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## IMPROVING GOVERNMENT CAPACITY TO ASSURE HIGH QUALITY REGULATION: DRAFT COUNTRY REVIEW OF THE UNITED STATES

**Meeting of the Regulatory Management and Reform Group, Public Management Committee,  
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## **CHAPTER 2: GOVERNMENT CAPACITY TO MAKE HIGH QUALITY REGULATION IN THE UNITED STATES<sup>1</sup>**

### **SUMMARY OF THE CHAPTER**

Can the national administration ensure that social and economic regulations are based on core principles of good regulation? Regulatory reform requires clear policies and the administrative machinery to carry them out, backed up by concrete political support. Good regulatory practices must be built into the administration itself if the public sector is to use regulation to carry out public policies efficiently and effectively. Such practices include administrative capacities to judge when and how to regulate in a highly complex world, transparency, flexibility, policy co-ordination, understanding of markets, and responsiveness to changing conditions.

Regulatory reform was pioneered in the United States and initiatives to improve the quality of national regulation have been underway for 25 years. They have been promoted mainly by the President, though recently the Congress has been more active. The most important general trend is the enormous shift since the 1970s away from anti-competitive economic regulation toward social regulation, which has greatly improved the benefits of the regulatory system as a whole, since social regulations are much more likely to produce net benefits than do economic regulations.

By many measures, the capacities of the U.S. federal government for assuring the quality of federal regulation are among the best in OECD countries. Considerable investments in the institutional, policy, and legal infrastructure for quality regulation has produced well-functioning systems in the critical areas of forward planning, regulatory impact analysis, centralised quality control, and consultation with affected entities. The public debate is intensive and well-informed. It includes input from academia and think-tanks which provide innovative ideas and critical analysis of efforts and progress.

But the U.S. regulatory system continues to have problems with both cost and policy effectiveness. The aggregate cost of regulations appears to stand at its highest level ever as a percentage of GDP, and the U.S. regulatory habits of excessive detail, legalism, and rigidity are still dominant. At the heart of the most severe regulatory problems is the poor quality of primary legislation, which severely limits, and threatens to reverse, the benefits to be gained from regulatory reform. A more structured process of rolling reviews of primary legislation could contribute to correcting some of these problems. Continuing efforts such as those in the National Performance Review process are needed to improve the responsiveness of the regulatory system. Substantial gains could be won by building capacities for government-wide priority-setting, reviewing policy areas rather than individual rules, and experimenting with use of advisory bodies for the reviews. Mandatory regulatory quality controls should be expanded to cover economic regulation. Operational guidance on use of alternative policy instruments could encourage regulators to be more innovative. Finally, co-ordination with the states on regulatory reform could preserve and extend the benefits of regulatory reform at the national level.

## 1. The institutional framework for regulatory reform in the United States

### 1.1. The administrative and legal environment in the United States

1. Like other OECD countries, the United States has over the course of a century constructed an enormous and complex regulatory state to provide to citizens a wide range of vital services and protections ranging from accessible buildings to safe food to a cleaner environment. In addition to new laws, over 60 executive agencies in the federal government are authorised to issue subordinate regulations. Each year, they issue between 4,000 and 5,000 new or proposed regulations. More than 200 volumes of federal rules are now on the shelves, and credible estimates of their direct costs as well as the value of their benefits for citizens and enterprises range from 4 to 10 percent of GDP.<sup>2</sup> The result is that “federal regulations now affect virtually all individuals, businesses, State, local and tribal governments, and other organisations in virtually every aspect of their lives or operations.”<sup>3</sup>

2. The role of regulation in American governance is at the centre of an intensive decades-long debate involving *ideological* issues of the role of the State in society; *economic* issues of the role of regulation in a dynamic and innovative economy integrating into world markets; *social* issues of the services and protections that should be provided by the State to its citizens; *federalist* issues of the balance between federal powers and state rights; *institutional* issues rooted in the constant struggle between the powers of the Congress, the President and the Executive Branch; and the judiciary; and *constitutional* issues of individual property rights versus collective rights.

#### **Box 1: GOOD PRACTICES FOR IMPROVING THE CAPACITIES OF NATIONAL ADMINISTRATIONS TO ASSURE HIGH-QUALITY REGULATION**

The OECD Report on Regulatory Reform, which was welcomed by Ministers in May 1997, includes a co-ordinated set of strategies for improving regulatory quality, many of which were based on the 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation. These form the basis of the analysis undertaken in this chapter, and are reproduced below:

##### A. BUILDING A REGULATORY MANAGEMENT SYSTEM

1. Adopt regulatory reform policy at the highest political levels.
2. Establish explicit standards for regulatory quality and principles of regulatory decision-making.
3. Build regulatory management capacities

##### B. IMPROVING THE QUALITY OF NEW REGULATIONS

1. Assess regulatory impacts
2. Consult systematically with affected interests
3. Use alternatives to regulation
4. Improve regulatory co-ordination

##### C. UPGRADING THE QUALITY OF EXISTING REGULATIONS

(In addition to the strategies listed above)

1. Review and update existing regulations
2. Reduce red tape and government formalities

3. Each President since Nixon has vowed to control the costs of the expanding federal regulatory state and to carry out policies more cost-effectively, while at the same time supporting the establishment of major new regulatory programmes. The balance of federal action has shifted from deregulatory “regulatory relief” under Reagan to the Clinton philosophy of “regulatory quality” based on the idea that “The American people deserve a regulatory system that works for them, not against them.”<sup>4</sup> Fueling the debate is a veritable industry of regulatory reform analysis produced by think tanks and academia, by well-funded and energetic interest groups, and by Congressional, Presidential, and state offices, who constantly recycle old ideas and develop new variants to reform the regulatory system.

4. The intensity and visibility of the debate on regulation is characteristic of policy-making in the United States. As in any country, the legal and administrative culture reflects the values implicit in the organisation of state, market, and society. In the United States, the nature and concept of regulation have been shaped by many values, key among them being traditional concerns for property rights and the rights of the individual (increasingly including rights to be free of externalities imposed by others); positive views of competition as consistent with individual self-reliance and risk-taking; and a preference for universal and specific processes and rules that bind everyone “fairly” (including the government). The tensions among these values explain much of the current debate on regulatory reform.

5. In many ways, the administrative and legal culture shaping regulation in the United States is the converse of that found in corporatist countries, where decisions are traditionally consensual and the administration has wide discretion in application, often sharing powers with organised market interests. Administrative action in the United States is taken within a strongly legalistic and adversarial (rather than co-operative) environment based on open and transparent decision-making, on strict separation between public and private actions; and on competitive neutrality between market actors. There are endless opportunities for anyone with an interest to challenge regulatory decisions before the courts on procedural and substantive grounds, which in theory enables regulated bodies to challenge and hold accountable the regulatory powers of the government.

6. These styles of the U.S. regulatory system, in particular its aversion to competition controls as an instrument of social policy, have helped create the regulatory framework for one of the most entrepreneurial and dynamic economies in the world, while establishing high levels of protection for consumers, workers, and the environment. The highly open, pluralist, and participative rulemaking process -- in which multiple interest groups compete at every stage to have their concerns heard and reflected in the outcome -- is seen as essential to legitimacy (by avoiding “capture” by special interests) and to informed decision-making.<sup>5</sup>

7. Yet legalistic and adversarial styles have also produced what comparative studies of the American system find are more complex, detailed and inflexible regulations than those in other OECD countries. This undermines the results and raises the cost of policies.<sup>6</sup> Experts have noted that “many of the laws Congress has passed call for highly prescriptive and often excessively costly regulation.”<sup>7</sup> A study of nursing home regulation found that the United States had adopted over 500 federal nursing home standards, supplemented by state standards that doubled or tripled the volume of regulation. Australia had adopted only 31 broad results-oriented standards. Yet it was the Australian standards that produced the best results and best compliance, and by a very wide margin. The pursuit of reliability in U.S. regulations produced so much complexity and detail that they reduced the performance of the whole. A vicious cycle was seen: disappointment with regulatory performance produced demands to “tighten up” standards, which further worsened the problem of complexity and rigidity.<sup>8</sup>

8. The regulatory process has become so encumbered that the term “ossification” has been used.<sup>9</sup> Procedures and relations with regulated entities tend to be highly formalised. One inquiry found a federal agency that needed an 18-foot chart, with 373 boxes, to explain its rulemaking process, and “this process was not unusually complex.”<sup>10</sup> A recent book warning against U.S. regulatory complexity noted that “modern regulatory law resembles central planning,” and identified the cause as an extreme application of the core American distrust of government discretion: “By imposing conditions on coercion, due process ensures our freedom.”<sup>11</sup> Calling for a return to “common sense”, the book became a national best-seller.

9. There is considerable concern over the costs and benefits of federal regulation in the United States, though as in other OECD countries the costs of regulation continue to receive less attention than the costs of direct government spending. Several studies carried out in recent years suggest that federal regulation costs several hundred billion dollars annually. Most recently, the office of the President reported to Congress that federal regulations -- defined as social environmental, safety, and health regulation, and economic controls on entry and prices -- cost \$279 billion/year, and produce \$329 billion<sup>12</sup> in benefits. According to the report, social regulations seem to produce more benefits than costs, while economic regulations probably reduce social welfare. In addition, the annual costs of federal paperwork for citizens and businesses has been estimated at around \$230 billion.<sup>13</sup> The total direct costs of regulation and paperwork appear to be on the order of 10 percent of GDP.

10. These studies recognise that such benefit and cost estimates are very uncertain. For example, the direct costs are significant understatements of the full costs of regulations, including impacts on productivity and welfare.<sup>14</sup> Indirect beneficial effects that may result from better health and longer lives are not included, either. There are significant methodological problems, such as that the estimates mix very different data sources.<sup>15</sup> Yet these estimates are a very large advance in understanding the costs and benefits of regulatory activities, and work is underway to improve them. Unfortunately, these aggregate cost estimates cannot be compared with those of other OECD countries due to an almost total lack of such data outside of the United States.

11. These kinds of global estimates are not very useful, however, in assessing whether particular regulations are beneficial, nor whether the regulatory costs maximise net benefits. In both cases, data at the micro-level suggest that the opportunities for improving the cost-effectiveness of federal regulation are very large. Research suggests that more than half of the federal government’s regulations fail a strict benefit-cost test, using the government’s own estimates.<sup>16</sup> Studies have repeatedly shown that redirecting regulatory activities away from low-priority to high-priority issues would have enormous payoffs in terms of delivering benefits to citizens at lower cost. For example, safety and health regulations aimed at reducing fatality risks have saved lives at costs ranging from \$10,000 to \$72 billion per life saved.<sup>17</sup> A recent study found that if existing regulations were re-targeted at those health and safety risks where lives could be saved at lowest cost, some 60,000 more deaths could be avoided each year without increasing regulatory costs.<sup>18</sup>

12. *Checks and balances in the U.S. regulatory system.* As is typical for a system based on common law, there is no common approach to the design of institutions nor the nature of delegated powers in the U.S. federal government. Reflecting the influences from the Congress, the Executive Branch, the courts, and the states, each law and regulatory body is unique. The only common element of rule-making is procedure. Among the milestones in U.S. regulatory reform was the establishment of common procedures for making new regulations that has produced one of the most open regulatory processes in OECD countries (section 2.1).

13. Legislative branch. All regulation starts in an act of Congress that defines the goals of regulatory programmes, identifies the agency responsible for achieving them, and contains substantive and procedural requirements as to how the agency will work.<sup>19</sup> Hence, the quality of law is a crucial issue for regulatory quality at all levels. Delegations of regulatory authority to the public administration vary widely. In some cases, laws are so specific that they require no subordinate regulations. In other cases, laws are so broad and general that subordinate regulations determine their impacts. In these cases, federal regulatory agencies have wide substantive discretion on when, what and how to regulate. A trend is underway, however, toward more detailed laws that circumscribe administrative discretion. This trend is rooted in Congressional frustrations about the performance of regulatory agencies and the continual tussle between the Congress and the President for control over policy. It has given rise to concerns that the Congress is “micro-managing” regulatory decisions, particularly in environmental protection, in ways inconsistent good regulatory decisions and innovation. Congressional oversight after regulations are developed is also quickly increasing. Since 1996, final regulations are tabled before the Congress for review, and since 1993 regulators are required to set performance standards for their actions.

14. Executive Branch. The President has constitutional authority to oversee the activities of the executive branch, but the wide range of designs in regulatory bodies varies the extent to which he can control their actions. In general., federal regulatory bodies are organised in two ways: as executive departments and agencies directly accountable to the president (which include most of the social regulatory agencies) or as independent commissions (a model begun in 1887 with the Interstate Commerce Commission) whose officers are appointed by the president, with the consent of the Senate, but whose terms are fixed by law (which include most of the economic regulatory agencies). The heads of some regulatory agencies are Cabinet officers; others are not.

15. Judiciary. No discussion of U.S. regulation would be complete without acknowledging the role that the courts play in regulatory decisions. “The courts have played a profoundly important role in setting the limits of congressional, presidential, and even judicial influence over regulatory policy-making in the agencies...the courts are empowered to hear variety of challenges to regulatory decisions, ranging from the delegation of authority to agencies by Congress to the legality and fairness of agency dealings with individual regulated parties.”<sup>20</sup> Legal challenges are the norm rather than the exception. In the environmental area, almost every major regulation is challenged in court. The workings of the common law system led to the emergence of a single judge as the *de facto* regulator of the huge telecommunications industry. An assessment of the impact of the courts on regulatory quality is beyond the scope of this review, but it is fiercely debated. For example, since successful legal challenges can be based on the poor quality of information and analysis, judicial review may have promoted the use of empirical analysis by regulators.

16. The States. Finally, regulation in the United States is a complex mixture of federal, state, and local rules and enforcement responsibilities. The 50 state governments have legal and regulatory authority in their areas of competence, including all areas not expressly pre-empted by federal legislation, and may delegate legal and regulatory authority to regional, local, or municipal governments. Interactions between federal and state regulatory powers are in constant flux, with concentration in some policy areas and decentralisation in others. The states are often seen as laboratories for regulatory innovation and experimentation, but, as in other federal governments, however, the United States has experienced a dramatic and increasing centralisation of regulatory power toward the federal level.<sup>21</sup>

**Box 2: MILESTONES IN MANAGING REGULATORY REFORM IN THE UNITED STATES**

- 1971** Quality of Life Review is undertaken as a means of improving regulatory co-ordination.
- 1974** Inflation Impact Statements are prepared for major regulations by the Council on Wage and Price Stability
- 1978** Economic Impact Analysis is conducted by regulatory agencies and CWPS.
- 1980** Office of Information and Regulatory Affairs (OIRA) is established by the Paperwork Reduction Act to provide centralised paperwork review and information management.
- Regulatory Flexibility Act requires agencies to assess the impact of regulations on small entities and publish regulatory activities in annual Agenda of Federal Regulations
- 1981** Presidential Taskforce on Regulatory Relief is established (a Cabinet level regulatory policy group, chaired by the Vice President). OIRA is responsible for formal regulatory review ( policy and analytical oversight).
- Regulatory Impact Analysis (including mandatory benefit-cost analysis) is established.
- 1985** Regulatory planning process is established, including publication of annual Regulatory Program of the US Government, containing descriptions of about 500 “significant” regulations under development.
- 1989** Council on Competitiveness (Cabinet level regulatory policy group chaired by Vice President) is established.
- 1993** Regulatory review and benefit-cost analysis are reaffirmed by President Clinton; Regulatory Working Group is established to advise the Vice-President.
- National Performance Review is established under the Vice President to “reinvent” government on results-oriented principles.
- 1995** Unfunded Mandates Reform Act provides a statutory basis for government-wide RIA for the first time.
- Amended Paperwork Reduction Act widens OMB authority and requires OIRA to establish government wide and agency specific paperwork reduction goals.
- 1996** Small Business Regulatory Enforcement Fairness Act toughens requirements to consider small business impacts of regulations

17. The effect of this tumultuous and complex environment, and its opposing values and institutions, on the quality of the national regulatory system and on developing a capacity to better manage federal regulatory powers is one of the key questions facing the United States. Amid this complexity and diversity, the great challenge of regulatory management and reform in the federal government has been construction of government-wide quality principles and processes of regulatory quality control. This requires both “discipline and flexibility” in the reform programme to accommodate such variety.<sup>22</sup>

18. Even this goal has been contested. The development of regulatory quality controls in the federal government has been characterised, to a degree unusual among OECD countries, by tension between, on the one hand, the need for clearer political accountability and stronger 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). This debate continues.

**1.2. Recent regulatory reform initiatives to improve public administration capacities**

19. The focus of reform shifted in the 1980s from economic deregulation to fast-growing social regulation. Today, the U.S. is rare among OECD countries in focussing on improving the quality of social regulations and reducing paperwork burdens as the main objectives of regulatory reform. This is rational, since estimates of the costs of federal regulation suggest that social regulations impose costs 3 to 4 times higher than do economic regulations.<sup>23</sup> For the Congress and the Executive, the 1990s have been an active period for regulatory reform in the United States (see box 2 for milestones).

20. In 1993, President Clinton issued a presidential order on “Regulatory Planning and Review” that aimed at “building the foundation for a regulatory system that will improve the lives of Americans without imposing undue costs and burdens.” Building from earlier orders issued by Presidents Reagan and Bush, it mandated for regulators a programme of regulatory quality standards, rational decision procedures, development of consensual rather than adversarial approaches, promotion of innovative policy instruments, and centralised oversight by the Office of Management and Budget of the most important regulations.

21. A systemic view of institutional reform and the “culture” of the public administration was taken with the launching of the National Performance Review (NPR) under Vice-President Al Gore in 1993. The NPR aims to “move from red tape to results to create a government that works better and costs less.” Under the goal of “eliminating regulatory overkill,” the Review recommended 10 reforms that are similar to best practices accepted by OECD countries, including:

- encourage more innovative approaches to regulation
- encourage consensus-based rulemaking
- streamline agency rulemaking procedures
- rank risks and engage in “anticipatory” planning
- provide better training and incentives for regulators

The NPR has been a key mechanism for identifying existing regulations for review and driving review activity, and five years on remains a major reform mechanism in the administration.

22. Another legislative tool with impacts on regulatory reform is the Government Performance and Results Act of 1993. This legislation requires government departments to prepare and submit to Congress strategic plans which cover ten specific issues: mission statement, strategic goals and objectives, strategies to achieve goals, relationship between general goals and annual performance goals, key external factors, programme evaluations, treatment of cross-cutting functions, treatment of major management problems, data capacity and Congressional and stakeholder consultations. These strategic plans are supplemented by a government-wide and agency specific annual performance plans, the first of which were required by the act in February 1998.

23. By increasing accountability, including explicit identifications of strategies and goals, the Results Act is intended to provide a clear stimulus to regulatory reform efforts, as the failings of ineffective regulation become more transparent and accountability to the legislature is increased. Its own performance in this respect is not yet demonstrated.



