulatory reforms have had a global knock-on effect, since they have been the basis for many international best practice benchmarks, through suasion (OECD, APEC), legal instruments (such as GATS), market power (technical standards), and the demonstration effect

1 These practices are now routine in the **US** government, and are no longer "reforms." In 1991, I grouped these practices under the term "regulatory quality management" to guide the OECD's work in this area.

(telecom deregulation, high environmental standards). Almost all OECD countries and economies in transition now have regulatory reform programs that borrow in some way from the US. For example, the long-awaited "Action Plan on Better Regulation" released by the European Commission on 5 June 2002 to "improve and simplify the EU's regulatory environment" owes a great deal to US experiences. Good ideas should also be imported, and in some areas the US can learn from other countries. The importance of OIRA's work, therefore, goes beyond US borders, and the new section in this report on international regulatory reform efforts is a positive recognition of that.

The generally positive context for US regulatory reform does not, however, permit room for complacency and premature congratulations, as the draft report recognizes.

LACK OF PRIORITIZATION OF PROBLEMS ADDRESSED BY REGULATION

It is deeply disappointing that Americans benefit so little from what is probably the world's most sophisticated regulatory system. The report estimates the annual benefits of major federal regulations cleared by OMB from April 1, 1995 to September 30, 2001 at from $49 billion to $68 billion, and the estimated costs from $51 billion to $54 billion. These figures are uncertain, given the assumptions and quality problems inherent in many of the underlying regulatory analyses, and possible benefits and costs vary widely. However, the figures seem to represent best estimates. These best estimates suggest that the *net social benefits for Americans of the six and a half years of Federal regulatory effort is probably small or close to zero.* Something has gone wrong with a system whose costs basically cancel out its benefits.

The key problem seems to be that regulatory agencies are not properly prioritizing potential regulatory actions, are spending time on trivial or less important issues, and so are missing opportunities for actions that produce the largest benefits for the American people. The more proactive role being taken by OIRA through the "prompt" letter is an extremely useful corrective mechanism. I have long thought that OIRA is too reactive and too restricted to saying "no" to new regulations, rather than championing a more balanced social welfare approach. Even working full steam, however, OKRA can identify only a few missed opportunities, and it is still the case the OIRA spends almost of its energies on improving individual rules rather than improving capacities to choose the right problems to regulate.

A longer-term solution is to construct incentives for better prioritisation in the regulatory departments and agencies. The biannual *Unified Agenda of Federal Regulatory and Deregulatory Actions* and the annual *Regulatory Plan* are not used very well to discuss priorities, although they have the potential to turn into a genuine priority-setting exercise. A better priority-setting exercise would compare the net benefits of regulatory actions across policy areas, departments and agencies, not only within narrow legal jurisdictions. This is difficult to do, but only OIRA is placed to do it. The regulatory budget idea advanced some years ago is also a useful one, and OIRA might consider resurrecting it. Some have recommended that a regulatory budget be applied only to new regulatory costs: a partial solution that may be more practical than a global budget constraint. It is possible that the Performance Management and Results Act is a step toward a priority-setting mechanism through which fiscal budgeting decisions are linked to the ability of regulatory programs to deliver more per dollar expended. Certainly, this was the expectation of some members of Congress.

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2 Crandall, Robert, et. al (1997), An Agenda for Federal Regulatory Reform, AEI and The Brookings Institution.

QUALITY OF REGULATORY IMPACT ANALYSIS

The quality of regulatory impact analysis still shows significant problems. Inadequate analysis by agencies is the most common reason for the growing volume of rules returned to agencies. Of 45 major social regulations that OMB reviewed from April 1999 to September 2001, estimates of both monetized costs and benefits were presented for only 19 rules. Seven of the 34 most important rules did not even estimate costs.

- A good part of the solution to this will be the revival of the "return letter," which improves incentives for good analysis.

- Another part may be even tighter reviews and better advice by OIRA, as is suggested by OIRA's intention to expand staffing in science and engineering to improve its reviews.

- It **might** also be beneficial that "agencies are beginning to invite OIRA staff into earlier phases of regulatory development in order to prevent returns," but care should be taken to ensure that this is purely an advisory function and to maintain an arms-length relationship between regulators and OIRA. OIRA should not become a part of an agency's internal decision process.

