



## THE NEED FOR A GREATER CONGRESSIONAL PRESENCE IN REGULATION POLICY AND OVERSIGHT

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### OVERVIEW

The economic world changes most and for the good in economies where rivalrous economic behavior is allowed most to flourish, that is, in economies devoted to free enterprise. The flood of new economic knowledge that these swiftly changing economies produce generally results in higher-quality products for consumers at lower prices on average, as businesses compete with each other for the consumer's dollars and strive to better serve consumer needs.

Congress has no end to the number of things it has to do, as I experienced not long ago as a staffer. Near the top of its list of "to-dos" is the protection of this amazing process of value creation through innovation, discovery, and competition. We depend utterly on the private sector to produce nearly all of the material things we value. While the public sector is a necessary partner in this production through its provision of public goods (courts of justice, defense of the country, highways, and so forth), the betterment of the American people since 1900 is almost wholly the accomplishment of competition between entrepreneurs trying to obtain the consumer's attention for their products or services.

It always is worthwhile to recall what a valuable asset for ordinary Americans is this free-enterprise system. Competitive, free-enterprise economies grow more rapidly over the long run than economies burdened by inadequate protection for private property, high taxes, and rapidly growing levels of regulation. Economies with a long-term growth rate of 1.5 percent will double in the size of per-person GDP in two generations, or in 47 years. However, a 3 percent growth rate results in a doubling of per capita GDP in only 23.5 years, or in one generation.<sup>1</sup> Thus, policy

1. Calculations by the author.

changes that increase the growth rate from 1.5 to 3 percent can double economic well-being in half the time. That is a huge economic dividend for ordinary Americans.

Given the vital place of the competitive economic world in bettering the general public, Congress must be especially vigilant about the regulatory burden it imposes on the economy. Regulations can do great good for the free-enterprise system when they work to assure a level playing field and extend the vital protections of the rule of law. But regulations also can do great harm, particularly when they work to reduce competition, innovation, and the growth of economic knowledge. When regulations act in this latter fashion, they reduce the rate of economic growth, which directly reduces the growth in well-being among ordinary Americans.

In this vein, I am particularly eager to draw the committee's attention to three areas of regulatory policy where my concerns are growing: 1) the decay of regulatory impact analysis, which tells policymakers about the benefits and costs of proposed regulations, 2) the economic effects of regulations on vulnerable populations and the cumulative economic effects on the economy generally, and 3) the growing absence of Congress in directing the future development of the administrative state. Let me address each of these items in turn.

### THE DECAY OF REGULATORY IMPACT ANALYSIS

Policymakers in Congress would largely be in the dark about the expected effects of regulatory policy changes were it not for the development of regulatory impact analyses (RIAs). Policymakers look at this analysis for estimates of a proposed regulation's costs and likely benefits. When well-prepared, the RIAs are highly valuable policy tools, particularly for the public affected by the proposed regulations. When poorly prepared, they can create inadequate and sometimes false information about a regulation's likely effects. In the worst case, Washington's policy leadership will think something should be producing benefits when, in fact, it may be doing just the opposite.<sup>2</sup>

The administration's oversight of RIAs is lodged in the Office of Information and Regulatory Analysis (OIRA). Under normal circumstances, this small office would have trouble enough monitoring the adequacy of agency RIA submissions, but it has been steadily reduced in size since its creation in 1981, and today it reviews hundreds of proposed regulations with a staff exactly half as large as when it was created: staffing has dropped from 90 in 1981 to 45 today.

This hollowing out of OIRA may partially explain the stunning and growing inadequacy of impact analysis for recent major proposed rules. My Mercatus colleague, Dr. Jerry Ellig, recently published a major retrospective evaluation of RIAs, which we call the Regulatory Report Card. His work reviewed 130 major proposed regulations from the period 2008 through 2013. He found (and I quote):

Regulatory Report Card evaluations show that RIAs often lack thorough analysis of key issues they are supposed to cover. This means that regulatory agencies often adopt regulations that affect several hundred million people and impose hundreds of millions of dollars in costs without knowing whether a given regulation will really solve a significant problem, whether a more effective alternative solution exists, or whether a more targeted solution could achieve the same result at lower cost.<sup>3</sup>

Ellig and his colleagues evaluated these major regulations using the standards laid out in Executive Order 12866 and OMB *Circular A-4*, both of which agencies must follow when preparing their impact analyses. Even with such required guidance, agencies fell woefully short of the mark. In recently published research, Ellig summarizes his findings:

2. An interesting example of inadequate attention to potential economic consequences of a proposed rule is the recently implemented overtime pay rule from the Department of Labor. For an analysis of how poorly the Department performed its impact work, see Donald Boudreaux and Liya Palagashvili, "An Economic Analysis of Overtime Pay Regulations" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, April 2016).