24. The 104th Congress (1995-1996) debated a raft of legislation on regulatory reform. Significant laws emerging from the debates include the Unfunded Mandates Reform Act of 1995, the Paperwork Reduction Act of 1995 and the Small Business Regulatory Enforcement Fairness Act of 1996. These are discussed below.

25. *Background.* The current programme builds on 25 years of earlier efforts that saw the development of two very different reform trends: deregulation of economic controls, and establishment of quality standards and processes for new social regulations and federal paperwork.

26. *Economic deregulation.* Economic objectives with respect to price stability, competition, job creation, and trade have provided strong and consistent support for regulatory reform efforts. The economic recession and surge of inflation that began in 1974 made regulatory costs for the first time "a national preoccupation"<sup>24</sup>, and President Nixon directed that major regulations be assessed for inflationary impact. In 1980, the Congress resolved that the president should implement a "Zero Net Inflation Impact" policy that would require existing regulations to be eliminated as new regulations were added.<sup>25</sup> This unrealistic resolution was soon forgotten.

27. Deregulation became central to economic policy in the mid-1970s as evidence grew that government intervention was needlessly restricting competition and harming the performance of many sectors. This led to unprecedented regulation in many areas: financial deregulation (abolition of fixed brokers' fees) began in 1975, followed by deregulation of the railroads (1976), air cargo (1977), airlines and natural gas (1978), satellite communications (1979), trucking, railroads again, financial institutions, cable television (1980), petroleum, radio (1981) and buses and communications equipment (1982). Replacement of price and entry controls with pro-competitive regulatory regimes, backed up by strong competition policies, continues today in many sectors (see Chapters 1, 3, 5, and 6).

28. *Quality of social regulation.* Attempts to impose quality controls on the use of delegated regulatory powers in social policy areas began in the 1970s "in reaction to the explosive growth of new regulatory programs" of the 1960s and 1970s.<sup>26</sup> By the mid 1970s, over 100 federal agencies were issuing economic and social regulations in areas such as health, safety, housing, agriculture, labour contracts and working conditions, environment, trade, and consumer protection. Their output was voluminous: the Code of Federal Regulations (the comprehensive collection of federal regulations) grew from 9,745 pages in 1950 to more than 100,000 pages by 1980 to almost 140,000 pages by 1995.

29. The new social regulations affected a far broader cross-section of economic, production and consumption activities than had older-style economic regulation, and hence they were far more visible and interactive. The administrative and economic side-effects of rapid regulatory expansion began, in the late 1960s, to command political attention. Conflict and duplication, for example, between various regulatory agencies occurred more and more frequently. Regulatory costs, both on and off-budget, escalated. The administrative on-budget costs of federal regulatory activities rose from \$4 billion in 1970 to over \$11 billion by 1994, while staffing of regulatory agencies rose from 70,000 to over 128,000 in the same period.<sup>27</sup>

30. Through the 1980s, new data on aggregate direct and indirect regulatory costs drew increasing attention to the cumulative economic burden of social regulations. By 1992, studies had estimated the economic costs of federal regulation as being as much as \$540 billion per annum, or about 10 per cent of GDP<sup>28</sup> and indicated that the costs of social regulation exceeded those of traditional economic regulation. Other studies suggested that workplace and environmental regulation had had significant negative effects on productivity.<sup>29</sup> As information about such regulatory costs improved, regulation began to be viewed as

a form of government spending that should be controlled as systematically as fiscal expenditures (see discussion of regulatory budgeting in box 8).

31. Criticism grew of the failure of detailed regulations to keep up with changing social, economic and technological conditions. By the 1980s, a political backlash against regulation had emerged, fueled by the economic crisis of the time. The message was simple: "American life is burdened by too much regulation".<sup>30</sup> To federal officials, the problem was that existing control and oversight processes were not suited to regulations. "The response from the vast array of entities subject to the new forms of regulation created an urgent demand for greater co-ordination, rationality, and executive accountability in the regulatory process," wrote the Office of Management and Budget. New means were needed to manage the enlarged federal regulatory structure.

32. *Co-ordination* between overlapping and inconsistent regulatory programs was the earliest objective of regulatory reform, and has continued to be an important stimulus, under both major political parties, for stronger central management. The first presidential initiative to improve regulatory management, a "Quality of Life Review", established in 1971 -- was intended to improve interagency co-ordination in expansive areas of regulation. In 1978, interagency consultation and co-ordination were further strengthened, and presidential orders on regulatory reform in 1981, 1985, and 1993 setting up and refining centralised regulatory oversight in OMB were intended in part to "minimise duplication and conflict" between regulations.

33. Co-ordination expanded over time from a focus on "consistent rules" to a wider focus on how to better balance competing values through the regulatory and political system. In 1986, the director of the White House Office of Management and Budget declared that "regulatory disarray" had resulted because "regulatory agencies, individually and collectively, did not appreciate the impact or the burden of what they were doing" and that "the regulatory system is desperately in need of a mechanism for balancing the demands of competing and conflicting regulatory agencies and programs."<sup>31</sup> Regulations, according to OMB, must fit into the larger legal, social and economic context.

34. In 1981, President Reagan made "regulatory relief a top priority...one of the cornerstones of my economic recovery program." Agencies were directed to "weed out and eliminate wasteful, unnecessary, intrusive regulatory standards". Late in the 1980s, competitiveness in opening global markets became key to the regulatory reform program. "Domestic policies, including regulation, have to be considered in the much larger context of our ability to compete in an international economy," OMB stated in 1987. In 1989, regulatory reform was linked directly to U.S. trade policy when President Bush established the cabinet-level Council on Competitiveness, chaired by the Vice-President, to review major regulatory issues. The Council was abolished by President Clinton in 1993 due to concerns about lack of transparency and bias toward business concerns.

35. Another theme which has been prominent since the early days of reform and remains a major consideration is the particular regulatory difficulties of small and medium Enterprises (SMEs), particularly by actions to reduce the administrative and paperwork burdens associated with regulatory requirements. As early as 1980, legislation was passed to require assessment of the impact of new regulations on SMEs. Further legislation has followed, with the most recent being the Small Business Regulatory Enforcement Fairness Act of 1996.

## 2. Drivers of regulatory reform: national policies and institutions.

### 2.1. Regulatory reform policies and core principles

36. The 1997 *OECD Report on Regulatory Reform* recommends that countries “adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.”<sup>32</sup> The 1995 *OECD Council Recommendation on Improving the Quality of Government Regulation* contain a set of best practice principles against which reform policies can be measured.<sup>33</sup> The content of, and formal political commitment for, U.S. regulatory reform policies demonstrates a high level of consistency with these recommendations.

37. The current reform policy for the executive branch establishes clear political accountability at the highest political levels. The framework reform policies are established directly by the President on the basis of his executive authority. In the current executive order, the Vice President is identified as the principal advisor to the president on regulatory policy, planning and review, OMB (part of the White House office) as the “repository of expertise” on regulatory issues, and the head of the Office of Information and Regulatory Affairs (appointed by the president) as the co-ordinator of the policies. These administrative policies are backed up in some respects by laws supporting central review and impact analysis.

38. During the Clinton Administration, the National Performance Review has constituted another powerful mechanism for regulatory reform. The NPR is conducted under the responsibility of the Vice-President, thus further strengthening political commitment to reform, and responsibility for it, at the highest levels.

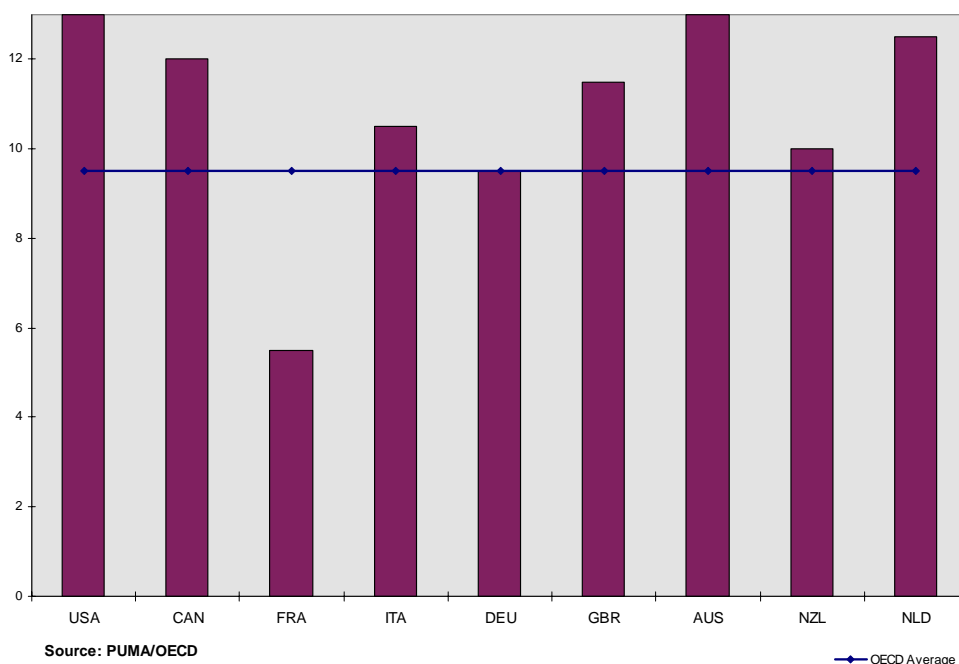
39. Consistent with the OECD recommendation that governments “establish principles of ‘good regulation’ to guide reform,” explicit standards for regulatory quality have been adopted, as have principles of regulatory decision-making. Clinton’s 1993 executive order is the primary reference for regulatory quality standards. The order requires that agencies take a “minimalist” approach to regulation, by promulgating “..only such regulations as are required by law, are necessary to interpret the law or are made necessary by compelling public need, such as material failures of private markets....”<sup>34</sup> It requires regulators to:

- identify the problem to be addressed and assess its significance
- identify and assess alternatives to direct regulation, including economic incentives and information, and use performance standards to the extent possible if regulation is chosen
- set priorities by considering the degree and nature of risks from different sources
- if regulation is the best method, to design it in the most cost-effective way
- regulate only upon a reasoned determination that benefits justify costs
- base decisions on best, reasonably obtainable information on the need for and consequences of regulation
- avoid regulations that are inconsistent or duplicative with other regulations
- draft regulations to be simple and easy to understand.

**Box 3: Indicators of policy commitment to regulatory reform in selected OECD countries<sup>35</sup>**

*In this synthetic indicator of the formal commitment to and comprehensiveness of regulatory reform policies (based on self-assessment), the U.S. receives a very high score. This indicator looks at several broad aspects of reform policy, and ranks more highly those that cover all policy areas of regulation, that establish explicit standards for regulatory quality, and that are accountable to the highest political levels. The OECD-area average score is high, reflecting a strong policy commitment to reform among Member countries. The United States ranks among the highest among OECD countries on this indicator, indicating that much of the machinery of reform is in place. It must be noted, however, that the U.S. regulatory quality policy does not cover independent regulatory commissions, a gap in the programme that is not picked up in this indicator.*

**Explicit policy commitment to regulatory reform**



40. These and similar principles in place since 1981 represent a critical shift in U.S. regulatory culture: they reversed the burden of proof for regulation (by, for example, ordering that regulations not be issued unless regulators showed that benefits justified costs). Under this programme, regulators themselves must show why they should regulate, and demonstrate that regulation is the most beneficial feasible approach. Uncertainty and lack of information work against rather than for regulation.

41. It is notable that the United States is one of only a handful of OECD countries to adopt a strict benefit-cost test for regulations. The OECD has recommended as a key principle that regulations should “produce benefits that justify costs, considering the distribution of effects across society.” Such a test is the preferred method for considering regulatory impacts because it aims to produce public policy that meets the criterion of being “socially optimal” (i.e., maximising welfare).<sup>36</sup>

42. Maximisation of social welfare, perhaps the broadest conceivable aim of reform, was placed alongside regulatory relief in 1981 as a major objective of regulatory reform. The 1981 presidential order was the first to explicitly require that new regulations pass a social benefit-cost test and that regulatory objectives, not just individual rules, “be chosen to maximise the net benefits to society”. The president,

OMB said in 1991, seeks "a regulatory structure that appropriately balances the benefits and costs of Federal regulations for the country's long-term well-being..."<sup>36</sup>

43. Although the economic concept of social welfare as articulated by OMB has always been quite broad, including both quantifiable and non-quantifiable benefits and costs, the benefit-cost test has drawn heavy criticism from those who believe that, in practice, quantified costs to businesses are given more weight than non-tangible social benefits. Regrettably, the Reagan Administration continued through the 1980s to emphasise regulatory "relief," a goal not consistent with the principle of maximising social welfare. This had the effect of confusing the purpose of benefit-cost analysis and reducing its credibility.

44. In his 1993 order, President Clinton reaffirmed the importance of the benefit-cost test and stated that maximising social welfare is the aim of the regulation, but took care to recognise that "some costs and benefits are difficult to quantify" and that net benefits can include "potential economic, environmental, public health and safety, and other advantages, distributive impacts, and equity."<sup>37</sup>

## **2.2. *Mechanisms to promote regulatory reform within the public administration***

45. Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed to keep reform on schedule, and to avoid a recurrence of over-regulation. As in all OECD countries, the United States emphasises the responsibility of individual heads of regulatory bodies for matters within their portfolios. Each regulatory body has responsibility for the implementation of its policies within the constraints of the president's regulatory quality policy.

46. But it is often difficult for regulators to reform themselves, given countervailing pressures, and maintaining consistency and systematic approaches across the entire administration is necessary if reform is to be broad-based. Hence, to manage the large and complex U.S. regulatory system, the United States has established a series of oversight mechanisms. Both the president and the Congress carry out strong regulatory oversight, the president through a central management office accountable directly to him, and the Congress through a system of oversight committees organised largely along program lines, and through investigations by its organs such as the General Accounting Office. The concerns of the two branches of government may not always coincide; a congressional committee, for example, may focus on implementation of a specific regulatory law, while the president may focus on the functioning of the regulatory system as a whole and its consistency with his policies.

47. In the executive, competition between president and Congress for influence over regulatory decisions has contributed to the emergence of an unusually centralised and hierarchical regulatory oversight process. In particular, the role of the Office of Management and Budget within the Executive Office of the President is among the most powerful of the central oversight bodies in any of OECD countries. This reflects the strong constitutional powers of the President in overseeing the executive branch, and for that reason OMB is probably not a feasible model for OECD countries with parliamentary systems.

48. The OMB has had a strong co-ordination, reviewing, and reporting role in relation to regulatory reform since the earliest days of the policy. Well resourced and located at the very centre of government, OMB is responsible for many central management tasks of government closely linked to regulatory reform. These include preparation of the President's budget, legislative review, information policy, and procurement policy. The traditional government-wide authority of OMB and its control of many levers of influence in the public administration has given it the potential for enormous authority in promoting broad-based reform. This is an important lesson from the U.S. experience.

49. A distinguishing characteristic of the Office of Information and Regulatory Affairs (OIRA) in OMB is its intimacy with every stage of regulatory decision-making in the agencies. President Reagan's 1981 order and subsequent orders have placed OMB firmly and unavoidably within the normal process of regulatory development. It reviews the most important regulations no less than three times: (1) at the planning stage during preparation of the annual Regulatory Plan; (2) at the proposed stage before they are published for comment in the Federal Register (the national gazette); and (3) at the final stage before publication as a finished rule. OIRA's role is to review the regulations and the impact analyses in order to identify decisions and policies that are not consistent with the president's policies, principles, and priorities; to co-ordinate among agencies; to discuss any inconsistencies with the regulators, and to suggest alternatives that would be consistent. OIRA is, in effect, the President's trusted intermediary in communicating with the regulatory apparatus of the federal government.

50. In addition, OIRA has legal authority under the Paperwork Reduction Act to review and nullify any "information collection" requirement imposed on citizens, businesses, or state and local governments. This far-reaching authority is described in more detail in section 4.

51. Closeness to Presidential power is a two-edged sword. When OMB has the support of the President, it ranks among the most effective of regulatory reformers in the OECD area. Yet the President has other policy priorities as well as regulatory reform priorities, and OIRA has not always enjoyed consistent support. 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 many conflicting claims.

52. The growing role of OMB has also raised concerns about fairness and accountability. During the Reagan administration, OMB regulatory review attracted considerable opposition on the grounds that the presidential supervisory program had "the potential to transgress substantive or procedural substantive limits"<sup>38</sup> and that it intruded on the decision-making authority of the regulatory agencies. Critics charged that the review program was a "pervasive and persistent" effort "to shift the locus of discretionary decision-making authority from the agencies designated by the Congress to OMB."<sup>39</sup> Efforts to make the OMB review more transparent have laid to rest many of these concerns, and centralised presidential oversight of regulation has today become a permanent and routine element of the Washington policy-making apparatus.

53. The Small Business Administration has a role, too, in reviewing assessments of small business impacts.

54. A long running theme of central management has been enhancing accountability for regulatory decision-making in a sprawling and fragmented regulatory system. Centralisation of review authority in the Office of the President is a means of exercising oversight on broad discretionary powers delegated to unelected officials. Such semi-legislative delegation has been described as "counter to the basic democratic tenets" of the U.S. system of government, requiring new forms of political oversight.<sup>40</sup> On practical grounds, the regulatory system seemed increasingly distant from elected officials: "...costly regulations... germinating and percolating through several Administrations, became creatures seemingly immune to political or policy influence, gaining and retaining a life of their own," complained OMB. Oversight of the regulatory system was placed in the Office of the President to enable the president to carry out his constitutional responsibilities as Chief Executive: "...because the President is accountable to the public -- the voter -- for how his appointees execute the law, he is obligated to oversee and manage what they do."<sup>41</sup> The high priority placed on better regulatory analysis reflected a belief that regulators would not truly be accountable to the electorate unless the consequences -- the social benefits and costs -- of their actions were known.

### 2.3. *Co-ordination within and between levels of government*

55. The 1997 OECD Report advises governments to “encourage reform at all levels of government.” This difficult task is increasingly important as problems and regulatory responsibilities are shared among many levels of government, including supranational, international, national, and subnational levels. High quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels, while, conversely, co-ordination can vastly expand the benefits of reform. Given the structure of the United States as a federation of fifty states, co-ordination of regulatory and its reform between levels of government is of major importance.