- Efforts to subject draft RIAs and risk assessments to formal, independent external peer review by qualified specialists will probably be the most effective approach. This analytical approach contrasts favourably with recommendations for more judicial review of technical aspects of agency regulatory decisions. The solution to better analysis is not more judicial review of the science. Judicial review of ***procedures*** is certainly needed to protect the rights of those who enjoy the benefits and pay the costs of prospective federal action, but on scientific judgements, judges are less likely to reach the right answer than are experts. Even worse, the threat of judicial review leads to highly cautious and rigid regulation based on solutions that have passed judicial scrutiny in the past, not on solutions that are better for the country. The US needs a more innovative and dynamic regulatory process, which cannot be achieved by expanding judicial review of details and expert judgements.

- An emerging risk to the quality of regulatory impact analysis is the proliferation of impacts to be specifically assessed. Regulatory analysis today is the sum of piecemeal procedures that have accumulated over years. Scarce resources are scattered through benefit-cost analysis; unfunded mandates analysis; paperwork estimates; small business analysis; environmental assessments; evaluation of the risks to children of planned regulations; reviews of significant impacts on energy supply, distribution or use; and consideration of State, local, and tribal effects. Most of the analytical tests are so imprecise and difficult to assess that they have little analytical credibility, and the criteria for regulatory efficiency are not clear. The social welfare analysis under E.O. 12866 is the broadest form of analysis, but has not been very effective at integrating partial assessments of distributional effects. The risk is that too many decision criteria and assessments create confusion and waste resources, and lead to inconsistent or incorrect policy conclusions. In OMB's refinement of its formal analytic guidance, steps could be taken to either integrate these analyses, improve consistency of treatment, and more clearly show how the distributional assessments fit into the E.O. 12866 social welfare analysis.

- More generally, the revision of the analytical guidance could include more discussion of how to assess and consider distributional effects. Disagreement over this issue has been the source of much conflict over regulatory decisions. Upfront guidance on assessment, presentation, and decision criteria could be helpful in focussing policy debates on any trade-offs between general and localized effects.

- Finally, although this is outside of the jurisdiction of the Executive branch, application of better evaluation techniques for bills merits more attention. Perversely, American laws are likely to be lower quality than subordinate regulations, due to the imbalance in quality controls between the two instruments and the lack of consistent evaluation of bills. This has substantial negative downstream effects on the quality of policy implementation and policy outcomes. The UMRA requirement that the Congressional Budget Office estimate the costs of proposed legislation was a good step, and anecdotes suggest that it has helped raise the level of debate on such costs, but the Congress has yet to become an informed consumer of good analysis.

A new quality discipline discussed in the OMB draft report relies too much on legalistic and judicial solutions to quality problems. To implement the new infomation guidelines, which "offer a new opportunity for affected members of the public to challenge agencies when poor quality information is disseminated," OMB has required each agency to develop an administrative mechanism to resolve challenges, including an independent appeals mechanism. These new guidelines are unlikely to have much benefit, but are likely to impose high costs.

DEMYSTIFYING OIRA

OIRA's continuing efforts to improve its transparency and credibility, to "demystify the process of regulatory oversight," are welcome. OIRA is in a particularly difficult situation. Criticisms of OIRA are often rooted in the ambiguous position of a body that claims to simultaneously represent a set of quality principles based on empirical decision-making, and the position of the President who must deal with political priorities and other possibly conflicting claims, as the OECD noted in its 1999 report. On a larger scale, there is inherent tension between, on one hand, the need for clearer political accountability and strong management of a large and fragmented regulatory system, and, on the other hand, the desire that individual regulatory decisions should be free from political influence (which dates from the anti-corruption "good government" movement of the 1920s).

OIRA is as necessary to modern governance as is OMB's centralized budgeting process, and its place should be reaffirmed at every opportunity. The good governance aspects of the regulatory quality agenda are sometimes lost to critics. For example, the **high** priority placed on better regulatory analysis reflects a belief that regulators are not truly accountable to the electorate unless the consequences -- the social benefits and costs -- of their actions are known. This series of reports is helpful in explaining the importance of good regulatory management and OIRA's contributions.

REGULATORY QUALITY AT STATE AND LOCAL LEVELS

Oddly, OMB has had more influence on improving regulatory practices in Europe and Asia than it has had on improving regulatory practices in US state and local governments. Of course, OMB has no authority to mandate or instruct other levels of government, but Federal-state cooperation on regulatory quality through more promotion, dissemination of good practices, and

awareness-raising at these other levels of government could generate very substantial benefits for Americans. Many states have already established excellent regulatory quality management programs, some involving state-level OIRAs and paperwork reduction efforts. These efforts could be extended if the National Governors' Association or other representative bodies would develop, in cooperation with the pioneering states and OIRA, good regulation benchmarks and practices to drive regulatory quality efforts at state levels.