3. Jerry Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis: The Mercatus Center's Regulatory Report Card, 2008-2013" (Mercatus Working Paper, Mercatus Center at George Mason University, July 2016), 2.

- Scores were consistently low for the analysis of the systemic problem. Only 13 percent of the regulations had significant evidence demonstrating the existence and cause of the problem.
- Less than one in five regulations, just 19 percent, were accompanied by analysis that considers a wide range of different solutions or levels of stringency.
- Just 24 percent of RIAs contained reasonably thorough assessments of price effects, and just 12 percent (about one in eight) contained reasonably thorough analysis of costs due to behavioral changes.
- Of the 130 regulations analyzed, *only one* included a reasonably complete framework for retrospective analysis.<sup>4</sup>

What can be done to improve the overall quality of RIAs?

- First, improve OIRA's resources. Without adequate staffing and other resources, the office's capacity to improve RIA quality will be substantially compromised.
- Second, implement process reforms that require agencies to produce a preliminary regulatory impact analysis and submit that to public comment before sending its final RIA work to OIRA. Research indicates that preliminary analysis with public comment yields much better final impact analysis.
- Third, Congress should require all agencies to perform regulatory impact analyses when proposing regulations. Moreover, Congress should specify the broad factors that the RIAs should contain when enacting new regulatory authority. Agencies pay close attention to what Congress requires in impact analysis out of fear that courts might vacate implemented regulations that run counter to Congress's explicit requirements.

## THE ECONOMIC EFFECTS OF REGULATION

Academics and policy researchers in disparate parts of the research world are increasingly concerned about the rapid increase in economic regulation. Indeed, a recent spate of research puts this surge in regulation at the front line of suspects when explaining the slowdown in growth among the most advanced economies. These researchers argue that regulations can yield benefits for the general public but also can reduce incentives to take economic risk, raise the cost of investment, and reduce profitability by boosting the costs of labor and other inputs.

The mounting likelihood that such harmful effects are occurring should concern Congress. As I mentioned earlier in my testimony, Congress holds a core responsibility to encourage a growing economy by encouraging competition among firms and innovation in products and services. If excessive regulation is reducing the overall growth rate, then the primary victims are the children and grandchildren of today's citizens, who will experience less prosperity during their productive years.

How much decline in growth have we experienced? My colleague Patrick A. McLaughlin and his coauthors recently used a growth model of the US economy and data from the *Code of Federal Regulations* to estimate a \$4 trillion loss in GDP in their base year 2012. That is, had regulations remained the same as they were in the very heavily regulated year of 1980, then the economy would have been 25 percent larger (\$4 trillion) in 2012 than it otherwise was.<sup>5</sup> This 2012 economy employed 135 million workers in December of that year. If a 25 percent greater GDP would employ a proportional number of workers, then the economy was missing not only output but also 34 million jobs.

4. For a detailed discussion of the evaluation criteria and results of the Regulatory Report Card project, see Ellig, "Evaluating the Quality and Use of Regulatory Impact Analysis."

5. McLaughlin's research and that of the others described in this section is summarized in a recent Mercatus publication. See Patrick A. McLaughlin, Nita Ghei, and Michael Wilt, "Regulatory Accumulation and Its Costs," *Economic Perspectives*, Mercatus Center at George Mason University, May 4, 2016.

This significant loss of GDP and likely jobs has been estimated by other researchers, as well. John Dawson and John Seater published research in the *Journal of Economic Growth* (June, 2013) showing that GDP had been reduced by a surprising \$39 trillion over the period 1949 through 2005 due to regulation. They estimated that this loss amounted to \$129,300 per person by 2005.<sup>6</sup> This finding was echoed by researchers at the World Bank who estimated that a 10 percent increase in regulatory burden is associated with a loss of .5 percentage points in the overall economic growth rate. That loss translates into thousands of dollars in lower income per person.<sup>7</sup>

In addition to this growing body of research on the harm to the overall growth rate, there also is evidence that rapidly growing regulations harm vulnerable populations, distort labor markets, and increase income inequality.

- Because regulations often increase the price of necessities like food, housing, and electricity, low-income populations shoulder a higher regulatory burden proportional to their income than higher-income populations while sharing no more than higher-income Americans in the benefits of the regulations.<sup>8</sup>
- Regulations can adversely affect labor markets as well. They can raise the cost of labor and other inputs, thus reducing production and the demand for labor. Regulations also can divert workers from the production of goods and services to jobs that involve little more than filling out compliance forms.<sup>9</sup>
- Finally, regulations that require laborers to acquire extensive education or training certifications can discourage people from taking higher-paying jobs, thus exacerbating the widening distribution of income. Likewise, regulations that make it more difficult for entrepreneurs to open businesses widen the distribution of income, since self-employment is one of the keys for upward mobility among low- and moderate-income individuals.<sup>10</sup>

## THE NEED FOR A REGULATORY BUDGET

At issue in my two previous points (the importance of better RIA work and the mounting case that regulations are, on net, harmful to economic growth) is the need for congressional policymakers to attend more to regulations than they have in the past. Policymakers in 1980 might have assumed that the grant of specific regulatory authority to the administration would be implemented in the most cost-effective, least intrusive way possible. That grant and regular oversight probably appeared to many as enough involvement by Congress in regulation.