56. The States have constitutional authority to issue laws and regulations in areas not pre-empted by Federal law, while the federal government also delegates authority to the states to implement many federal regulatory programmes, often on a cost sharing basis. Municipalities and local governments, such as counties, are creations of the states, and typically have regulatory and legal authorities of their own. A substantial volume of regulation is issued by the states, and, like the federal government, state governments are regulating more. "This increased rulemaking activity threatens to rival, or even replace, state legislatures as the principal source of new laws emanating from state government," an observer wrote in 1990.<sup>42</sup> Federal regulatory reform does not affect state regulations, and OMB has not done very much to promote reform at the state level. Many of the states, however, have employed some form of review to oversee their own regulatory agencies, and 27 states require economic impact analysis for their proposed rules.<sup>43</sup>

57. Expansion of federal regulation over many decades has centralised more and more regulatory authority in the federal government. The federal government has also increasingly regulated the activities of the states themselves, by mandating large new burdens and costs that have often proved difficult for state and local governments to finance. In the 1960s and 1970s “federal mandates and regulations began to rival grants and subsidies in importance as federal tools for influencing the behaviour of state and local governments”<sup>44</sup>

58. A more “structural” critique also developed: In 1986, the Working Group on Federalism established by the White House concluded that “expansive, intrusive and virtually omnipotent national government” had transformed state governments from being “the hub of political activity ... into administrative units of the national government”. Federalism was soon after officially established as a regulatory principle, with President Reagan ordering in 1987 that regulations should pre-empt state authority only if required by Congress or if necessary to address a problem of national scope.

59. The continued importance of this issue was demonstrated by the adoption in 1995 of the Unfunded Mandates Reform Act. This Act is important in a number of areas and is discussed below. However, from the point of view of federalist relations the key requirement is for a cost-effectiveness analysis of any regulation that would impose costs of more than \$100 million per annum on state, local or tribal governments. OMB and the Congressional Budget Office both scrutinise compliance, and the analytical requirements

60. The Federal government has recently begun to pay more attention to co-ordination of Federal regulatory actions with those at state and other levels. The Clinton presidential order states that “respect” for other levels of government is fundamental, and instructs regulators to consult earlier with state, local, and tribal authorities. In some cases, progress has been seen in developing new consultation capacities to harmonise regulations among many jurisdictions. The Great Lakes Water Quality Initiative is a comprehensive plan to restore and maintain water quality in the Great Lakes Basin. It was the result of a collaborate effort by EPA, eight state governments, environmentalists, and local representatives. The

flexibility for states to adapt standards to their own needs is expected to reduce the costs of protection. Such examples are not, however, very common, and there is enormous scope for further progress in co-ordinating regulatory approaches among levels of government.

### **3. Administrative capacities for making new regulation of high quality**

#### **3.1. Administrative transparency and predictability**

61. Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. Just as important is the role of transparency in reinforcing the legitimacy and fairness of regulatory processes. Transparency is a multi-faceted concept that is not easy to change in practice. It involves a wide range of practices, including standardised processes for making and changing regulations; consultation with interested parties; plain language in drafting; publication, codification, and other ways of making rules easy to find and understand; and implementation and appeals processes that are predictable and consistent. The U.S. regulatory is one of the most transparent among OECD Members, but some problems merit attention.

##### *Transparency of procedures: administrative procedure laws*

62. The 1946 Administrative Procedure Act (APA) established a legal right for citizens to participate in rulemaking activities of the federal government on the principle of open access to all. The APA sets out specific requirements for administrative procedures to be followed in promulgating subordinate regulation, and hence meets the OECD benchmark in this area. The key mechanism through which participation occurs is known as “notice and comment” (described in more detail in the section on consultation, below).

##### *Transparency for affected groups: forward planning of regulatory actions*

63. The United States has had for many years an extensive planning system for regulations under development that ranks among the most developed in OECD countries. There are two major planning documents:

- The *Unified Agenda of Federal Regulatory and Deregulatory Actions* is published twice a year. It provides information in a common format to help the public identify which new regulations will affect them. All entries include information about the regulation’s priority, its affect on SMEs and other levels of government, whether it is part of the NPR programme, an abstract and timetable for action.
- The *Regulatory Plan* is published annually as a defining statement of the Administration’s regulatory and deregulatory policies and priorities. Entries are restricted to only the most important regulations, and contain a statement of need, a description of the alternatives considered, and description of the magnitude of risks and risk reduction expected.

64. The October 1997 document that combined both the *Agenda* and the *Plan* is 1,600 pages long, and contains over 4,000 entries from more than 60 federal departments and regulatory agencies. A subject index is included. The documents are produced through a computer regulatory tracking system maintained by the Regulatory Information Service Center, which also provides information about federal



regulatory activities to the president, his Executive Office, the Congress, regulatory agencies, and the public.

65. The forward planning process has been a core element of the regulatory quality control system. In 1985, President Reagan ordered that federal agencies conduct, under the oversight of OIRA, an annual process of regulatory planning that would produce the *Regulatory Program of the United States Government*, to be issued under the president's signature. The planning process was intended to improve interagency co-ordination, establish the president's regulatory priorities, increase the accountability of agency heads for the regulatory actions of their agencies, and improve public and Congressional understanding of the president's regulatory objectives.<sup>45</sup> Regulatory planning was needed because regulation was "one of the most important and costly activities of government," yet, despite the regulatory review process set up in 1981, it was "managed far less systematically than direct government spending."<sup>46</sup>

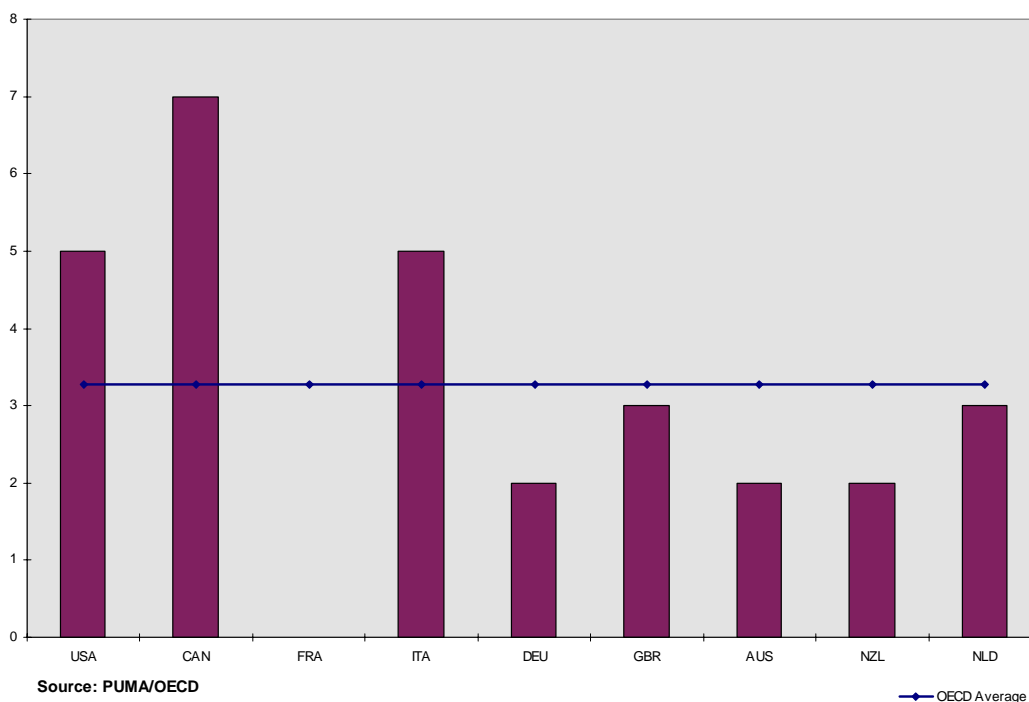
66. According to OMB, regulatory planning also put into place a more rigorous and careful priority-setting process:

*Scarce government resources must be allocated according to some set of priorities. Given his Constitutional responsibilities, the President decided that regulatory priorities should not be determined unilaterally by each agency. Rather, these priorities should be selected by the President's Administration as a whole, through a process that takes into account a wide spectrum of agency demands and Presidential policies.*<sup>47</sup>

67. The 1993 Clinton executive order retained forward planning, and put more emphasis on its value for communication and consultation. The regulatory plan made it possible for the citizen "to be a well-informed participant in the regulatory matters that affect your life," Vice-President Gore wrote to the readers of the 1997 Regulatory Plan.<sup>48</sup>

**Box 4: Forward planning of regulatory activities.**

*In this synthetic indicator of the scope of forward planning of regulatory activity, the United States ranks among the highest in OECD countries. Based on self-assessment, this indicator measures the extent to which governments collect and publish information on new legislative and regulatory proposals and its availability to the public. It ranks more highly publication of information on proposed lower-level regulations, since this is where the major transparency problems are found. The United States, which regularly publishes plans containing a wealth of detailed information on subordinate regulations receives a high score on this indicator, but falls short because the U.S. legislative system does not lend itself to forward planning of legislation.*



*Transparency for affected groups: use of public consultation*

68. Public consultation is highly developed in the United States. Almost all federal regulations are developed through mandatory administrative procedures intended to ensure public consultation and openness. These "notice and comment" procedures dominate the rulemaking process in Washington by establishing the channels through which multiple interest groups strive to influence the regulatory decision by developing empirical or legal arguments supporting their positions.

69. The Administrative Procedure Act, enacted in 1946, establishes minimum procedural requirements for rulemaking. While it leaves agencies great flexibility to develop procedures, the Act requires that an agency publish a proposed rule in the Federal Register. With some exceptions, the public must be given at least 30 days to comment in writing and the agency must consider any comments received. The comments themselves are made public via the establishment of a legal rulemaking "record", which contains all factual material received and potentially relied upon in the regulatory decision. When an agency publishes a final rule, it must explain the factual and logical basis for its decision, how it reached its conclusion, and how it dealt with the public comments received. Where important new material is received, there may be a need for more than one round of comments. Rules must be published not less than 30 days before becoming effective.

70. Written comments may be supplemented by a public hearing. Hearings tend to be formal in character, with limited opportunity for dialogue or debate among participants. Experimentation with “on-line” hearings has also commenced. A separate consultation process on paperwork requirements is established by the Paperwork Reduction Act, which is described below.

71. *Assessment of consultation and reforms.* The American system of notice and comment has resulted in an extremely open and accessible regulatory process at the federal level that is consistent with international good practices for transparency. The theory of this process is that it is open to all citizens, rather than being based on representative groups. This distinguishes the method from those used in more corporatist models of consultation, and also from informal methods that leave regulators considerable discretion in who to consult. Its effect is to increase the quality and legitimacy of policy by ensuring that special interests do not have undue influence.

72. 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 tended to develop 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 an honest inquiry. This has helped to discredit consultation. The Clinton Administration noted that even during the comment period, the agencies had already made up their minds and were unlikely to make changes based on public comment.<sup>49</sup>

73. Too, effective ability to participate is often limited by the complexity of the rules in question, particularly where scientific or technical matters dominate the considerations. The failure of regulators to clearly state the implications of regulatory decisions leaves the field to well-funded experts representing highly organised interests.

74. The National Performance Review considered the performance of existing consultation processes and recommended changes. It concluded that, notwithstanding the extensive consultation processes already in place, “without exception”, all groups wanted earlier and more frequent consultation opportunities. Moreover, while to provide these was potentially costly, there were significant potential benefits in terms of greater regulatory quality and compliance. NPR recommended that agencies investigate more flexible and more interactive means of consultation, provide assistance to regulated groups to enable them to participate more effectively, increase programme evaluation and make better use of information technologies.

75. The 1993 Clinton executive order dealt with a number of these recommendations. Agencies were ordered to involve affected parties earlier in the regulatory development process and to use consensual mechanisms such as negotiated rulemaking. There has been some progress here, as noted in the section on state co-ordination above and below in the discussion on negotiated rulemaking. Another important reform with the potential to transform access to the U.S. consultation system is that public comments are now solicited through the Internet, which has noticeably increased participation.

*Transparency in implementation of regulation: communication, compliance and enforcement*

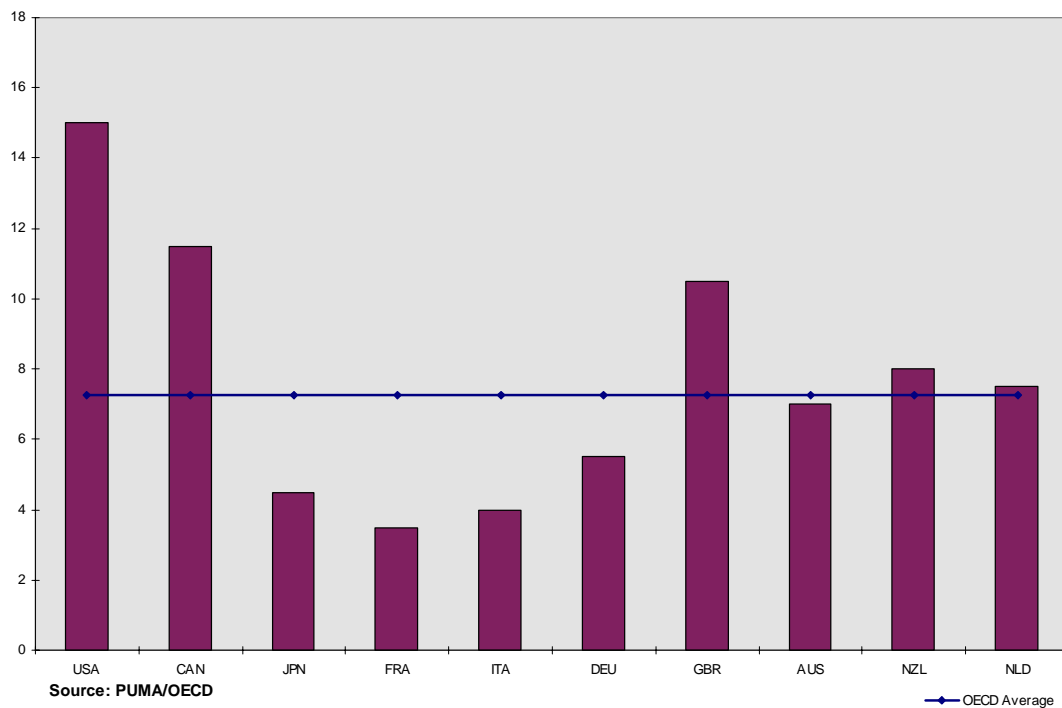
76. Once a regulation is adopted, it is easily accessible to affected entities. To become effective, final regulations must be published in the *Federal Register*, which is also available on-line. Final regulations are indexed and published in the consolidated *Code of Federal Regulations*, which is also available on-line. The *Code* provides a comprehensive view of the regulation in force at a given time.

77. A “simplicity and clarity” policy was adopted in June 1998 when President Clinton instructed civil servants to write all documents “in plain language.” This is the latest effort in a long series of battles dating from the Carter Administration that seem to have had little impact on the clarity of regulatory texts. One notable effort to improve communication of regulatory text has been the publication by some regulators of plain language “Small Business Compliance Guides” distributed by “outreach” programmes.

78. Improving enforcement strategies became a priority only recently. The Vice-President has, through the National Performance Review, instructed agencies to shift the focus of enforcement activities away from “paperwork violations” to an emphasis on performance results and to move away from adversarial relations with regulated parties toward a more co-operative approach.

**Box 5: Transparency of regulatory systems in selected OECD countries**

*Based on self-assessment, this broad synthetic indicator is a relative measure of the openness of the regulation-making and regulatory review system. It ranks more highly national regulatory systems that provide for unrestricted public access to consultation processes, access to regulation through electronic and other publication requirements, access to RIAs, and participation in reviews of existing regulation. It also ranks more highly those programmes with easy access to licence information, which tends to favour unitary over federal states. The United States scores very highly on these criteria. It loses points due to the absence of single contact points for obtaining information on business licence and permit requirements.*



### 3.2. *Choice of policy instruments: regulation and alternatives*

79. A core administrative capacity for good regulation is the ability to choose the most efficient and effective policy tool, whether regulatory or non-regulatory. The range of policy tools and their uses is expanding as experimentation occurs, learning is diffused, and understanding of the markets increases. At the same time, administrators often face risks in using relatively untried tools, bureaucracies are highly conservative, and there are typically strong disincentives for public servants to be innovative. A clear leading role -- supportive of innovation and policy learning -- must be taken by reform authorities if alternatives to traditional regulation are to make serious headway into the policy system

80. Here, the U.S. system presents both strengths and weaknesses. There is a long history of efforts to expand the use of innovative instruments. In 1978, President Carter issued an order to regulators -- to install what he called "common-sense management for the regulatory process" -- to show that "alternative approaches have been considered and the least burdensome of the acceptable alternatives have been chosen."<sup>50</sup> Similarly, in 1981, the Reagan presidential order required regulators to ensure that "Among alternative approaches to any given regulatory objective, the alternative that maximises net benefits to society should be chosen." Crucially, assessment of alternatives was to be documented through regulatory impact analysis. "If regulatory reform is judged useful according to whether it improves the cost-effectiveness of regulation, then regulatory impact analyses that contain estimates of the costs and benefits to society of alternative regulatory approaches is a necessary condition for regulatory improvement," OMB wrote.

81. The current Clinton presidential order also makes clear that alternatives such as market incentives are preferable to command and control regulations, and a considerable amount of effort has gone into encouraging regulators to be more innovative by using three main approaches: performance standards, market incentives, and information strategies.

82. Anecdotes suggest that innovative approaches are beginning to pose genuine competition to old styles of regulation. Expectations are higher that alternatives will be seriously considered, and several approaches now underway are useful experiments that should, if successful, help persuade a public administration that is extremely risk-adverse of the benefits of innovation.

83. Yet progress is very slow. Despite two decades of effort, the U.S. regulatory system still relies mainly on command and control rules. Progress is most evident in the environmental area, but overall there is little sign that the diversity and scope of alternative instruments has increased very much in recent years, and in fact the U.S. system seems less innovative than does other OECD countries. The 1993 NPR found that regulators continued to over-rely on command and control regulations, and blamed several factors, including:

- congressional and agency lack of know-how about innovative approaches and how to design them,
- congressional distrust of agencies, which means that Congress does not give agencies the flexibility to try new approaches
- agency and congressional distrust of the regulated public.

The NPR recommended creation of a regulatory working group to consider new, creative and more effective alternatives and approaches to regulating (the interdepartmental Regulatory Working Group has made some effort to carry this out), and development of guidance on alternative instruments for regulators (not implemented).

84. A possible untapped source of innovative and experimentation in the U.S. regulatory system is the 50 states, although the states have not been as innovative in the regulatory area as in other areas of public policy. One reason may be that the federal government, by creating a rigid national regulatory regime, stifles innovation at lower levels. A key problem, according to the Environmental Council of the States (ECOS), was that federal agencies have no procedures for dealing with new ideas. That is, innovations do not fit into standard operating procedures, and hence cannot be pursued effectively by civil servants.