REVIEW OF EXISTING RULES

The draft OMB report rightly raises the issue of how to review and update existing regulations that are years or decades old. OMB engages in understatement when it notes that "across-the-board reviews of all existing rules have been attempted in the past but have not always been particularly successful...." The current US system is very weak with respect to systematic review of the vast body of existing laws and other regulations. It looks forward, but not back. Other OECD countries have unfavourably compared the incremental and piecemeal nature of legislative change in the United States to the greater capacity for reform often enjoyed by parliamentary governments. More work is needed particularly in important sectors characterised by fast technological change (communications, energy, transport) where the sluggishness of US regulation can erode competitiveness.[3] OMB recommends that "a targeted review process for existing rules, pursuant to public comment and new statutory authority provided to OIRA" is "the best available mechanism to facilitate review of existing rules....", given available resources.

I do not agree. The OIRA approach, inviting nominations and meanwhile looking at "71 specific nominations covering 17 agencies suggested by **33** commentators," seems focused on pruning each tree rather than improving the health of the forest. That is, this process is transactions-oriented rather than results-oriented. Like previous review attempts, it works better in analysing individual regulations than in understanding interactions between a group of regulations affecting an economic or social sector, having a cumulative and overlapping impact, originating from different agencies or even different levels of government. Moreover, the regulating agency itself decides what corrective action is needed, leading to the predictable result that, as OIRA already notes, "the new reform ideas" from regulators are "modest in nature." The OIRA approach will probably have only marginal benefits.

I would rather see reviews of existing regulations conducted through comprehensive assessments by a high-level advisory board, commission or task force of how **a** regulatory framework affects an economic sector, emphasising policy effectiveness and impacts on consumer welfare as performance measures (for example, reviewing "chemical safety" rather than a rule on air sampling). Recommendations would include dramatic reinvention of regulatory policies, or groups of specific reforms affecting different instruments or policies, packaged to permit quicker regulatory improvement. In every regulatory area reviewed, emphasis should be given to encouraging innovation in approaches, with clear accountability for results, and to identifying the most efficient federal/state relationship in the policy area. For example, OIRA's new scientific advisory panel could be asked to review broader areas of regulatory policy and suggest initiatives to update regulatory regimes. Structuring an effective review process will be key to its results, and may require strengthening the capacities of OMB and congressional offices such as GAO and CBO.

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3 The failure of the Federal Communications Commission to prepare benefit-cost analyses of rules that affect a substantial **part** of the US economy is surprising **and** alarming.

Efforts in other OECD countries show that achieving consensus in advance on a transparent and measurable set of principles for review is essential. This would reduce the risk, to which OIRA draws attention, that "any attempt to modernize or streamline old rules" would be seen as "a veiled attempt to "rollback" needed safeguards." Advance consensus on review principles was critical to the current Australian regulatory review based on competition principles, which includes both federal and state governments and is unprecedented in its scope. The requirement in UMRA for a cost-effectiveness test for new legislation was a good step toward consensus on results-oriented principles, but a benefit-cost test and an emphasis on innovation and experimentation will produce the best results in increasing social welfare.

In addition, the role of sun-setting could be expanded in the US regulatory system, as it has in some other countries.

REGULATORY GOVERNANCE ABROAD AND THE AMERICAN EXCEPTION

I note above how useful is this new OMB initiative to place regulatory reform in a global perspective. The description of various efforts to promote good regulation through the OECD, APEC, and European institutions is highly relevant to US interests. Continued US leadership and participation in these forums are critical in driving global reforms and speeding up convergence of regulatory practices that can increase trade and investment. Regulatory differences account for an increasingly large percentage of the world's most contentious trade disputes.

In particular, US support for better European regulation could produce major gains for Americans as European growth improves. Currently, policies are developed, debated, and adopted at the European level without the most elementary safeguards on quality, transparency, and efficiency. European officials have almost no idea as to the economic impacts of their decisions. The risk of policy failure -- due to bad regulation, over-regulation, or under-regulation -- is high, undermines EU credibility, and produces trade disputes. Sound reforms, such as wider consultation and use of regulatory impact analysis, were recommended at the EU Stockholm summit in March 2001, and were echoed in July 2001 in the Commission's white paper on "European governance," and most recently in the Commission's Regulatory Action Plan. US Government cooperation with European institutions in implementing and deepening these mutually-beneficial reforms will be extremely valuable.