Those happy days are long gone. Today, regulatory agencies consume a rapidly growing portion of the total federal budget and cost the economy trillions annually in compliance costs and lost output and jobs. Congress can no longer sit on the sidelines while the administrative state reduces the American economy to a long, slow period of growth. It is time for a regulatory budget.

6. John W. Dawson and John J. Seater, "Federal Regulation and Aggregate Economic Growth," *Journal of Economic Growth* 18, no. 2 (2013): 137-177.

7. Norman V. Loayza, Ana María Oviedo, and Luis Servén, "The Impact of Regulation on Growth and Informality: Cross Country Evidence," World Bank Policy Research Working Paper No. 3623, June 2005.

8. See Diana Thomas, "Regressive Effects of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, November 2012); and Dustin Chambers and Courtney A. Collins, "How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, February 2016).

9. See Keith Hall, "The Employment Costs of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, March 2013).

10. Steven Horowitz, "Breaking Down the Barriers: Three Ways State and Local Governments Can Improve the Lives of the Poor" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, July 2015); and Patrick A. McLaughlin and Laura Stanley, "Regulations and Income Inequality: The Regressive Effects of Entry Regulations" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, January 2016).

The concept of a budget for regulations was first introduced in 1978 by Senator Lloyd Bentsen, who held hearings on regulatory budgeting legislation when he chaired the Joint Economic Committee. It has since then found many champions in both political parties.<sup>11</sup> Indeed, a number of countries use a form of regulatory budgeting that caps regulations (either in quantity or in value), thus instituting a form of regulatory pay-go. That is, a legislative body can enact new regulations only if it can eliminate an equal amount of existing regulations.

My colleagues at Mercatus have designed a new process for assessing the costs of federal policies, including regulations, that involves significantly new and powerful policy evaluation and oversight by Congress. The key to overseeing the growth of regulations is the institution of new processes for assessing how well existing regulations are working and the likelihood that new ones will achieve their stated goals. Surprisingly, Congress currently must rely almost entirely on administrative agencies to inform them on the effectiveness of regulations. Worse, Congress lacks nearly any capacity to determine if these agencies are telling them the truth.<sup>12</sup>

Many in the current Congress are backing some form of regulatory budgeting. Hearings have been held in the budget committees of the House and Senate. Legislation has been introduced by Senator Mike Lee and Representative Mark Walker to institute this oversight capacity as part of the annual budget process,<sup>13</sup> and Senator Amy Klobuchar has floated legislation to significantly increase staffing inside the Congressional Budget Office to evaluate regulatory impact assessments of proposed major regulations.

## CONCLUSION

These happy developments on regulatory budgeting evidence a new stirring of interest in Congress on regulatory matters generally, and it is about time. There is no dispute, certainly not from me, that regulations in some areas of economic life currently pay benefits that outweigh their costs. That said, the last 20 years has seen such an explosion in regulations that Congress now has a duty to ascertain whether some of the experts are right about the harmful cumulative effects of regulatory burden.

Executing that duty must start by improving the information that policymakers receive from the administration, but better information is not enough. Congress needs now to put itself in the middle of the administrative state's evolution and guide it more than it has heretofore dared. The Constitution lodges in the Congress the primary duty to see that the property of the citizens, once taken by government, is well spent and supports the common good. That responsibility now must extend beyond taxes to include the reshaping of private resource use by public regulation.

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11. For a history of the concept, see Jeffrey A. Rosen and Brian Callanan, "The Regulatory Budget Revisited," *Administrative Law Review* 66, no. 4 (2014).

12. See Jason Fichtner and Patrick A. McLaughlin, "Legislative Impact Accounting: Rethinking How to Account for Policies' Economic Costs in the Federal Budget Process" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, June 2015).

13. See coverage of the Regulatory Assessment Act in Lydia Wheeler, "Senator Pushes Budget for Regulations," *The Hill*, March 15, 2016. Senator Lee was joined by several House members in this legislation.

## APPENDIX I

Donald Boudreaux and Liya Palagashvili, “An Economic Analysis of Overtime Pay Regulations” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, April 2016), <http://mercatus.org/publication/economic-analysis-overtime-pay-regulations>.

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