85. A solution was to create new procedures through which civil servants could deal with experimentation and innovation. The 1998 ECOS-EPA Agreement to Pursue Regulatory Innovation "creates a path and a process that is clear to everyone" for how EPA will deal with state innovations.<sup>51</sup> The agreement contains operating principles giving states greater scope to implement innovative ideas to achieve better environmental outcomes and giving states and regional EPA offices the freedom to test different projects, as well as providing monitoring and information-sharing of the results.

86. *Market incentives.* Properly structured, economic incentives offer two great advantages over traditional "command and control" regulation. First, they allow business and others to achieve regulatory goals in the least costly manner. Second, market incentives reward the use of innovation and technical change to achieve these goals. There is some experience with the use of market-based instruments in the United States. The most innovative policy field is environmental protection, where a wide range of instruments is employed. While the US has played a pioneering role in the use of tradable permits (and is in fact the only country where these are used to any significant extent), it is striking to see that the tax instrument is hardly used, especially in energy and transport-related issues. This is exactly the reverse of the situation in most OECD countries.

87. In the last decade, marketable permits are slowly increasing their reach, due in part to the increased complexity of pollution controls. The standardised regulatory approach to control of emissions from factories, for example, does not work with non-point sources of pollution that require flexible and source-specific solutions. EPA states that "[emissions] trading, in particular, has become a standard environmental management tool, with the number of national programs offering this compliance option increasing markedly in recent years".<sup>52</sup> Recently, the Clinton administration has promoted the use of an international permit trading system as the most cost-effective to reduce greenhouse gases. Examples of other trading arrangements include:

- Marketable permit programmes for water rights in the western United States have been active for many decades. Lead credit trading (1982-1987) and the CFCs production allowance trading (1990) were also quite successful.
- Trading of air-pollution permits is taking place in the United States on both local and regional levels. Southern California's Regional Clean Air Incentives Market (RECLAIM) aims to reduce industrial emissions by 80 per cent by 2010. A general set of rules for local air-pollution-permit trading has been proposed by EPA. This set of rules is called the Open Market Trading Programme (OMTP). Any state whose air quality problems and planning for compliance with federal air-pollution-laws are consistent with emissions trading will be able to adopt these rules without a lengthy EPA review process
- The New Jersey programme of tradable Regional Contribution Agreements allows a town to meet its legal obligation to provide low- and moderate-income housing by transferring the housing requirement to another willing municipality through a regional contribution agreement (RCA). An RCA is a cash payment from one municipality (usually suburban) to another municipality for the purpose of building or refurbishing low- and moderate-income housing in the receiving municipality.

88. EPA views tradable permits as offering both the possibility of stricter standards and better environmental protection, due to the lower unit costs of pollutant reduction, as well as holding “promise for addressing problems, such as polluted runoff, that have not been brought under control through traditional regulatory means.”

89. Other economic incentives used in the environmental area include tax incentives, including a federal incentive that encourages commuting, and pricing reforms that ensure that environmental costs are better reflected in consumer choices for services such as household garbage collection and disposal.

90. *Information approaches.* One of the most powerful alternative approaches to regulation is the use of information to empower citizens and consumers to take actions in their own interests. Typically for the United States, information has been approached in many policy areas from the perspective of a legal “right to know” rather than a flexible programme response to problems. There are many interesting examples of the use of information in the United States as a substitute or complement to other forms of regulation.

- Drinking water information for consumers. Stating that “an informed and involved public is necessary to keep [a high] level of safety” in water quality,<sup>53</sup> the EPA proposed in February 1998 to provide consumers with better information about the quality of water in the community. Water suppliers would, for the first time, be required to report to their customers at least once a year on the quality and sources of local drinking water, its compliance with health standards, likely sources of any contaminants, and the risks of any contaminants. This “consumer confidence reporting” would apply to all of the nation’s 56,000 community water systems.
- Toxic release inventory. The 1986 Emergency Planning and Community Right to Know Act mandated that plants communicate information about toxic releases to local communities. Together with recent changes in 1997, the information is intended to provide a picture of how toxic chemicals are being managed within communities, and thereby improve the accountability of the private sector to those who may be affected by its activities.
- Consumer labelling. In 1996, EPA launched an initiative to improve consumer labelling information on pesticides, cleaning supplies, and other household products. Labels are being made more user friendly, with phone numbers for more information, and efforts are being made to standardise environmental information and storage and disposal instructions. A consumer education programme is planned to improve consumption of the information provided.

91. *Voluntary approaches.* The environmental programmes have experimented with a variety of voluntary programmes in the 1990s, under names such as the Pesticide Environmental Stewardship Program, Encouraging Environmental Excellence, and Common Sense Initiative. A recent study<sup>54</sup> found that voluntary programmes in the United States combine the features of unilateral, negotiated, and public voluntary approaches employed in the European Union (EU). In the United States, VAs are primarily employed to address legislative shortcomings. Most U.S. voluntary efforts are co-operative, non-mandatory strategies.

92. Implementation problems have led to lower-than-expected environmental results for all VA categories. Among the different types of VAs employed in the United States, programs designed to reduce greenhouse gas emissions and a subset of toxic chemicals have contributed to emissions declines. However, weak evaluation methods likely caused EPA to overstate the environmental effectiveness of both climate change and prevention programs. In all cases, VA assessment is hampered by program novelty, lack of data, and weak metering and evaluation methods. In most cases, it is difficult to attribute environmental changes exclusively to voluntary programs. Due in part to the lack of environmental data, virtually no studies have been developed to demonstrate whether voluntary approaches are efficient.

**Box 6: Marketing pollution permits - clean air at lower cost**

Marketable permit or obligation programmes provide administrators with an alternative to traditional regulatory techniques. If developed and applied appropriately, they can reduce the cost of regulation, increase compliance flexibility, support economic-growth goals, and reduce the adversarial nature of regulation while still achieving regulatory goals.

Perhaps the best known example of such trading is the acid rain programme operated by EPA that is designed to reduce U.S. sulfur dioxide emissions by 10 million tons annually from 1980 levels. In the programme, emitters of SO<sub>2</sub>, a precursor to acid rain, have been issued a finite number of allowances (permits) that can be used over the next 50 years. SO<sub>2</sub> allowances are denominated in tons of SO<sub>2</sub>, but not by year. This is because acid rain is a cumulative problem, so the absolute amount deposited matters more than the timing of the deposition. Although participants (predominantly coal-fired power plants) may use up their allowances at any rate they wish, their incentive is to spread them out over the 50-year period envisioned by the programme.

There are two deadlines for individual plants to reduce emissions: at the end of 1995, SO<sub>2</sub> emitters had to achieve a first level of emissions reductions. A second round of reductions must be achieved by 2000. The number of allowances issued to individual plants reflects these reduction targets. Plants that over-comply and have excess allowances may sell them.

SO<sub>2</sub> trading regulations were developed from 1991 to 1992, with the programme launched in 1992. Strict enforcement measures are built into the federal legislation, including automatic fines (indexed to inflation), plus a requirement to purchase the missing allowances in the next period, for failure to demonstrate ownership of sufficient allowances. For intentional (criminal) non-compliance, heavy fines and jail terms are possible consequences. As of March, 1996, there have been no violations (Kruger, 1996). CEMS technology enables EPA to match output with allowances. When allowances are traded, the buying and selling entities must register the trade with EPA. The traders' computerised inventories are updated so that compliance in terms of the new levels of allowances can be monitored.

An important design feature of the SO<sub>2</sub> programme that was debated in Congress concerned how much electric utilities should have to spend to reduce SO<sub>2</sub> emissions. To estimate cost, an estimate of the value and volume of tradable allowances was needed. Utilities predicted that a one-ton allowance would cost roughly US\$1 000; USEPA thought between US\$500 and US\$600. In fact, allowance prices originally (in 1992) traded for \$250, and as of June 1995 were trading for \$140, well below any prediction (Wald, 1995).

The original over-estimation of allowance prices had important public policy implications. Part of Congress's decision on how much acid rain reduction to require was based on predictions of how much the clean-up would cost. That is, Congress not only considered the health, ecological, and other impacts of acid rain when choosing a target for reductions, but it also had in mind a reasonable spending target for electric utilities. Because the cost of allowances was over-estimated, the overall SO<sub>2</sub> reduction goal is lower than it might have been. While some criticism has been levelled at the programme for this reason, it overall has been viewed as a success, since compliance costs have fallen dramatically.

There is a great deal of speculation as to why the cost of SO<sub>2</sub> allowances fell so far below predicted levels. Among the possible explanations are that utilities purposely overestimated allowance cost, aware of the link between allowance cost and total obligation to reduce SO<sub>2</sub> emissions (Wald, 1995), that the cost of natural gas, a low-sulfur substitute for coal, has fallen more than expected, that costs of low-sulfur-coal mining and transport by rail are lower than predicted, making low-sulfur coal a more attractive substitute for high-sulfur coal, and that the price of technologies that reduce sulfur emissions, such as scrubbers, has fallen (Palmisano, 1995).

The programme has produced significant, additional, unexpected cost savings, and reductions in emissions are ahead of schedule. The annual costs of meeting the full reductions is expected not to be between \$2 and \$2.5 billion per year, about half the cost estimated originally. This represents a cost-savings of about 25 percent relative to achieving the targets in the absence of allowance trading.



93. The data that do exist identify a number of “soft effects.” Participants in most VAs cite public opinion and/or regulatory goodwill as significant benefits. In some cases, VAs may confer competitive advantages to participants as well. Improved goodwill may indirectly lower costs associated with permitting and reporting, as well as minimize the threat of more stringent regulation. Soft factors may indirectly reduce administrative and abatement costs. At a minimum, VAs have the potential to promote interaction among groups who normally interact through the regulatory process as adversaries. Such VAs provide more opportunities for stakeholder participation than the status quo. However, implementation is hampered by the lack of clearly-defined administrative, monitoring, and participatory procedures. Thus, VAs -- particularly unilateral and negotiated approaches -- lack credibility among environmental groups and some industries. To promote trust, VAs must be made more transparent. If they are made more viable, then VAs can help to promote agreement on ways to improve the U.S. legislative framework.

94. As with other innovative approaches, federal laws often impede VA implementation, particularly of industry-led efforts and public projects that employ negotiation.<sup>55</sup> As a result, voluntary approaches remain largely “marginal” to federally-mandated air, water, waste, and toxics programs. Implementation may be strengthened by taking legal factors into consideration. However, in the United States, it is likely that the effectiveness of VAs will remain limited until the existing legislative framework is changed.

#### **Box 7: Regulatory innovation through HACCP**

The US Food and Drug Administration was an early advocate of an alternative form of regulation known as “process regulation”. This approach requires producers to document and analyse the different stages of the production process, identifying key points at which hazards arise and putting into place site-specific strategies to manage them. The idea is that producers are better at identifying hazards and developing lowest-cost solutions than is a central regulatory authority. This approach is particularly useful where there are multiple and complex sources of risk, and *ex post* testing of the product is either relatively ineffective or prohibitively expensive.

The FDA’s Hazard Analysis Critical Control Points (HACCP) programme to regulate seafood safety shifts the basis of regulation to one consistent with quality assurance principles, rather than the older approach focused on verifying “end of pipe” compliance. The seven key HACCP components are:

- Hazard analysis: identification of likely hazards that could occur in specific products as a result of specific processes.
- Critical control points (CCPs): the key elements of the production process in terms of potential for health hazards to arise in the absence of adequate control measures.
- Critical limits: Measuring levels of control performance at CCPs.
- Monitoring: Keeping watch over CCPs to assess if controls are within critical limits
- Corrective action: Steps to be taken when monitoring indicates that critical limits are exceeded.
- Record-keeping: recording and maintaining information about results of monitoring, corrective actions and verification.
- Verification: Reviewing all HACCP components periodically or when a production element changes.

FDA’s economic analysis concluded that the present value of benefits of HACCP, compared with existing regulatory approaches, would be in the range of \$1.435 billion to \$2.561 billion, with up to 58 000 illnesses due to contaminated seafood being avoided annually.

HACCP approaches have now been recommended by the UN based Codex Alimentarius Commission and a number of other countries (e.g. Canada in relation to seafood) have also moved toward HACCP.

95. *Negotiated rulemaking.* Negotiated rulemaking, new to the United States, is familiar in most OECD countries where consensus-based approaches to regulation are used. Involvement of affected parties in decisions seeks to improve regulatory performance in several ways: by drawing on the expertise of the regulated to improve the technical quality of regulation; by fostering “ownership” of the outcome and, hopefully, the level of consent and voluntary compliance; by increasing the legitimacy of regulations; by diminishing the risk of hostile litigation by achieving a high degree of consensus; and by reducing the time to develop and implement new rules.

96. The legalistic environment for rulemaking in the United States has discouraged consensus-based approaches. The Negotiated Rulemaking Act of 1990 formalised a legal process to bring stakeholders into the process of developing rules at an early stage. It sets out a range of process requirements that establish a framework for attempts by regulators to reach consensus among major regulated groups on new regulations. It is carried out via an iterative, committee based approach to rule development, with safeguards to ensure that all significant interest groups have an opportunity to request involvement. The negotiation is an additional element in the rulemaking process. The agreed text is published as a proposed rule and undergoes subsequent consultation in the normal way.

97. While there were some experiments with negotiated rulemaking in the 1970s and 1980s, the passage of the Negotiated Rulemaking Act in 1990 gave it a higher profile in the regulatory system. This innovation received significant political support. A 1993 presidential order asked agency heads to identify potential areas for negotiated rulemaking. By the end of 1996 -- or almost six years after the introduction of the Act -- 17 agencies had initiated at least one negotiated rulemaking. The total number of negotiated rule-makings was 67, although approximately one quarter of these predated the introduction of the 1990 Act which formalised the process. Moreover, agencies had abandoned the process without any consensus in at least 13 of these cases.

98. As these figures suggest, negotiated rulemaking carries risks. The process can be resource intensive and yield little of value if agreement is not reached. The parties may use the process as a rent seeking opportunity by trying to insert particular advantages for their constituents into the regulation. The relatively low take-up rate suggests that regulators are relatively unconvinced as to the benefits of using the process or, alternatively, that the situations where negotiated rulemaking can be useful are rare.

99. Early assessments<sup>56</sup> suggest that significant time savings had been achieved by negotiated rulemaking, but a subsequent comprehensive study<sup>57</sup> disputes this finding and adds that not only has the process failed to save time, it has also required a more intensive use of agency resources. This observation has intuitive merit since the negotiated rulemaking process is conceived formally as an addition to processes already mandated in the Administrative Procedure Act. The notice and comment procedures still apply at the conclusion of negotiations. This design of negotiated rulemaking reflects a desire to maintain an “open” process of consultation in all cases and avoid charges of “corporatism” and lack of transparency, but results in a process still mired in formalistic and time-consuming steps.

100. Similarly, evidence suggests that negotiated rulemaking has failed to reduce the incidence of legal challenge to regulations. Analysis of EPA’s experience (EPA is the largest user of negotiated rulemaking) indicates that the incidence of litigation is no lower than for conventionally made rules, despite the fact that the criteria for use imposed by the Act would tend to favour the selection of rules which were likely to be less prone to litigation. Possible explanations for this observation include the exclusion of affected interests from the negotiations, the extent to which the final rule reflects the agreed consensus and conflict over matters not dealt with in the agreements. It has also been suggested that, by raising expectations of accommodation of private interests in the rulemaking process, regulatory

negotiation may make parties more sensitive to outcomes adverse to their interests and so more inclined to litigate.

101. Despite these concerns, it remains possible that negotiated rulemaking has improved the technical quality of regulations. As noted above, attempts to reform consultation procedures in general have pointed toward the need for more intensive, iterative procedures which commence far earlier in the development of regulatory proposals. Negotiated rulemaking appears to respond to all of these requirements. Moreover, the theoretical potential for it to compromise regulatory quality via the insertion of self-serving elements in proposed rules by the parties must be much attenuated by the very open “notice and comment” process which must be undertaken after the negotiations and by the very real threat of subsequent litigations.

102. There is also the possibility that a number of the shortcomings of negotiated rulemaking (vis-à-vis the expectations held for it) at least partly result from relative inexperience with its use, on the part of all parties. If so, this may be a self-sustaining problem, as agencies may be reluctant to extend their use of the process precisely because early experiences with it are not favourable.

### 3.3. *Understanding regulatory effects: the use of Regulatory Impact Analysis (RIA)*

103. The 1995 *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options were chosen. The 1997 *OECD Report on Regulatory Reform* recommended that governments “integrate regulatory impact analysis into the development, review, and reform of regulations.” A list of RIA best practices is discussed in detail in *Regulatory Impact Analysis: Best Practices in OECD Countries*<sup>58</sup>, and provide a framework for the following description and assessment of RIA practice in the United States.

104. Regulatory impact analysis was in many respects pioneered in the United States, beginning in 1974 with Inflation Impact Assessments. Full RIA has been required by presidential order for all major social regulations from 1981, with quality control placed in OMB. The value of RIA has been considerably enhanced through its full integration into the public consultation process.

105. The design of the U.S. RIA programme is based on several key threshold, cost-effectiveness, and benefit-cost principles already noted in section 2: the government should not regulate unless there is adequate information concerning the need for and consequences of regulatory action; regulatory action should not be undertaken unless potential benefits to society justify potential costs; regulatory objectives should be chosen to maximise the net benefits to society; and among alternative approaches to a given objective, the one chosen should be that which maximises the net benefits.

106. The trend today is to further standardise and upgrade RIA methods by establishing binding legal requirements that are judicially reviewable. A 1995 law (UMRA), for example, requires cost-effectiveness analysis of a “reasonable number” of alternatives for any regulation that would require expenditures costs of more than \$100 million in any one year. This is an important step though the UMRA cost-effectiveness test is substantively weaker than the benefit-cost test contained in the presidential order, and the “expenditures” threshold is less analytically sound than the broader “effects”, including both costs and benefits, in the presidential order. Proposals to strengthen this law by including the benefit-cost principle continue to be pursued by regulatory reformers.

107. At the same time, independent review by OMB has become more selective. While an average of over 2000 agency rules and 75 RIAs per year were reviewed by OMB during the 1980s and early 1990s, this fell to fewer than 500 rules by 1996, although the number of RIAs remained roughly the same. This is the result of a policy of focusing resources on more important rules to maximise the expected benefits of the review process. In addition, OMB has attempted to become more closely involved with agencies during the course of the drafting of these major rules, thus having an input at an earlier stage of their development and, potentially, maximising their ability to achieve change. It has also argued that this approach allows routine or administrative regulation to be made more expeditiously<sup>59</sup>.

108. This change in policy has coincided with a sharp reduction in the percentage of rules that OMB returned to the agencies to be revised -- from an average of 1.2 percent of those reviewed in the period to 1993 to 0.2 percent from 1994-1996. The implications of this with respect to OMB oversight of regulatory quality are unclear. The drop seems surprising, given the focus on more important regulation, as potential gains from improvements are greater for these regulations. Moreover, if reviews have become more thorough and intensive, discovery of cost-effective improvements seems more likely. On the other hand, as OMB argues, earlier involvement with regulators during the development phase may have reduced the likelihood that regulations containing major problems are sent to OMB for formal review.