In general, more communication with Europe and other parts of the world on US regulatory practices would speed up convergence, trade and investment. It is worth considering whether the US approach to regulation is different from that of other countries, and if so, how? This issue was considered in detail in the 1999 OECD report. The US economic model is often wrongly criticized in Europe as "hyper-capitalism'' or a "jungle economy,'' by which the critic means almost entirely unregulated and therefore destructive of social values. This mythic view of the savage American economy is an important part of global anti-American sentiment. Americans, however, see their country as over-regulated and over-legalized. The 1994 book, "Death of Common Sense: How Law Is Suffocating America" by Philip Howard, made the case that almost every aspect of American life is regulated. The contrasts in these points of view about the under-regulated and over-regulated American economy could not be clearer. To make things even more complicated, the American economy is among the strongest in the world, with the highest year-on-year productivity growth and the best record in job creation, which does not support a hypothesis of over-regulation.

In fact, the OECD found that, measured by the volume and detail of national regulation and the size of the national regulatory administration, the United States does not appear to be *less* regulated than other OECD countries. However, the United States is often *differently* regulated, even where policy objectives are substantially similar. US regulation tends to be based on two fundamental regulatory styles that support economic dynamism and market adjustment:

- The *pro-competition policy stance* of federal regulatory regimes, supported by strong competition institutions, has meant that regulators tend to prefer policy instruments, such as social regulation and market-driven approaches, that are competition neutral over public ownership and economic regulations that impede competition. In post-war years, regulation has usually been used to establish conditions for competition rather than to replace competition. The OMB draft report cites the usual academic conclusion that "Economic regulation is often used to protect industries and their workers from competition," which is certainly true, but the draft report might also mention that the US regulatory system is more inherently pro-competitive than any other in the world (except, possibly, New Zealand).

- The *openness and contestability* of regulatory processes weakens information monopolies and the powers of special interests, while encouraging entrepreneurialism, market entry, consumer confidence, and the continual search for better regulatory solutions. The US federal system is, on balance, a promoter of good regulation because of its capacity to test multiple solutions.

OMB's draft report is right to emphasize that transparency and openness is a linchpin of US regulatory processes. This is a major difference from most other countries in the world, and US openness operates in an unusual social context that is often neglected in recommending American practices to other countries. American processes of transparency have a legal framework in common law, restraints on *ex parte* communications, the Administrative Procedure Act (particularly the notice and comment procedure), and related statutes. Transparency is further supported by a strong rationalist logic in the United States that welcomes empirical analysis and fact-finding (as opposed to Cartesian logic, common to European civil law, which starts from general principles and works backward to the solution.) American rationalism has supported OMB's work over 25 years to build regulatory impact analysis as a key input into regulatory decisions. The most important factor supporting transparency in the United States, though, is its vibrant civil society. Notice-and-comment would mean little without the clash and challenge of groups participating in the process. For these reasons, US transparency practices are not always transferable to other countries, and care should be taken in recommending US models.

Even with respect to transparency, though, the US government should not rest on its laurels. It is time to find new ways to communicate and listen to citizens. The federal government has not adapted its consultation practices to the information age. Serious thinking is needed about how to enrich debates and empower the huge majority of people who are not involved in issues important to them. Specifically, it is time to re-examine a sacred cow that has served the United States very well for almost 60 years, but is in need of a serious overhaul. That sacred cow is the Administrative Procedure Act, conceived under the Roosevelt Administration by his critics who were concerned that the build-up of the regulatory state in post-Depression years threatened American liberties, and wanted safeguards to ensure that growing Federal power was used properly. The APA has been the cornerstone of the regulatory process ever since. Its notice and comment procedures are among the most open in the world.

That said, there are serious problems with consultation that are rooted in the legalistic and adversarial tendencies of the American regulatory system. Notice and comment has developed into a legalistic, formalistic process that can prevent rather than promote dialogue, co-

operation, and communication. The role of the formal record in subsequent court challenges has too often meant that interest groups use it as the first stage of litigation, rather than as honest inquiry. Effective ability to participate is often limited by the complexity of the rules in question, particularly where scientific or technical matters dominate. The failure of regulators to clearly state the implications of regulatory decisions leaves the field to well-funded experts representing organised interests. Rather than organising information and communication, regulators have a passive role, in most cases simply waiting for the public to respond.

The key task facing the United States is to marry a high level of transparency with development of a less adversarial system for consultation through more flexible and more interactive communications. Supplements to "notice and comment" procedures that enrich dialogue and draw in a wider range of interests should be considered, and IT approaches should be critically assessed.

I appreciate the opportunity to provide these comments, and hope that they are useful.

Best wishes,

(original signed)

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