WRITTEN STATEMENT OF MICHAEL MANDEL, PHD

CHIEF ECONOMIC STRATEGIST
PROGRESSIVE POLICY INSTITUTE
Mmandel@progressivepolicy.org
(202) 656-7633

Senate Committee on Homeland Security and Governmental Affairs
"Toward a 21st Century Regulatory System"

February 25, 2015
10 AM

SUMMARY

How can we reduce the economic burden of regulation on innovation and growth, without losing its benefits? Since Jimmy Carter, every president has tried introducing retrospective regulatory review, with less-than-stellar results.

This statement draws extensively on work done by the Progressive Policy Institute, where I am Chief Economic Strategist. In this statement, I will first explain the reasons why retrospective regulatory review is fundamentally flawed when used by itself. I will then describe an alternative approach for lowering the regulatory burden, the Regulatory Improvement Commission, which was introduced in the previous Congress as S.1390 (Regulatory Improvement Act of 2013) and H.R.4646 (Regulatory Improvement Act of 2014).

Statement

Chairman Johnson, Senator Carper, members of the committee. Thank you very much for the opportunity to address the question of how to design a “21st Century Regulatory System.” My remarks will focus on retrospective regulatory review, and alternative mechanisms for reducing the burden of regulation without losing its benefits.

My testimony is drawn from a series of policy briefs on “regulatory improvement” issued by the Progressive Policy Institute, where I am Chief Economic Strategist. I am also a senior fellow at the Mack Institute for Innovation Management at Wharton School of Business at the University of Pennsylvania. Until 2009, I served as Chief Economist at BusinessWeek, where I helped direct the magazine’s domestic and international economic coverage. I’ve written three books on uncertainty, innovation and growth, and one basic economics textbook.

As you likely know, PPI stresses the importance of growth and innovation for lifting the living standards of middle-class Americans. There are many policy levers for increasing growth and innovation, including R&D spending, education, and fiscal policy.

But we’re especially concerned with regulatory policy as an untapped tool for accelerating innovation and growth. On the one hand, technological and institutional innovation is the key force propelling sustained gains in living standards and creating jobs. On the other hand, our economy would not work without regulation. Policymakers are continually striving to find the right balance between innovation and regulation in every area of the economy—telecom, tech, biosciences. It affects both big companies and small.

Unfortunately, if policymakers allow the regulatory burden to become too heavy, innovation and entrepreneurial energy can be suppressed. So the long-term performance and competitiveness of the American economy and the long-term growth of living standards depends on periodically lightening the regulatory load—the equivalent of scraping the barnacles off the bottom. This is a goal where Democrats and Republicans can find common ground.

As I noted in a recent essay, "Hacking the Regulatory State," (Mandel 2014):

> To lift long-term growth levels, policymakers in developed countries must consider making systematic changes in the "operating code" of regulatory institutions in order to encourage innovation and disruptive innovation in particular. Advocating deregulation per se is rarely the right answer, because consumers and workers rightfully see regulation as essential protection against profit-focused businesses. Voters widely support social goals such as clean water and air, and even businesses would not want to see government abandon the market to the law of tooth and nail.
>
> Yet even the most regulation-minded can see how the accumulation of well-intentioned rules can have a pervasive and negative effect on innovation. One useful analogy is that of a small child idly tossing pebbles in a stream. One or two or even ten pebbles won't make an obvious difference in the flow of the stream. Yet, accumulating gradually over the years, thousands of pebbles can make an effective dam. Or to put it into technology terms, asking a software developer to add one more feature or requirement to a program may seem like a small and innocuous request. Yet enough such 'minor' requests turns a simple task into a bloated, ungainly, and bug-ridden piece of code that may be virtually unusable.

Retrospective Review

One logical way to fix the regulatory system is to go back and review old rules, to find the ones that are out-of date, unnecessary, redundant, or have become excessively burdens because of technological or market changes. This process of "retrospective review" has been embraced by every president from Jimmy Carter to Barack Obama.

Administratively, retrospective review seems quite simple: Executive agencies are ordered to make a list of regulations that are candidates for reform. They then go down the list one-by-one and ask if the benefits exceed the costs. This procedure seems fool-proof.

And yet, with no exceptions, these attempts at retrospective review seem to have fallen far short of the desired result, based on any objective assessment (See, for example, GAO[2007] and Lutter [2013]). The Obama Administration's effort at retrospective review was admirable.

However, Aldy [2014] notes that:

> In 2014, executive branch agencies issued 24 major rules, only two of which were identified as the products of retrospective review under Executive Order 13563. Less than one-third of the rules were issued with monetized benefits and costs, and not one regulation included a plan for retrospective review of the rule in the future.

Aldy goes on to observe that in 2013 and 2014:

> …the independent regulatory agencies issued 39 major rules, none of which monetized the benefits and only eight monetized the costs of the regulatory action. None of the rules were identified as the result of retrospective review under Executive Order 13579 and none of the rules included a plan for future retrospective review of the rule.

I will argue here that retrospective review is a seriously flawed process that cannot by itself provide the answer to regulatory accumulation. There are four reasons retrospective review is so hard to do effectively.

1. Agencies that pass rules have a vested interest in justifying their original decisions.
2. Rules are often the result of Congressional mandates, which cannot be undone without legislative action
3. Changing or eliminating an existing rule is not simply a matter of a stroke of a pen. In general, the agency must go through the same lengthy process, including public comments, which the original rule required.
4. The retrospective review process is based on examining the costs and benefits of each regulation individually. However, even if every individual regulation passes a cost-

benefit test, the total accumulation of regulation can create a heavy burden on innovation. The number of regulations matter, even if individually all are worthwhile.