109. *Evidence on the results of RIA.* Evidence on the value-added of RIA indicates that it has significantly improved the quality of some regulations, but that implementation continues to fall short in many respects, while major regulatory quality problems continue.

110. As long ago as 1981, an analysis of regulatory proposals critiqued by a Carter-era regulatory analysis review group showed that about one third were significantly improved. In 1987, the EPA analysed its own experience with the use of RIA in 15 cases and concluded that its \$10 million expenditure on RIA had reduced the costs of proposed rules by \$10 billion, or a benefit/cost ratio of 1000 to 1.

111. There is also evidence of a profound cultural change among regulatory agencies, particularly insofar as the need to take economic costs into account is now much more widely accepted than in 1970s. However, there appears to be a considerable range of attitudes. Viscusi presents data on the cost effectiveness of regulations from several agencies and argues that there is a clear correlation between internal agency attitudes and the efficiency of the regulations.<sup>60</sup> For example, a Department of Transportation policy to issue only regulations that save statistical lives at a cost of less than \$3 million is consistently applied in practice. On the other hand, other major regulatory agencies are shown to have issued many numbers of regulations that do not meet effectiveness criteria of this sort.

112. Moreover, Hahn<sup>61</sup> finds in an analysis of 92 health, safety and environment rules that in fewer than 20 percent of the RIAs were benefits quantified in monetary terms and shown to justify costs. His analysis also found considerable inconsistency -- within and between agencies -- in assumptions and methodology. These included differing discount rates, failure to present BCA in Net Present Value terms and widely differing assumed benefits for reduced death and injury rates.

**Box 8: Regulatory budgeting: a new way to control regulatory costs?**

An innovative policy tool that has been examined in the United States is regulatory budgeting, which uses traditional budgeting concepts to better manage aggregate regulatory costs. The regulatory budget concept is modelled on the fiscal budget approach, in which an agency or programme head is given a budget ceiling, within which funds are allocated among competing needs. In the regulatory budget, however, the ceiling would be measured by the economic costs of regulatory compliance borne by the private sector. That is, the regulatory body would be given a ceiling on new regulatory compliance costs.

While this tool has had limited practical implementation to date, it has the potential to transform the transparency, accountability, and incentives of regulatory decisions. Recent estimates of the annual cost of federal regulation are in the range of \$280 - \$700 billion, and projections show the costs of regulation continuing to climb. These costs can be seen as a form of indirect taxation because the economic effects of taxes and regulatory costs are similar. From this perspective, regulation is a mechanism for government spending and regulatory costs are a form of government expenditure. Regulatory expenditures are the major government expenditure still “off-budget”, that is, not included in the accounting and control system called the fiscal budget.

Budgeting would produce four major benefits when applied to regulatory costs. First, placing a fixed limit on the amount of resources available to an agency or programme head with a defined mission should result in more cost-effective allocation of those goods, because priorities would have to be set among possible actions. Second, a budgeting approach would require explicit consideration of the aggregate economic cost of regulation. Third, the regulatory budget, like the fiscal budget, would rely more on decentralised decision-making by the programme office than on centralised regulatory reviewers, and hence place decisions closer to the real expertise in allocating scarce resources. Fourth, it would increase legislative accountability for regulatory costs.

The key problem with development of a regulatory budget is lack of information on regulatory costs. Budgeting will require a consistent and comprehensive set of estimates on the costs of new regulation. After almost two decades of effort, the United States has established a government-wide process of regulatory analysis that it believes could form the basis for aggregate estimates of regulatory expenditures. Several accounting problems, mostly arising from difficulties in measuring indirect regulatory costs, are still troubling and will need to be answered. The regulatory budget has been under discussion in the United States for the past decade and continues to command significant interest. However, it is clear that its adoption, should it come about at all, is still some way off.

Experimentation with regulatory budgeting concepts is already underway. In an informal way, a cost ceiling was used as a benchmark for negotiation between the President and the Congress on the content of the Clean Air Act Amendments of 1990. The agreed ceiling, about \$25 billion in annual costs, served to focus the negotiations on the most highly valued alternatives and may have been responsible for some of the most innovative provisions of the Act.

A possible use of the regulatory budget is the inclusion of a “regulatory cost ceiling” in new legislation that delegates regulatory authority. Each new law would place a ceiling on the total private sector costs that agencies could impose in writing implementing regulations. Once the ceiling was reached, new regulations would require either additional legislation to raise the ceiling or offsetting changes in other regulations to stay within the ceiling. This system would increase the accountability of the legislature and provide agencies with incentives to produce regulations that produce benefits at the least possible cost. The long-term goal is to develop a management or budgeting system that treats fiscal and regulatory expenditures in an equal manner, since both ultimately are diverted from private use. Integrating the fiscal budget with the regulatory budget - creating a “superbudget” that measures the full cost of government action - appears to be the logical final step.

**Source:** This discussion is adapted from John F. Morrall III (1993) “Controlling Regulatory Costs: The Use of Regulatory Budgeting” OECD Occasional Papers in Public Management and from the Budget of the United States Government, Fiscal Year 1993, Chapter 17, “Reforming Regulation and Managing Risk Reduction”.

113. Notwithstanding these problems with the quality of RIA, the quality of the resulting rules appears to be high. Hahn's analysis of "adjusted" agency RIA showed a net benefit for the 92 health, safety and environment regulations of \$280 billion, although it is suggested that these agency estimates may be highly optimistic. In addition, this figure could be increased by a further \$115 billion by eliminating those rules that failed the benefit/cost test.

114. While full quantification of monetary benefits of regulation is perhaps unachievable, significant benefits would be expected (both directly and indirectly) by "making key assumptions explicit, using best estimates and appropriate ranges to reflect uncertainty, providing estimates of the NPV of benefits and costs and summarising sensitivity analyses and base case results" In addition, "Agencies should also do more peer review to improve quality of analysis, but the nature of this peer review needs to be carefully designed".<sup>62</sup>

115. As previously noted, OMB's recent report to Congress on the costs and benefits of economic and social regulations<sup>63</sup> concludes that the annual benefits of regulations in force in 1997 marginally exceed the costs (\$298 billion vs \$279 billion). However, OMB was unable to present an aggregate number for the 41 major regulations reviewed in the reporting period due to lack of data. For example, of the 41 regulations, 21 required substantial additional private expenditures. Of these, only in 8 cases did agencies provide monetized benefits estimates, while cost estimates were presented in 16 cases.

116. OMB's report echoes other analyses in noting that the benefit/cost ratios for different areas of regulation differ markedly within this total. Thus, while regulatory quality appears to be high in many areas, it appears that RIA has had only limited success in preventing poorer quality regulation, notwithstanding the considerable experience with the tool in the United States and the significant amount of agency resources devoted to it.

#### *Assessment against best practices*

117. *Maximise political commitment to RIA.* Political commitment to RIA has come from the highest level in the United States. The obligation to carry out RIA has, since its inception in 1981, been through presidential orders. Moreover, each president since 1981 has issued his own revision of RIA, ensuring that the commitment to RIA has been reaffirmed by the current presidency. The support of Congress in promoting RIA has been more tentative. It was only with the passage of the Unfunded Mandates Reform Act in 1995 that there is a government-wide legislative requirement for RIA.

118. *Allocate responsibilities for RIA programme elements carefully.* To ensure "ownership" by the regulators while at the same time establishing quality control and consistency, responsibilities should be shared between regulators and a central quality control unit. The U.S. approach gets good scores in this regard. The United States has established clear responsibility for regulators to conduct RIA in the first instance and a strong role for a central review authority. Moreover, that authority (OMB) has always been located within the Executive Office of the President and, thus, has enjoyed a high level of authority and, hence, ability to exercise effective quality control over the RIA efforts of agencies.

119. *Train the regulators.* OMB has published detailed guidance on conducting RIA.<sup>64</sup> The document includes an exposition of the purposes of RIA under EO12866 as well as detailed methodological guidance including such issues as discount rates and valuation of human life. However, this is not backed by the provision of training for regulators in RIA or related topics such as regulatory alternatives. This appears to be an area for consideration for US RIA policy.

120. *Use a consistent but flexible analytical method.* In practice, regulators need flexibility in conducting useful and feasible analyses. OMB's 1996 RIA guidance document states

*"This document is not in the form of a mechanistic blueprint, for a good economic analysis cannot be written according to a formula. Competent professional judgement is indispensable for the preparation of a high-quality analysis. Different regulations may call for very different emphases in analysis. For one proposed regulation, the crucial issue may be the question of whether a market failure exists, and much of the analysis may need to be devoted to that key question. In another case, the existence of a market failure may be obvious from the outset, but extensive analysis might be necessary to estimate the magnitude of benefits to be expected from proposed regulatory alternatives."*

121. Nonetheless, there are inconsistencies in the methodologies required for RIA. While the Executive Order imposes the benefit-cost principle, the Unfunded Mandates Reform Act requires cost effectiveness analysis. The existence of two parallel and inconsistent requirements is not necessarily a danger, since the two methods are complementary to good decision-making, but there is the potential for conflict between the implicit principles underlying the methods. This will have to be carefully managed to ensure that the benefit-cost principle is not undermined.

122. *Develop and implement data collection strategies.* Lack of information is one of the key sources of quality control problems in RIA and the elaboration of innovative and cost-effective data collection strategies is therefore a key area of concern in efforts to improve data quality. Surprisingly perhaps, given its extensive experience in the oversight of agencies' RIA efforts, OMB has not, to date, provided published guidance to agencies on the development and implementation of data strategies. This seems to be an area worthy of consideration as a "next step" in refining RIA processes.

123. *Target RIA efforts.* RIA resources should be targeted to those regulations where impacts are most significant, and where the prospects are best for altering outcomes. In all cases, the amount of time and effort spent on regulatory analysis should be commensurate with the improvement in the regulation that the analysis is expected to provide.<sup>65</sup> US RIA efforts rate relatively well according to this criterion. Review of agency regulations by OMB is widespread, while formal RIA has always been targeted toward "major" or "significant" regulations. "Major" regulations were defined in 1981 as those imposing annual costs exceeding US\$100 million, likely to impose major increases in costs for a specific sector or region, or have significant adverse effects on competition, employment, investment, productivity or innovation. EO12866 distinguishes between "economically significant" regulations and "significant" regulations, and requires a full cost/benefit analysis for the former.

124. The degree of targeting employed has varied over time. During the Bush Administration, two changes significantly increased the number of rules subject to RIA. In 1991, OMB extended the impact assessment requirement by ordering that analyses be conducted on all "significant" rules, while in 1992, President Bush further extended the requirement by directing agencies to estimate the likely costs and benefits of all proposed legislation within their jurisdictions. However, the approach to RIA under the Clinton administration has become more selective and, as noted above, the number of rules reviewed by OMB in 1996 stood at less than one quarter of the average for the years 1984 - 1993. The absolute number remains large, at 460, suggesting that the most important regulations continue to be subject to review by the central agency. However, only 41 of these rules met the definition of economically significant regulations in the year to 31 March 1997 and thereby qualified for a full benefit/cost analysis.

125. While these changes presumably represent differing views taken over time on the desirable degree of targeting, two significant concerns exist regarding the “reach” of RIA requirements. Firstly, a number of major statutes have specifically excluded the consideration of economic costs by rulemaking agencies in particular areas - prohibitions not affected by the Executive Orders mandating RIA. Thus, either RIA will not be conducted in these cases or, even when conducted, regulators will be effectively prohibited from using their conclusions in determining policy. It does not appear that the passage of the Unfunded Mandates Reform Act will alter this situation.

126. The second issue regarding “reach” is that the Executive Orders requiring RIA have not historically applied to a large group of independent regulatory agencies, established under their own statutes. Thus, a class of regulations are effectively exempt from RIA requirements because of the legal status of their sponsoring agencies, rather than their intrinsic importance.

127. *Integrate RIA with the policy-making process, beginning as early as possible.* US RIA procedures require that RIA on both preliminary and final rules be released for public consultation, ensuring that agencies are made accountable for their RIA prior to the finalisation of proposed rules. OMB has in recent years pursued the objective of becoming involved with agencies at an earlier stage in their rulemaking processes in order to improve the effectiveness of their RIA oversight and thus favour the development of better regulation and reduce conflict at the formal RIA stage.

128. It can also be argued that the considerable exposure of US rules to litigation through the courts favours the effective integration of RIA with the policy process. While the standard of RIA itself is not justiciable, RIA can be used in evidence in litigation over the rules and thus must create a pressure for agencies to ensure that decisions taken on rules are supportable via the results of RIA.

129. *Involve the public extensively.* RIA in the United States is closely integrated with the public consultation process. All RIA are required to be released to the public as part of “notice and comment” based public consultation processes which allow all members of the public to provide comment on the assumptions and results of the impact analysis. Public consultation on RIA is a two stage process, as RIA on both preliminary and final rules must be released for comment.

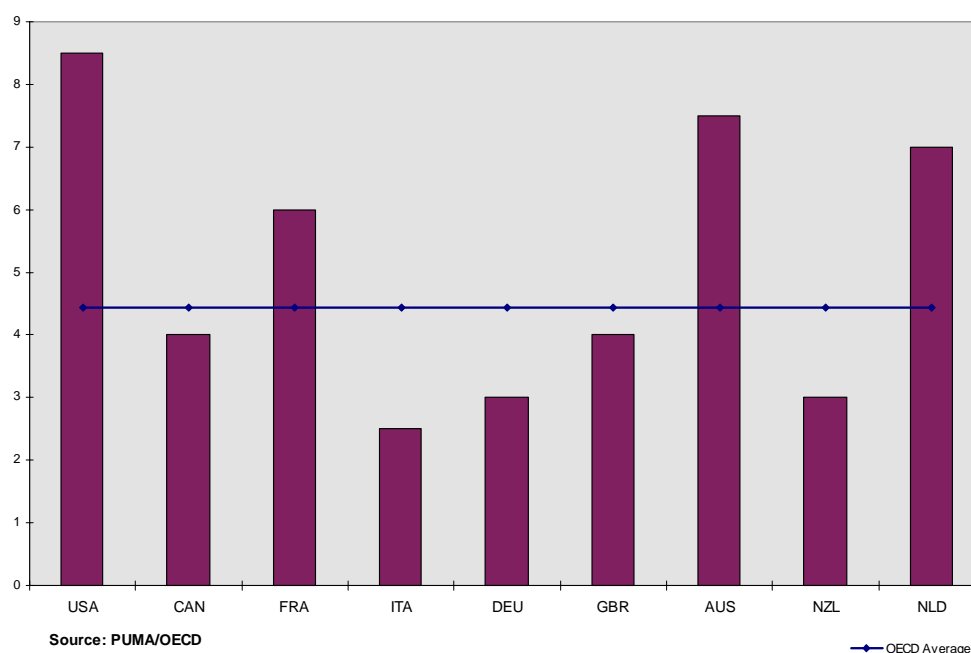
130. *Use of risk assessment.* A discussion of RIA in the United States would be incomplete without noting the key role of quantitative risk assessment. The United States is rare among OECD countries in making extensive use of various forms of risk analysis (including risk-risk analysis - see box x) as an input into benefits assessment. Fewer than 10 OECD countries use risk assessment systematically, and of these the United States is the most enthusiastic consumer of risk information in setting health and safety standards.

131. Quantitative Risk Assessment (QRA) typically forms the basis for regulation in the health, safety and environment areas - among the most important and fastest growing areas of regulatory activity. The first formal use of QRA occurred in the early 1970s, when the Food and Drug Administration used QRA to determine the need for regulation of various drug residues with carcinogenic potential in food producing animals. Since 1981, the OMB has encouraged the use of QRA to calculate the benefits of all risk reducing regulations, thus providing a strong central impetus for this methodology. OMB has stated that “For government to carry out its risk-management responsibilities, there must be extensive investment in the careful assessment and quantification of risks”<sup>66</sup>. The courts have also supported the use of risk assessment as a way of defining and limiting the discretion of agencies in regulating risk.



**Box 9: The Formal Scope and Breadth of the RIA System**

*This indicator looks at several aspects of the use of RIA, and ranks more highly those programmes where RIA is applied both to legislation and lower-level regulations, where independent controls on the quality of analysis are in place, and where competition and trade impacts are identified. The United States receives the highest ranking among the OECD countries on this criterion, although some elements of the RIA process, such as its applicability to legislation, are new and the quality of application has yet to be proven.*



132. However, laws are highly inconsistent about how risks are to be regulated and hence agency practices vary considerably. One fundamental problem is that, as with benefit-cost analysis, a number of important statutes prohibit the use of risk assessment. In some cases this is due to the statutes dating from periods in which detection techniques were much less advanced than today: The recently repealed “Delaney Clause” for pesticides, which prohibited any trace of a potentially carcinogenic pesticide in food items, had become widely recognised by regulators as an impediment to the competent management of such risks as the threshold of detection of such substances fell precipitously over past decades. It must be noted, however, that similar Delaney clauses for food additives, and cosmetics remain on the books unmodified.

133. Even in the absence of legislative limitations, however, agencies may adopt very different benchmarks as to what constitutes an “acceptable” risk or an acceptable mandated cost of risk reduction. For example, regulators often use worst-case assumptions so as to build a safety margin into the regulatory decision. Done systematically, this practice can severely distort regulatory activities. OMB has summarised the problem thus: “The continued reliance on conservative (worst case) assumptions distorts risk assessment, yielding estimates that may overstate likely risks by several orders of magnitude...Conservatism in risk assessment distorts the regulatory priorities of the Federal Government, directing societal resources to reduce what are often trivial carcinogenic risks while failing to address more substantial threats to life and health”.<sup>67</sup>

**Box 10: Using risk-risk analysis: does a regulation really save lives?**

Risk-risk analysis is a variant of risk analysis which looks beyond the direct impacts of a regulation on risk. Its starting point is the question of whether a regulation designed to reduce one risk would also have identifiable effects on other risks. Risk-risk analysis has arisen from concerns that some regulation has actually increased, rather than reduced, total risks due to perverse indirect effects outweighing the direct risk reductions which initially motivated the regulation.

Two major mechanisms by which other risks can be increased exist. Firstly, the regulation may lead to a risk trade off in terms of a behavioural response. Regulations which restrict or discourage the consumption of one risky substance may lead to consumers substituting another which has its own, possibly greater risks. For example, regulation of artificial sweeteners may lead to increased consumption of sugar, which may have greater risks in terms of heart disease than the risks associated with the artificial sweeteners.

Secondly, actions taken to reduce one risk can simultaneously increase another, even without behavioural change. For example, chlorinating drinking water reduces the risk of bacteria borne illnesses but may slightly increase cancer risks. Similarly, switching to lead-free petrol reduces the developmental problems of high blood lead levels in children but may also increase cancer risk due to increased exposures to benzene.

A variant of risk-risk analysis considers the impact of income on health. Studies show that as income declines, mortality rates increase, with one widely cited study indicating that each \$12 million (1991 prices) reduction in aggregate income costs a statistical life. Thus, every regulatory expenditure of this amount costs a statistical life. This form of analysis has received some prominence in the US, with OIRA advocating its importance to both agencies and the Senate.

Source: Viscusi, W.K. "Improving the Analytical Basis for Decision-making" in **Regulatory Impact Analysis: Best Practices in OECD Countries. PUMA/OECD 1997** pp. 200-204.

134. A detailed analysis of the inclusion of several mutually reinforcing "safety margins" in risk assessment was contained in a report commissioned by the Department of Energy in 1993<sup>68</sup>. It identified ten key policy assumptions, each widely used in the conduct of risk assessment, each of which introduced a conservative bias into the results. The accumulation of these biases can, and often does, lead to policy outcomes which are inconsistent with each other and with cost-effective approaches to risk management. A frequently cited example is the pursuit of clean-ups of toxic sites under the 1980 "Superfund" legislation (referred to in a recent Congressional publication as "the infamous superfund"<sup>69</sup>), where critics argue that the high cost of conducting clean-ups to reduce risks to unnecessarily low levels has meant that only a small minority of identified sites have received any remedial action at all.

135. An additional issue is the often large degree of uncertainty attached to risk calculations, in term of both the calculation of the initial risk and the productivity of measures that can be taken to ameliorate it. Again, different approaches are likely to be taken in dealing with this uncertainty in the absence of clear guidance.

136. For these and other reasons, there is huge inconsistency in risk management across the federal government. As noted earlier, federal health and safety regulations show an extremely wide variability in the costs per life saved -- from thousands to billions of dollars. The highest costs are associated with regulations aimed at low-probability cancer risks resulting from occupational and environmental exposure. This enormous variance in the cost-effectiveness of various regulations has suggested to OMB that "aggregate risk mortality would be substantially reduced at considerably lower cost by shifting the Federal government's regulatory focus away from relatively small...cancer threats toward other health risks and causes of injury."

137. Initiatives have been taken in recent years to improve and standardise risk assessment techniques. In 1991, the White House Office of Science and Technology Policy convened a number of interagency groups to develop guidelines for agencies to use in conducting risk assessments. The National Academy of Sciences has also conducted a review of risk assessment.

138. While risk assessment remains a highly imperfect tool, and one whose utility in policy-making continues to be questioned in some quarters, the United States is in the forefront in its adoption and refinement as a policy tool. One particular variant of risk assessment which has developed in the US in recent years is risk-risk assessment, and the closely related health-health analysis, which have arisen in part as a response to legislative limitations on the use of risk assessment.

#### **4. Dynamic change: keeping regulations up to date**

139. The OECD Report on Regulatory Reform recommends that governments “review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.” In the United States, three key mechanisms are currently employed to review existing regulations, each authorised by presidential order 12866.

140. The first mechanism is decentralised: Section 5 of the presidential order directs agencies to undertake periodic reviews of their existing “significant” regulations in order to identify modifications or repeals that would better contribute to achieving regulatory objectives, reduce burdens or better align regulation with the President’s principles and priorities as reflected in the order. No specific mechanisms are set out to ensure compliance with this requirement. However, the Performance Management and Results Act may have an impact in holding agencies accountable for compliance with this general direction.

141. The second review mechanism is based on OMB. The administrator of OIRA is required to work with a regulatory working group, drawn from regulatory agency personnel, to identify regulations that require modification. The design of this mechanism scores highly in terms of consistency with OECD best practice recommendations which emphasise the need to balance regulatory agency responsibility for reform with centralised co-ordination and management by an expert reform body.

142. Thirdly, the Vice President is asked to lead a programme of regulatory review. The National Performance Review, which is the mechanism by which this request has been implemented set a radical target of a 50 per cent reduction in the number of existing regulations within five years. OMB reported in 1996<sup>70</sup> that NPR efforts had led to the removal of 16,000 pages from the Code of Federal Regulations and that another 31,000 pages were modified out of a total of 86,000 pages reviewed to that point. This represents a total of about 40 per cent of the total number of pages of the Code either removed or modified. Nonetheless, it is unclear that this review activity produce significant benefits, since cost-savings were not documented. Experiences in many other countries show that it is not difficult to produce impressive results if non-monetary units such as page numbers or numbers of regulations revised are used instead of more relevant measures. For example, the General Accounting Office looked more closely at four agencies and found that these reported page reductions were almost entirely offset by new regulatory requirements in the same period.<sup>71</sup>

143. Sunsetting and automatic review requirements are not drivers of significant review activity, except in the case of three-year sunsets on all government formalities and paperwork requirements (see below). A new requirement in the small business act requires periodic reviews every ten years for small business impacts.

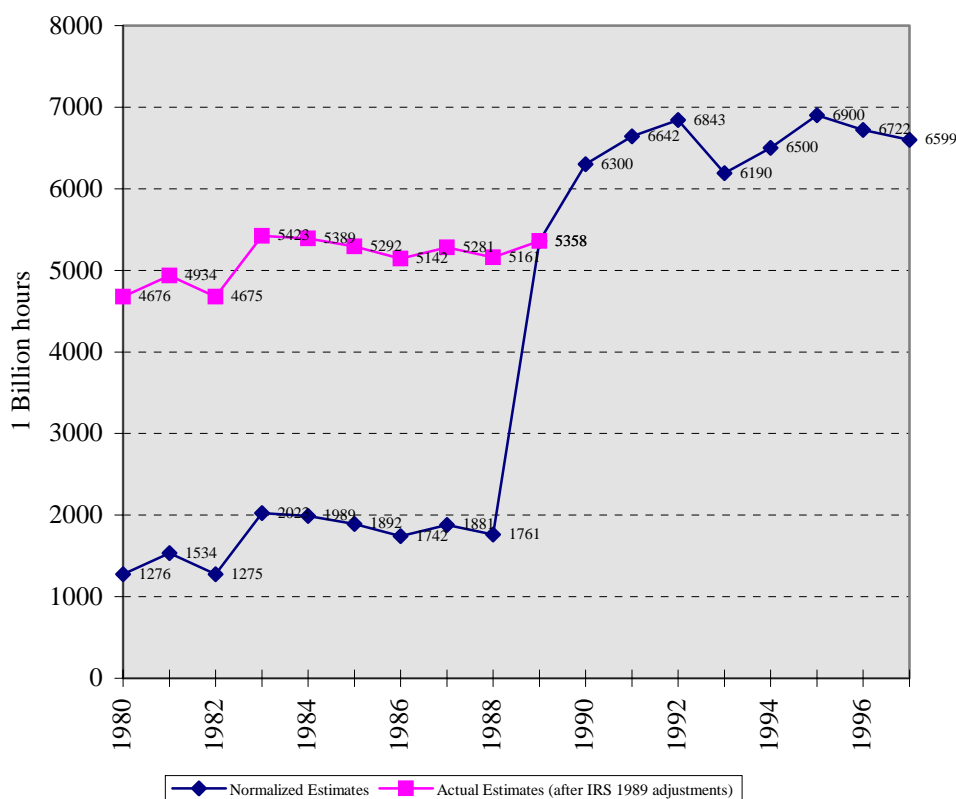
144. *Cutting Red Tape* The U.S. federal government has an enormous appetite for information that must be fed by enterprises and citizens. This seems to be a natural result of the information age, of pressures on public administrations to target and assess programmes, and of budget cuts that have shifted costs from public to private sectors. The demand is also driven by the trend toward the use of information as a supplement or alternative to traditional forms of regulation.

145. Since 1980, the United States has developed an intensive system (characteristically highly legalistic) for controlling paperwork burdens. The Paperwork Reduction Act establishes an independent reviewing agency (OIRA) and a centralised approval procedure, and offers legal protection to citizens if agencies attempt to enforce paperwork requirements that are not OIRA-approved. Granting legal authority to a central review agency to disapprove decisions by regulators -- an authority that seems to be the only one of its kind in OECD countries -- indicates the depth of public frustration over mandated paperwork. And indeed the magnitude of the problem is impressive: in 1996, businesses and citizens spend 6.7 billion hours filling out Federal government forms, responding to surveys, keeping records, collecting information, and dealing with other kinds of government paperwork (see Chart 1). Tax formalities accounted for roughly 80 percent of the total burden.

146. An annual planning process -- called the "Information Collection Budget" -- supplements the review of individual paperwork requirements. A computerised list of all federal paperwork requirements and the number of personhours required to comply with each is maintained in OIRA. Each agency has its own "paperwork budget" (the total number of personhours required to comply with its paperwork requirements) and each year agrees in negotiation with OIRA to a target reduction, taking into consideration new program needs and the possibility of reducing existing burdens. This management tool appears to be a "best practice" that should be considered by other countries.

147. The success of Federal efforts to manage paperwork burden is mixed. OMB made significant progress in improving awareness of the costs and consequences of information collection activities, and has succeeded in slowing the growth of paperwork burdens. Yet OIRA's efforts are overwhelmed by major new regulatory programmes that require information from the public. Hence, the programme has not been successful in reducing the burden on the public, though this was a major goal of the PRA. Between 1980 and 1996 total paperwork burden grew from 4.6 billion hours per year to 6.7 billion hours per year.

**Chart 1: Aggregate number of hours spent filling out federal government forms. Selected Fiscal years 1981 - 1997<sup>72</sup>**



*The sharp increase in FY 1989 is due to a comprehensive reassessment of the tax-related burdens by the responsible agency. The Normalised Estimates adjust the previous burden estimates incorporating the new measurements.*

148. *The Paperwork Reduction Act.* Under the Act, each federal requirement that the public or businesses collect, keep, or submit information to the government (through, for example, tax forms or record-keeping) must be approved by OIRA at least once every three years. The Act gives OIRA broad authority to disapprove a paperwork requirement or order its revision if OIRA finds that (1) it does not have practical utility; (2) is not the least burdensome necessary; or (3) duplicates information otherwise available. Requests for OIRA approval are published in the Federal Register, and the public is given 30 days to provide comments. If OIRA approves a requirement, an approval number is issued that must be displayed on the form or regulation. If a current approval number is not displayed, a member of the public cannot be penalised for refusing to keep or submit the required information. Agencies are forbidden to expend resources carrying out unproved collections of information. OMB follows up any violations with the responsible agencies, and notifies the Congress annually of such violations. Notably, the three year “reapproval” cycle means that consultation here is conducted on an *ex post* basis, rather than simply an *ex ante* one, as is the case with most consultation requirements.

149. *The Information Collection Budget (ICB).* A second instrument created by the PRA to control paperwork burden is the annual publication of the Information Collection Budget (ICB). The ICB is the vehicle through which OIRA, in consultation with each agency, sets annual agency goals to reduce information collection burdens. At the end of the fiscal year, OIRA reports to Congress the results for the whole government and each agency and the achievement of the goals. Since 1980, the reduction targets

have varied. In 1996 the PRA set an annual government-wide goal for the reduction of the total information collection burden of 10% during each of fiscal years 1996 and 1997 and 5% during each of fiscal years 1998 through 2001.

150. The ICB is built around fiscal budgeting concepts. Each agency calculates its total information collection "budget" by totalling the time required to complete all its information requests. This budgeting exercise is then used to measure progress toward reduction goals. The ICB is also an important mechanism in developing a comprehensive strategy to manage Federal information resources. The budgeting process has been considered useful because it assists agencies to evaluate broad categories of information as they relate to programme objectives, rather than as isolated collections of information. It encourages trade-offs between low and high priority information.

151. Recent reports have revealed some weaknesses in the ICB process. First, reduction targets have important measurement limitations. Estimating the time for an individual to collect and provide information is not simple. OIRA has not issued guidance on how to measure such burdens. Consequently, the ICB is undermined by a lack of quality and comparability of targets among agencies. For example, in 1989, IRS re-estimated the tax-related burden, tripling the government-wide burden. In 1997, the same agency concluded that tax compliance burdens may have been overstated by a factor between 3.8 and 5 and should be re-adjusted downward<sup>73</sup>. Second, the reduction targets lack binding force.<sup>74</sup>

152. *New uses for information technologies.* These responsibilities are closely tied to OMB's responsibility for management and co-ordination of federal information policies. An important advance in the PRA was the placement of paperwork reduction objectives squarely within a comprehensive framework for managing information resources. Paper is viewed merely as a means of handling information, and is not different in kind from other means such as electronic media. Reducing paperwork makes sense only within the broader context of information management. In a recent report, Vice President Gore stated his intent to use information technologies to create a government that works better and costs less.<sup>75</sup> This has been accelerated by the increasing use of the Internet which provides not only linkages and research capacities but the possibility to build user-friendly electronic one-stop shops.

153. Two approaches have been used by Federal agencies: use of IT to collect information more efficiently and rapidly, and use of IT to better inform the public of its rights and obligations. An example of the former concerns new ways to complete forms by "taking the paper out of paperwork". A recent initiative by the Internal Revenue Service (IRS), to offer Telefile to most single filers allows over 4 million taxpayers who used to file a paper form to file tax returns using a touch-tone phone. An example of the use of IT to provide better information and open new channels for consultation is the electronic one-stop link Business.Gov (<http://www.business.gov>). This service provides practical assistance to businesses through answers to frequently asked questions, search capacities for Federal information, browsers for Government documents, and viewing of business-related items from Federal agencies.

154. *Simplifying permits and licenses.* One of the more damaging forms of regulation is the *ex ante* licensing or permitting requirement. These kinds of regulations increase investment delays and uncertainties, have disproportionate effects on SME start-up, and are very costly for public administrations to apply. Yet they are pervasive in OECD countries. The United States has made substantial reforms in this area, although the potential for further gains remains substantial.

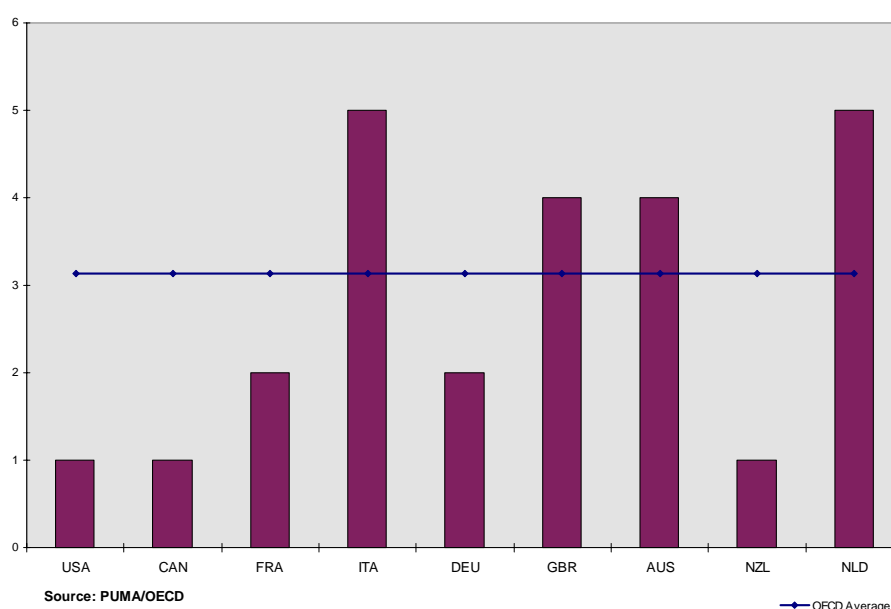
155. Permitting and licensing activities are split between levels of government in the United States. States use licences and permits to control the proficiency and quality of professional services (e.g. lawyers, doctors, accountants) and the impacts of activities at the local level (e.g. zoning permits). At the federal level, licences and permits are used mainly to control risks imposed by activities in interstate

commerce, like medicines, or that involve special concerns, such as nuclear reactors. Such Federal procedures can be very complex and time consuming. They often require overview by different agencies, previous notification in the Federal Register or third party approvals<sup>76</sup>. After issuance, the licence or permit can be challenged in court.

156. The use of licenses and permits at the federal level has evolved very slowly in the past decade. Alternatives to this ‘command and control’ measure are still scarce, despite real concerns about effects on market access. Despite the opportunity offered by the PRA, no federal programme has concentrated on simplifying or reducing them government-wide. There may be a perception that the United States simply has fewer permits and licensing requirements, although the lack of any inventory at federal or state levels means this is difficult to assess. There are also indications that some large cities are taking steps to streamline licensing to attract investment, and this is a positive dynamic. However, if the extensive experiences of other OECD countries are a guide, this is an area where more attention in the United States could yield substantial efficiencies.

### **Box 11: Simplifying business licences and permits**

*This synthetic indicator of efforts to simplify and eliminate permits and licences ranks more highly those programmes where countries use the ‘silence is consent’ rule to speed up decision or, have set up one-stop shops for businesses, where there is a complete inventory of permits and licences; and where there is a specific programme, co-ordinated with lower levels of government, to review and reduce burdens of permits and licences. Despite the efforts related to the PRA, the United States ranks low on these scores relative to other OECD countries. The lack of attention to the costs of licences and permits may reflect the relatively prominent role of the states in this area, given the U.S. federal structure. However, other federal states, such as Australia, have nonetheless acted at federal level to reduce the burdens of licences and permits at all levels of government.*



*Reducing regulatory burdens on SMEs*

157. The OECD Report on Regulatory Reform suggests that priority reform issues include reducing regulatory burdens on small and medium-scale businesses, which are disproportionately hit by the cumulative impact of administrative and other regulations to the extent that there are fixed compliance costs. For these reasons, an important feature of the regulatory and paperwork reduction programmes in the United States has been the focus on SMEs.

158. In response to these concerns Congress has enacted and subsequently improved several laws<sup>77</sup>. In 1980, the Regulatory Flexibility Act (RFA) was enacted. Sixteen years later, the Congress passed the Small Business Regulatory Enforcement Fairness Act (SBREFA) to correct flaws in the RFA that had undermined its effectiveness. The Small Business Administration's (SBA) Office of Advocacy has been the main institution to administer these laws. Both acts increased SBA powers in order to pave three avenues for SMEs in influencing their regulatory environment

159. *SME participation to the development and review of regulations.* The most significant mechanism concerns the RFA review process which requires federal agencies to analyse the anticipated effects of proposed rules on small entities unless they certify that the rules will not have a "significant economic impact on a substantial number of small entities".<sup>78</sup> Moreover, federal agencies are required to identify alternative regulatory approaches. This review process is done through a "Regulatory Flexibility Analysis" and the notification requirements in the *Federal Register*<sup>79</sup>. SBREFA reinforced these requirements by permitting judicial review of agency compliance with the RFA and enhanced the authority of the SBA Office of Advocacy to file *amicus* briefs in court involving agency violations. In practice, this provides to the aggrieved SME court awards, attorney's fees, and costs when an agency has been found to be excessive in its enforcement of federal regulations.