Let's discuss each of these flaws in turn. Clearly agencies have an incentive to defend decisions they have made in the past—that's pure bureaucratic self-interest. But if agency self-interest were the main reason for the failure of retrospective review, it would be easy to fix by closer monitoring of agencies by the White House.

More importantly, retrospective review is often limited by the interaction of Congressional mandates and executive rule-making. Regulations are the joint product of legislative action and executive authority. For that reason, the executive branch has a limited ability to achieve regulatory reform by itself. Moreover, it's important to remember that the original legislation is generally the result of an explicitly political process, not a cost-benefit analysis of what legislation would be best. As a result, contradictions and overlaps are often built into the original legislation.

Third, ironically, we must recognize that assessing the costs and benefits of an existing regulation is far more expensive and time-consuming than projecting the costs and benefits of a prospective rule. When an agency is first considering a new rule, it can use whatever limited evidence exists from academic studies and existing research. By contrast, after a major regulation has been effect for years, the amount of potentially relevant real-world data is enormous, expensive to collect, and potentially burdensome for companies.

For most regulations, it is no easy task to design a study that fairly measures what would have happened in the absence of the regulation, including technological change, investment decisions by companies, and changes in markets. As a result, regulatory agencies do not have the financial, intellectual, or managerial resources to assess the costs and benefits of more than a small handful of existing regulations. Notes Aldy (2014)

> An agency could identify a small number (e.g., two or three) rules that exceed a specified economic threshold (economically significant, or perhaps even a larger quantitative threshold) for detailed ex post analysis of efficacy, benefits, and costs.

Finally, retrospective review is inherently focused on assessing individual regulations. However, the impact of regulation on growth and innovation appears to be nonlinear and cumulative. That is, as rules pile up, they interact with each other to create more of an impediment, even if each rules makes sense on its own.

The cumulative impact of regulations has been accepted by both Democrats and Republicans. In his role as OIRA Administrator, Cass Sunstein issued a 2012 memo entitled the "Cumulative Effects of Regulations" which said, in part:

> Consistent with Executive Order 13563, and to the extent permitted by law, agencies should take active steps to take account of the cumulative effects of new and existing rules and to identify opportunities to harmonize and streamline multiple rules.

However, despite the lip service paid by successive administrations to the cumulative effects of regulation, the agencies still don't take it seriously in any way, and neither does OIRA. Aldy notes that:

> The complete absence of discussion of cumulative impacts in identified regulatory actions in the semi-annual progress reports suggests that this issue does not receive substantial consideration by agencies. This reflects, in part, the standard approach to regulatory review – whether a rule is in the development stage at the agency, in its consideration in OMB coordinated interagency review, in its prospective analyses, and in this retrospective analysis effort – to focus one rule at a time

One alternative

To augment the formal process of retrospective analysis, we see the need for a low-cost, non-bureaucratic channel for improving regulations. Mandel and Carew (2013) proposed a Regulatory Improvement Commission (RIC) that would be authorized by Congress for a fixed length of time, and consist of a panel appointed by the President and by Congressional leaders of both parties. The RIC would have a limited period of time to come up with a package of regulations to be eliminated or fixed, drawing on public suggestions. The package would then be sent to Congress for an up-or-down vote, and then onto the President for signing.

A version of the RIC was introduced in the Senate and House in the last two years, with bipartisan sponsorship in both cases (S.1390, Regulatory Improvement Act of 2013, and H.R.4646, Regulatory Improvement Act of 2014). It has the virtue of embodying regulatory reform that can be embraced by both Democrats and Republicans, and conceivably be enacted even in today's tense political climate.

Let me mention several important characteristics of the RIC. First, it is specifically designed not to eliminate any Congressional prerogatives. Indeed, Congress gets two bites at the apple, once when the RIC is authorized and then again when the package of proposed rule changes comes through.

Second, and related, the RIC does not lean exclusively on a supposedly objective measure such as cost-benefit analysis. Instead, the RIC embraces the idea that regulations are a joint creation of the executive and legislative branches, with politics deeply embedded.

Finally, the RIC is about 'small steps to build trust.' Rather than big dramatic changes, the RIC is designed to show voters that Washington can get things done

Conclusion

Retrospective regulatory review sounds good, and can be unilaterally implement by the executive branch. However, in practice it falls short of expectations for fundamental reasons. We suggest that at the appropriate time, the Committee seriously considers the RIC legislation when it is re-introduced.

References

Aldy, Joseph E. 2014. "Learning from Experience: An Assessment of the Retrospective Reviews of Agency Rules and the Evidence for Improving the Design and Implementation of Regulatory Policy," November 17, 2014.

Government Accountability Office. 2007. "Reexamining Regulations: Opportunities Exist To Improve Effectiveness and Transparency of Retrospective Reviews", July 2007.

Lutter, Randall. 2013. "Regulatory Policy: What Role for Retrospective Analysis and Review?" *Journal of Cost-Benefit Analysis,* May 2013.

Mandel, Michael. 2014. "Hacking the Regulatory State," November 2014.

Mandel, Michael and Diana Carew. 2013. "Regulatory Improvement Commission: A Politically-Viable Approach to U.S. Regulatory Reform," Progressive Policy Institute Policy Memo, May 2013.

Sunstein, Cass. 2012. "Cumulative Effects of Regulations," Office Of Information And Regulatory Affairs, March 20, 2012.