160. A second innovation introduced by SBREFA concerns the establishment of EPA and OSHA Regulatory Review Panels to review the initial Regulatory Flexibility Analysis for each draft rule. The panel process supplements the public comment requirements established by law. Each panel consists of employees from OMB and SBA's Office of Advocacy, the regulatory agency responsible for the draft rule and representatives of affected small entities.

161. *Compliance Assistance and Enforcement issues for SMEs.* Another important improvement for alleviating SME regulatory burdens is compliance assistance and mechanisms for improving enforcement actions by agencies included in SBREFA. The Act obliges agencies to publish compliance guides for all rules with a significant small business impact. SBREFA also establishes a complaint process whereby any SME can complain about enforcement actions to the new SBA Ombudsman or one of the 20 small business regulatory fairness boards established across the country.

162. *Assessment of the US response to regulatory concerns of SMEs.* In the past two decades, mechanisms have been built into federal regulatory processes to improve transparency, impact assessment, compliance and enforcement for SMEs. The significance of the original problem is not, however, clear, despite continuing complaints from small businesses. A recent study highlights the US positive institutional framework existing in the US, where a vibrant and diversified SME sector operates,<sup>80</sup> though it is entirely possible that the SME sector would perform even better if regulatory burdens were reduced. The biggest problem seems to be tax-related burdens, as is true in most countries. The complexity of the tax system may require an additional Advocacy Review Panel.



163. One issue that should be closely watched is the tension between treating SMEs fairly and treating them preferentially. Too much tailoring of rules could result in a “positive” discrimination mechanism that distorts competition. Too much attention to the particular interests of a very diverse set of SMEs may create a more complex regulatory system. Exception and loopholes may reduce the transparency of the system. SME concerns may also hinder important global reforms, affecting consumers as well as other firms. For instance, the SBA Office of Advocacy successfully argued that the Federal Communication Commission adopt a plan that telephone carriers would receive full funding to support universal service to high-cost and rural areas. This cross-subsidy from consumers to some producers to a particular class of SMEs may be imposing costs on new or high tech SMEs, among other consumers.

## **5. Conclusions and policy options for reform**

### **5.1. General assessment of strengths and weaknesses**

164. By most measures, the capacities of the U.S. federal government for assuring the quality of federal regulation is among the best in OECD countries. Considerable investments in the institutional, policy, and legal infrastructure for quality regulation has produced well-functioning systems in the critical areas of forward planning, regulatory impact analysis, centralised quality control, and consultation with affected entities.

165. An impressive example of reform is the collective and steady efforts over 20 years, through changes in political control of the Congress and the presidency, to improve analytical capacities and acceptance of the benefit-cost principle within regulatory agencies, under the leadership of OMB. While there are still substantial problems with adoption of regulations that do not pass the test, the degree of quantification of the impact of regulations in U.S. federal regulatory bodies is unique in OECD countries. The lesson to be learned here is the value of persistence and policy stability over the long term in embedding new ways of thinking into bureaucracies..

166. The 1980s was a period of considerable investment in reform institutions and processes, but the programme was weakened by stressing “regulatory relief” rather than benefit-cost principles aimed at maximising social welfare, and by relying too much on an over-centralised and confrontational process that improved the quality of individual regulations, but did little to change incentives and administrative cultures within the regulatory agencies. For example, the role of the central oversight body (OMB) was too oriented toward reacting to transactions, and not enough to general systemic and institutional change. This lesson was learned, and an important retuning of the reform programme took place in the 1990s, with a targeting of OMB’s efforts and a focus on government reinvention and on results-oriented policy-making.

167. This review of regulatory reform in the United States should help dispel the myth that the United States is less regulated than other OECD countries. The United States is different from many countries certainly not in the amount of regulation, but in its style. The most important factor for U.S. regulation is that American regulatory culture incorporates competition principles to a greater extent than in most countries, which stems from deep-seated habits and values than from any organised vigilance. This is an asset of increasing value in a world economy characterised by globalisation, responsiveness, and rapid technological progress. The U.S. regulatory system illustrates well the conclusion in the OECD Report on Regulatory Reform:

*“...economic regulations have often proven to be extremely costly and ineffective means of achieving public interest goals...In general, public policies such as protection of health, safety, and the environment are better served by using competition-neutral instruments, such as well-targeted social regulations and market incentives, to change behaviour in competitive markets.”<sup>81</sup>*

168. The key questions today are these: Are federal regulations of higher-quality today than 25 years ago? Do they, in the aggregate, produce higher net social benefits for the American people? While no answer can be definitive, the answer is probably yes to both questions, for two reasons:

1. The enormous shift since the 1970s from anti-competitive economic regulation toward more neutral styles of social regulation has greatly improved the benefits of the regulatory system as a whole, since social regulations are much more likely to produce net benefits than do economic regulations. OMB has calculated that the total benefits of social regulation in 1997 exceeded costs by about \$80 billion, while the costs of economic regulations greatly exceeded its benefits.<sup>82</sup>
2. controls on quality of social regulations and paperwork have steadily developed and government capacities to assure high-quality decisions are stronger than ever.

This improvement is a longer-term trend, since application of quality control capacities can obviously vary over time, and hence the overall quality of new federal regulations probably varies as well, depending on political commitment. Yet the trend is in the right direction.

169. This relative ranking should not induce complaisance. There continue to be severe problems with both cost and policy effectiveness in the U.S. regulatory system. The aggregate cost of regulations appears to stand at its highest ever point in relative terms, and the U.S. regulatory habits of excessive detail, legalism, and rigidity are still dominant.

170. The U.S. faces enormous difficulties in establishing consistent regulatory quality standards and controls on the sprawling regulatory apparatus of the federal government. There are enormous tensions in the system, between due process and flexibility, between legal clarity and innovation, and between empirical and legal/adversarial methods. Since the earliest days of regulatory reform, consistency and coherence have been at the heart of attempts to strengthen central management. An analysis of governance in the United States found this difficulty to be inherent in the constitutional set-up of the American government:

*“The problem of governance in the United States is mainly one of creating institutions or governing arrangements that can pursue policies of sufficient coherence, consistency, foresight, and stability that the national welfare is not sacrificed for narrow or temporary gains. The United States has difficulty in arriving at such arrangements because it must fashion them out of three substantially autonomous political institutions: Congress, the presidency, and the bureaucracy.”<sup>83</sup>*

171. This suggests that limits to rationality in the American regulatory system are inherent in the American way of governance. But there is considerable distance to travel before these limits are reached. At the heart of the most severe regulatory problems is the quality of primary legislation. The trend toward higher quality in delegated regulation cannot be seen in the quality of primary legislation, and this severely limits, and threatens to reverse, the benefits to be gained from regulatory reform.

172. More so than in other OECD countries, the United States has found it extremely difficult to develop controls on legislative quality. This is partly structural, arising from the constitutional balance of powers between the executive and the legislative. And, unlike parliamentary systems, bills originate from

many sources. The result is that, perversely, there is less attention to quality of laws than to decisions authorised by the laws. In the past, the Congress has ignored even those slight controls that it adopted for itself, though recent reforms, such as the UMRA requirement that the Congressional Budget Office estimate the costs of proposed legislation, are positive. If this is to have any value, members of Congress will have to become consumers of such information. It remains to be seen how such estimates will be considered in Congressional processes. Strikingly, some recent laws, such as the Clear Air Act of 1990, expressly prohibit good decision practices by regulatory agencies in order to limit administrative discretion (and presidential powers) in regulating.

173. Crucially, innovation and the development of more cost-effective policy approaches are often blocked by rigid legislation. "EPA is hobbled by overly prescriptive statutes that pull the agency in too many directions and permit managers too little discretion to make wise decisions. Congress should stop micro-managing EPA." concluded a recent report of the National Academy of Public Administration. A deeper problem, noted a former head of the U.S. environmental agency (and as noted earlier in nursing home regulation), is that frustration with regulatory performance, perhaps justified or perhaps stemming from unrealistic expectations, can lead to a vicious cycle of controls and increased barriers to good performance:

*When traced to their source, many of the more vexing problems...have their roots in the underlying statutes. Besides being prescriptive, these statutes tend to over-promise setting up expectations of absolute safety within extremely tight time frames. While this is well-intentioned, it has an undermining effect on the Agency and those who rely on it. As EPA misses one deadline after another, the courts intervene, as requested by an aggrieved party, and Congress turns the screws even tighter, further limiting the Agency's ability to respond creatively and responsibly to problems far more complex than lawmakers could have possibly envisioned.<sup>84</sup>*

OMB has similarly warned that, "It is our view that highly prescriptive legislation...has contributed to a regulatory system that is sometimes unmanageable or is driven by plaintiffs rather than by a rational planning process that directs the nation's resources to the most important problems and the most cost-effective solutions."<sup>85</sup>

174. Without genuine progress at the legislative level in placing accountability on results and in encouraging risk-taking and policy innovation, it is doubtful that the executive branch can make substantial additional progress in the quality of subordinate regulations, or even preserve the progress that has been made. Reforms in the Congress are beyond the scope of this review, but it is clear that there is no quick fix. The two most positive steps in recent years is the Performance Management and Results Act, which builds a foundation for results-oriented policies, and the trend toward improving dialogue and consensus on innovation approaches, which experience in other countries shows is a necessary condition for building the trust that is needed if administrators are to have the flexibility to innovate and take risks.

175. The importance of a vigorous academic community in producing policy-relevant data to support regulatory reform should not be over-looked. The continuing efforts of researchers in American think tanks and universities have mapped the evidence of benefits from reform and posed strong challenges to the status quo. Such scholarship is, in fact, one of the most influential exports of the United States to the rest of the world (once in circulation, it can be considered a public good).

## 5.2. *Policy options for consideration.*

176. There is a large and growing volume of recommendations from many sources on ways to improve regulatory reform in the United States. Most of these consist of fine-tuning existing structures; some, such as those in the NPR, are more profound, aimed at changing the incentives and culture of regulators. Based in part on this body of work, this section identifies actions that, based on international consensus on good regulatory practices and on concrete experiences in other OECD countries, are likely to be particularly beneficial to improving regulatory management and reform capacities in the United States.

- *Improve the responsiveness of the regulatory system by continuing to seek means to streamline regulatory processes through the NPR process.*

177. Sluggishness, delay, and inefficiencies in regulatory processes will increasingly penalise the United States as the pace of globalisation and innovation steps up. The lack of policy responsiveness and flexibility implied by the long and cumbersome regulatory process has been long-recognised. The 1993 NPR noted that a layering of procedural requirements have, cumulatively, “made the rulemaking process increasingly burdensome and rigid.”<sup>86</sup>

178. Further, the adversarial and legalistic process for producing new regulations produces an incentive for “all or nothing” solutions that drive regulators away from the rule of reason, and limit the sensible application of rules in the field. The NPR too found that “Lack of information is [a] serious problem. To some extent, this stems from the adversarial nature of the rulemaking process; in many rule-makings, regulated entities, public interest groups, and other parties are more interested in protecting their own positions than in providing useful information to the agency or finding a solution to the problem.”

179. The cost and length of time needed for regulatory change has imposed large hidden costs on the quality of the national regulatory system. Regulators are less willing to implement new regulatory quality procedures when it already takes so long to get regulations through the pipeline. Beneficial modifications to old regulations are less likely to be carried out. Given the enormous investment needed, regulators are less likely to innovate and take risks, since a setback can cost several years of effort. Of great concern is the tendency by regulators to use policy statements, guidance, and memos to agency personal that side-step procedural requirements. While such methods can be efficient, incentives to use them as time-saving measures are likely to be perverse, and can undermine the transparency of the regulatory system.

180. Reform in this area will be difficult, since procedural and legal formalism is so heavily embedded in the U.S. policy system. Some steps are underway, such as use of “final” rules for minor issues to avoid the lengthy proposal process. Targeting of OMB review to only major reviews eliminates a step for many regulations. Regulatory negotiations and consensus-building processes offer the best chance for real change.

- *Increase regulatory benefits by improving interagency priority-setting capacities*

181. The single regulatory reform measure likely to produce the most substantial gains in social welfare is improvement of priority-setting mechanisms across the government. Several attempts have been made to improve priority-setting. Forward planning through the Regulatory Plan has been useful for other reasons, but has been ineffective in forcing trade-offs between regulatory agencies, though this was one of its original purposes. The regulatory budget concept is very attractive from a theoretic view, but its methodological difficulties have prevented its implementation. Others have recommended that the regulatory budget be applied only to new regulatory costs,<sup>87</sup> a partial solution that may, however, be more

practical than a global budget constraint. The NPR recommended that similar risks be ranked and that priorities be set across agencies, but nothing has come of the recommendation. No OECD country has solved this problem, but it is possible that the Performance Management and Results Act is a step toward a priority-setting mechanism through which fiscal budgeting decisions can be linked to those regulatory programs that deliver more per dollar expended.

- *Expand the value, speed and scope of review of primary legislation and other regulations by launching a structured process of rolling reviews, reviewing policy areas rather than individual rules, and experimenting with use of advisory bodies for the reviews.*

182. One of the strongest points of the US system is the central review mechanisms for new regulations and formalities. Quality procedures that in many countries would be perceived as intolerable have been integrated into the regulatory culture of the public service. Yet the current 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. For example, while reviews by the regulators themselves in 1993-1994 eliminated many pages of regulations, the actual benefits in terms of cost-savings or policy effectiveness were not well documented, and are unlikely to be very significant since most changes were marginal.

183. A high priority should be placed on developing better review procedures for legislation in particular. As noted, 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 any consistent evaluation of the performance of existing laws. This has substantial negative downstream effects on the quality of policy implementation and policy outcomes. This review has documented in particular the negative effects of current styles of law on innovation and experimentation by the administration.

184. More attention should be placed on systematic review and upgrading of legislation through, for example, a rolling review process based on a prioritization of policy areas. Structuring of an effective review process will be key to its results, and may require strengthening the capacities of the OMB and congressional offices such as CBO. First, efforts in other OECD countries show that achieving consensus in advance on a transparent and measurable set of principles for review is essential. This was seen in the Australian competition principles review, 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 is a good step toward consensus on results-oriented principles, but a benefit-cost test and an emphasis on innovation will produce the best results in increasing social welfare.

185. Second, the reinvention principle should guide the reviews. Current review processes work 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. Such linkages are often not analysed. At the end, this seems a review process focused on pruning each tree rather than improving the health of the forest. The effectiveness of U.S. regulatory review could be improved with a thorough assessments of the regulatory framework affecting a given economic sector or a particularly relevant issue done by high-level advisory board, commission or task force. Its recommendations would include groups of reforms affecting different instruments or policies packaged together in order to permit a higher and quicker regulatory improvement. In every law reviewed, emphasis should be given to encouraging innovation in approaches, with accountability for results.

186. The setting up of an advisory group may gain from the recent experience of various OECD Members where ad hoc or standing task forces, often formed by senior business people, have presented closely and interrelated reform measures to central government institutions and decision makers. For

example, Australia set up in 1996 the Small Business Task Force in order to propose changes to reduce "the paper and compliance burden on small business by 50 percent". The United Kingdom established more recently the Better Regulation Task Force with its members drawn from big and small businesses, consumer and citizen groups, the charity and voluntary sector, trade unions and enforcers to review nine selected regulatory areas (i.e. principles of good regulation, consumer law, employment law, social services, charities and the voluntary sector, company law and corporate governance, environmental regulation, food, and licensing). The Danish regulatory programme has also gained coherence and speed from the establishment of specific topic high level commissions and task forces. Using this approach effectively may require review and revision of the restrictive procedures in the Federal Advisory Committee Act.

187. One area where such an approach has been shown to be useful is simplification of tax-related paperwork, the largest single source of paperwork burden on enterprises in any OECD country. In the United States, tax-related paperwork burdens represent 80 percent of the total burdens. The "Van Lunteren Commission" in the Netherlands is a model for an effective ad hoc commission in this area. The Commission produced short term and long term recommendations, organised into two categories: within existing legislation and with legal reforms.

- *Expand coverage of mandatory quality controls to economic regulation.*

188. As noted, economic regulation produces far fewer benefits than does social regulation, yet is costly. An ideal regulatory reform programme would therefore put stricter controls on the use of economic regulations than on social regulations. The U.S. programme does the opposite. The independent commissions responsible for most of the economic regulations are not covered by the presidential order on regulatory quality. This is rooted in the historical relations between the independent commissions and the president. Similar to the coverage of the Paperwork Reduction Act, however, the other regulatory quality controls should be extended to the independent regulatory commissions.

- *Further encourage the use of cost-effective alternative policy instruments by developing operational guidance for ministries and by developing a wider range of co-operative methods.*

189. One of the anomalies in the American regulatory system is that positive social views toward competition have not led to more market-based approaches to problem-solving. Market approaches have been recommended for years, most recently by the Vice-President's National Performance Review. However, the U.S. regulatory system is relatively less innovative than those in some other OECD countries. For example, ten years later there is still only one nation-wide system of marketable permits for air emissions, though the benefits of such an approach have been well-documented in other areas. Other OECD countries use taxes to restructure incentives to a much greater extent than does the United States, suggesting missed opportunities for cost-effective action. Voluntary approaches have been hampered by inflexible statutes.

190. The current Clinton presidential order requires that analysis of alternatives be documented and subjected to public scrutiny through the RIA process to stimulate genuine comparisons of the benefits and costs of various approaches. UMRA requires agencies to certify that they are choosing the most cost-effective approach. These are good practices of value to other OECD countries. However, they do not seem sufficient in themselves to stimulate innovation, since there are powerful countervailing pressures to risk-taking and co-operation.

191. One of these pressures is the legalistic habits of the administration that, while intended to promote fairness and transparency, lead almost always to traditional command-and-control means. This is

reinforced by traditionally weak accountability mechanisms for the performance of regulatory programmes, which have emphasised inputs such as inspections and rules, rather than outcomes in terms of results and costs. Incentives within the bureaucracy have been deeply conservative and risk-avoiding. Finally, the traditional adversarialism of decision-making emphasises an all or nothing approach

192. There are some hopeful signs. The Performance Management and Results Act should weaken incentives to avoid risk-taking at any cost to programme results. The focus on consensus-building is another positive step, though current approaches seem to be hampered by legal constraints and formalistic habits. A good practice that should be considered government-wide, and by other OECD countries, is to build responsibility for innovation into the bureaucracy through processes such as the 1998 ECOS-EPA Agreement, in which there is a legitimate and transparent channel for new ideas to be considered.

193. As recognised by the NPR in 1993, policy makers are likely to require assistance in the identification of suitable alternative policy tools. Operational guidance on the characteristics and use of alternative approaches should be developed for use by the line ministries. Such guidance has been useful in several countries such as Australia and Canada.

194. Perhaps the most important lesson for the United States from other countries is the value in terms of flexibility, cost-effectiveness, and responsiveness of more co-operative approaches to problem solving. Already, agencies in the United States are experimenting with such approaches. Negotiated rulemaking is one such effort, but the current approach still relies very heavily on traditional regulatory processes, and its value is not yet proven. It may be that covenants as used in many European countries are an example of a different approach. Continued leadership from the centre to encourage risk-taking and experimentation, and evaluation will be needed to promote efforts to inject a degree of co-operation into adversarial systems.

- *Develop a stronger role for the central reform authority in promoting, facilitating and providing practical guidance on reform to regulatory agencies.*

195. OMB has recently moved to develop more co-operative relationships with regulatory agencies and to become involved at earlier stages in rule-making processes. This is consistent with changes in a number of countries with extensive experience with reform, including the Netherlands, Canada and Australia, where central reform bodies have moved toward a more positive approach to regulators.

196. However, a key change not so far adopted in the United States is an emphasis on the provision of tools to assist agencies to regulate better, including practical guidance manuals on issues such as regulatory alternatives, principles of good regulation and regulatory impact assessment, backed by extensive training programmes to ensure skills acquisition by regulators. Initiatives of this sort could help build on the cultural changes among regulators that previous OMB reform efforts have produced, by giving regulators better tools for reinventing regulation. It is also useful in the context of a more results-oriented environment in which regulators become problem-solvers rather than production lines for legal texts.

- *Encourage entrepreneurialism by streamlining permits and licenses at the federal level, by coordinating with the states on review and streamlining of permits and licenses, and by building more complete information systems for enterprises*

197. Though *ex ante* permits and licenses can be among the most damaging of government formalities with respect to business start-ups and among the most costly regulations to administer, current efforts in the United States place too little focus on ensuring that such requirements are the minimum

necessary to achieve policy objectives. This is probably due to the fact that most such requirements take place at state and local levels. Yet new ideas -- such as the move to a "supply model" in Germany that offers various choices to investors, depending on the degree of risk they wish to accept<sup>88</sup> -- are being developed and implemented in many OECD countries, and could be useful in the United States.

198. At the federal level, OIRA may wish to lead an interagency programme to "re-engineer" important licences and permits. The thrust of this programme could be to reduce the most frequently used and costly licences and permits. An important criteria would be to minimise their cost collectively as well as individually (i.e. reducing the overlap between them, increasing the information collection synergies between agencies).

199. The federal government should consider means of promoting the streamlining of permits, licenses, and other government formalities carried out at state and local levels. For example, it may wish to encourage adoption of paperwork reduction acts at state levels. A programme of regulatory benchmarking across states may help stimulate political interest in improving the business environment, as it has in Australia. Also, Australian state governments have agreed to adopt parallel regulation in many areas where divergent regulations would impose extra costs. The federal government has been a key facilitator of this process in Australia.

200. Finally, information technology has been under-used in this area in the United States. Development of a user-friendly public registry and inventory of formalities on the Internet could provide useful information on approved information collections., such as a plain language list of the items would be available: all the information elements required, the statutory time responses of the authorities, if the 'consent is silence' rule applies, the means or procedure to present (or maintain) it an electronic copy of the forms, etc. This central data base could evolve progressively into becoming an electronic one-stop shop where the formalities could be directly inputted and sent to the agencies.

### **5.3. *Managing regulatory reform***

201. The most important determinant of the scope and pace of further reform is the attitude of the Congress. Congressional incentives to relinquish control over *how* policies are carried out in return for more accountability for policy results are not strong, though they are improving. In the end, it will be the management of a more results-oriented relationship between the executive and the legislative that will determine the scope and pace of regulatory reform in the United States.

202. While the U.S. public debate over regulatory reform is among the most well-informed and transparent in OECD countries, there is still too little information on the results of reform strategies, including their effects on programme effectiveness, costs, economic performance, and distribution of gains and losses. Yet this information is critical if reform is to enjoy support from citizens who place high value on safety, health, environmental quality, and other values promoted by regulation. At this juncture, it seems that fears about the effects of reform on levels of protection have not been borne out, but continued reform will proceed faster and more deeply if reformers take concrete steps to demonstrate that protection has been maintained. Evaluation of the impacts of reform and communication with the public and all major stakeholders with respect to the short and long-term effects of action and non-action, and on the distribution of costs and benefits, will be increasingly important to further progress.



## NOTES

- <sup>1</sup> This chapter was prepared by Scott Jacobs, Head of the OECD Programme on Regulatory Reform; and Rex Deighton-Smith and Cesar Cordova-Novion, Administrators for Regulatory Management and Reform in the Public Management Service of the OECD. It has benefited from extensive comments provided by OECD colleagues.
- <sup>2</sup> A summary of these estimates is given in US Office of Information and Regulatory Affairs, Office of Management and Budget (1997) Report to Congress on the Costs and Benefits of Federal Regulations, September 30.
- <sup>3</sup> US Office of Information and Regulatory Affairs, OMB (1994) Report to the President on Executive Order No. 12866, 1 May.
- <sup>4</sup> President Bill Clinton (1993) Executive Order No. 12866, Regulatory Planning and Review (30 September)
- <sup>5</sup> Noll, Roger and Bruce Owen (1983) *The Political Economy of Deregulation: Interest Groups in the Regulatory Process* (American Enterprise Institute: Washington, D.C.), pp. 26-27.
- <sup>6</sup> For comparisons of U.S. regulatory styles with other countries, see, *inter alia*, Vogel, David (1986) *National Styles of Regulation* (Cornell University Press: Ithaca); Badaracco, Joseph (1985) *Loading the Dice: A Five-Country Study of Vinyl Chloride Regulation* (Harvard Business School Press: Boston); Kelman, Steven (1981) *Regulating America, Regulating Sweden* (MIT Press: Cambridge); Heidenheimer, Arnold; Hecl, Hugh; Adams, Carolyn (1983) *Comparative Public Policy: The Politics of Social Choice in Europe and America* (St. Martin's Press: New York).
- <sup>7</sup> Crandall, Robert, et. al (1997) *An Agenda for Federal Regulatory Reform* (AEI and The Brookings Institution), p. 5.
- <sup>8</sup> Reported in Braithwaite, John (1993) "Improving Regulatory Compliance: Strategies and Practical Applications in OECD Countries," PUMA Occasional Papers in Public Management, (OECD: Paris).
- <sup>9</sup> McGarity, Thomas, cited in Kerwin, Cornelius (1994), Introduction to the Congressional Quarterly's Federal Regulatory Directory (Washington, D.C.).
- <sup>10</sup> Vice President Al Gore (1993) "Creating a Government That Works Better and Costs Less: Improving Regulatory Systems" Accompanying Report of the National Performance Review. (September).
- <sup>11</sup> Howard, Philip K. (1994) *The Death of Common Sense: How Law is Suffocating America* (Random House: New York)
- <sup>12</sup> Office of Information and Regulatory Affairs, Office of Management and Budget (1997) "Report to Congress on the Costs and Benefits of Federal Regulations" (September 30). The figure of \$329 billion is adjusted to account for a mathematical error in OMB's report to the Congress. See Hahn, Robert W. (1998) "An Analysis of the First Government Report on the Benefits and Costs of Regulation," Belfour Center for Science and International Affairs, John F. Kennedy School of Government, Harvard University (May).

- <sup>13</sup> Hopkins, Thomas D. (1996) "Regulatory Costs in Profile," Policy Study No. 132, Center for the Study of American Business (August); see also Hopkins, Thomas D. (1995) "Profiles of Regulatory Costs," Report to U.S. Small Business Administration.
- <sup>14</sup> See, among others, Hazilla, Michael and Raymond Kopp (1990) "Social Cost of Environmental Quality Regulations: A General Equilibrium Analysis," *Journal of Political Economy* (Vol. 98, No. 4); and Jorgensen, Dale W. and Peter J. Wilcoxon (1990) "Environmental Regulation and U.S. Economic Growth," *Rand Journal of Economics* (Vol 21, No. 2).
- <sup>15</sup> Hahn, Robert W. (1998) "An Analysis of the First Government Report on the Benefits and Costs of Regulation," Belfour Center for Science and International Affairs, John F. Kennedy School of Government, Harvard University (May).
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- <sup>18</sup> Teng, Tammy and John Graham (1997) "The Opportunity Costs of Haphazard Social Investments in Life-Saving," published in Hahn, Robert, *Risks, Costs and Lives Saved -- Getting Better Results from Regulation* (Oxford University Press, New York and Oxford), p. 173.
- <sup>19</sup> Kerwin, Cornelius (1994) *Introduction to the Congressional Quarterly's Federal Regulatory Directory* (Washington, D.C.), p. 16.
- <sup>20</sup> Kerwin, p. 40.
- <sup>21</sup> Beam, David, et al (1992) "Federal Regulation of State and Local Governments: Regulatory Federalism a Decade Later" draft report prepared for the US Advisory Commission on Intergovernmental Relations.
- <sup>22</sup> US Office of Information and Regulatory Affairs, Office of Management and Budget (1994) *Report to the President on Executive Order No. 12866, Regulatory Planning and Review* (May 1).
- <sup>23</sup> US Office of Information and Regulatory Affairs, Office of Management and Budget (1997) "Report to Congress on the Costs and Benefits of Federal Regulations" (September 30).
- <sup>24</sup> McCraw, Thomas K. (1984) *Prophets of Regulation*. Belknap Press, p. 259.
- <sup>25</sup> House Concurrent Resolution 448, 94 Stat. 3680 (November 20, 1980).
- <sup>26</sup> Much of this discussion is adapted from US Office of Management and Budget (1988) *Introduction to The Regulatory Program of the United States Government*, April 1, 1987 -- March 31, 1988.
- <sup>27</sup> Data from the Washington University Center for the Study of American Business.
- <sup>28</sup> See Hopkins, T.K, "Costs of Regulation: Filling the Gaps" (1992), a report for the US Regulatory Information Service Centre and Hahn,R. & Hird, J. "The Costs and Benefits of Regulation: Review and Synthesis" in *Yale Journal of Regulation* Vol. 8. No. 1.
- <sup>29</sup> One study found that 0.44 percent, or 31 percent, of the decline in U.S. manufacturing productivity in the 1970s was due to these kinds of regulation. See Gray, W. (1987) "The Cost of Regulation: OSHA, EPA and the Productivity

Slowdown," *American Economic Review*, December, 77(5), pp. 998-1006. See also Gray, W. (1991) "The Impact of OSHA and EPA Regulation on Productivity Growth," *Journal of Regulation and Social Costs*, June, 1(3), pp. 25-47.

<sup>30</sup> President Ronald Reagan, "The Regulatory Message of the President," *Regulatory Program*, April 1, 1988 - March 31, 1989, p. vii.

<sup>31</sup> Testimony of James C. Miller III, Director of the Office of Management and Budget, in hearings before the Subcommittee on Intergovernmental Relations, Committee on Governmental Affairs, U.S. Senate, January 28, 1986 (S. Hrg. 99-839), p. 104.

<sup>32</sup> OECD (1997) *The OECD Report on Regulatory Reform: Synthesis* (Paris), p. 37.

<sup>33</sup> OECD (1995) *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, Paris.

<sup>34</sup> Presidential Executive Order 12866, *Regulatory Planning and Review*, September 30, 1993.

<sup>35</sup> The indicators used here are part of a dataset under construction as a contribution to the OECD Secretariat's horizontal work programme on regulatory reform. They are based in part on a survey of all OECD countries carried out in March-April 1998. The dataset and its applications will be discussed by the Economic Department's Working Party No. 1.

<sup>36</sup> Deighton-Smith, Rex (1997) "Regulatory Impact Analysis: Best Practices in OECD Countries," published in OECD (1997) *Regulatory Impact Analysis: Best Practices in OECD Countries* (Paris), p. 221.

<sup>37</sup> President Bill Clinton (1993) Executive Order No. 12866, September 30.

<sup>38</sup> Bruff (1989), "Presidential Management of Agency Rulemaking," *Geo. W. L. Rev.*, p. 562, as cited in *A Guide to Agency Rulemaking*.

<sup>39</sup> Rosenberg, Morton (1986) "Regulatory Management at OMB," Congressional Research Service, Library of Congress, published in *Office of Management and Budget: Evolving Roles and Future Issues*, the Committee on Governmental Affairs, U.S. Senate, Feb., (S.Prt. 99-134), p. 213.

<sup>40</sup> See Rosenberg, Morton (1986).

<sup>41</sup> Testimony of James C. Miller III, Director of the Office of Management and Budget, in hearings before the Subcommittee on Intergovernmental Relations, Committee on Governmental Affairs, U.S. Senate, January 28, 1986 (S. Hrg. 99-839), p. 104.

<sup>42</sup> Bowers, James. R. (1990) *Regulating the Regulators: An Introduction to the Legislative Oversight of Administrative Rulemaking*. Praeger Publishers: New York, p. xi.

<sup>43</sup> Reported in Hahn (1998).

<sup>44</sup> Beam (1992).

<sup>45</sup> President Ronald Reagan (1985) Executive Order No. 12498, "Regulatory Planning Process," January 4.

<sup>46</sup> White House, Memorandum for the Heads of Executive Departments and Agencies, "Development of Administration's Regulatory Program," January 4, 1985.

- <sup>47</sup> Regulatory Program, April 1, 1988- March 31, 1989, p. 15.
- <sup>48</sup> Statement by the Vice President, The Regulatory Plan, 29 October 1997, FR 57003.
- <sup>49</sup> More Benefits, Fewer Burdens, p. 18.
- <sup>50</sup> Executive Order No. 12044 of March 23, 1978, "Improving Government Regulations".
- <sup>51</sup> Environmental Council of the States, Press release of 30 April 1998.
- <sup>52</sup> US Environmental Protection Agency (1998) The Changing Nature of Environmental and Public Health Protection: An Annual Report on Reinvention (March).
- <sup>53</sup> Environmental Protection Agency (1998), p. 28.
- <sup>54</sup> Mazurek, Janice (1998) The Use of Voluntary Agreements in the United States: An Initial Survey. Resources for the Future, forthcoming.
- <sup>55</sup> Davies et al. (1996), Pollution control in the United States: Evaluating the System (Resources for the Future/Johns Hopkins Press); Kappas, Peter (1997), The politics, practice, and performance of chemical industry self-regulation. Doctoral dissertation in political science, University of California Los Angeles; Boyd, Krupnick and Mazurek (1998) Intel's XL Permit: A framework for evaluation. Discussion Paper 98-11 Resources for the Future (Washington, D.C.).
- <sup>56</sup> See, e.g., Kerwin, C.M. & Furlong, S.R. "Time and Rulemaking: An Empirical Test of Theory" cited in Coglianese, G. "Assessing Consensus: The Promise and Performance of Negotiated Rulemaking" Duke Law Journal, Vol. 46, No. 6 (April 1997).
- <sup>57</sup> Coglianese, G. *op. cit.*, from which much of the following discussion is adapted.
- <sup>58</sup> OECD: Paris, 1997.
- <sup>59</sup> Katzen, Sally (1997) Administrator, OIRA, cited in Business Daily (Los Angeles), March 18.
- <sup>60</sup> Viscusi (1996).
- <sup>61</sup> Hahn (1997).
- <sup>62</sup> Hahn (1998).
- <sup>63</sup> US Office of Information and Regulatory Affairs, Office of Management and Budget (1997) Report to Congress on the Costs and Benefits of Federal Regulations, September 30.
- <sup>64</sup> "Economic Analysis of Federal Regulations Under Executive Order 12866", (1996).
- <sup>65</sup> Morrall, John and Ivy Broder (1997) "Collecting and Using Data for Regulatory Decision-making," published in OECD (1997) Regulatory Impact Analysis: Best Practices in OECD Countries (Paris), p. 245.
- <sup>66</sup> Regulatory Programme, 1990-1991, p. 13.
- <sup>67</sup> Regulatory Program 1990-91, *op.cit.*, p. 14.

- <sup>68</sup> Choices in Risk Assessment: The role of Science Policy in Risk Management Choices. Cited in “Risk Assessment: The US Experience” paper delivered by Steven Milloy to the conference “Managing Risk: A Balancing Act”, European Policy Centre, London, April 29, 1998.
- <sup>69</sup> Congressional Quarterly “Federal Regulatory Directory”, 7th Edition, 1998. Introduction, p. 13.
- <sup>70</sup> “More Benefits, Fewer Burdens”, Office of Management and Budget, 1996.
- <sup>71</sup> General Accounting Office (1997) “Agencies’ efforts to eliminate and revise rules yield mixed results.”, p. 2.
- <sup>72</sup> Antonelli, A, and OIRA (1997).
- <sup>73</sup> GAO, Paperwork Reduction. Government-wide Goals Unlikely to be Met. June 4 1997 (GAO/T-GGD-97-114), p.19.
- <sup>74</sup> Antonelli, A p. 15.
- <sup>75</sup> Gore, Al (1997) *Access America: Reengineering Through Information Technology* .
- <sup>76</sup> Kerwin, Cornelius (1994) Introduction to the Congressional Quarterly’s Federal Regulatory Directory (Washington, D.C.), p. 18.
- <sup>77</sup> See for instance the Unfunded Mandates Reform Act of 1995, the Paperwork Reduction Act of 1980 (amended in 1996) referenced above.
- <sup>78</sup> The RFA is aimed at “small entities”: small businesses, small organizations, small governmental jurisdictions (GAO March 1998, p. 2).
- <sup>79</sup> Although the RFA does not require agencies to use the *Unified Agenda* to publish the statutory notices, the *Agenda* has been increasingly used by the agencies.
- <sup>80</sup> OECD, *Economic Surveys, United States*, 1997.
- <sup>81</sup> US Office of Information and Regulatory Affairs, Office of Management and Budget (1997) Report to Congress on the Costs and Benefits of Federal Regulations, September 30, p. 44.
- <sup>82</sup> US Office of Information and Regulatory Affairs, Office of Management and Budget (1997) Report to Congress on the Costs and Benefits of Federal Regulations, September 30.
- <sup>83</sup> Chubb, John E. and Paul E. Peterson (1989) *Can the Government Govern?* (Brookings Institution: Washington, D.C.), p. 4.
- <sup>84</sup> “Enterprise for the Environment,” statement by William D. Ruckelshaus, Chairman, Browning-Ferris Industries, Inc. before the Senate Appropriations Committee Subcommittee on VA-HUD Independent Agencies, February 29, 1996.
- <sup>85</sup> OMB (1994) “Report to the President on Executive Order No. 12866 Regulatory Planning and Review,” May 1.
- <sup>86</sup> “Improving Regulatory Systems,” *op cit*.
- <sup>87</sup> Crandall, Robert, *et. al* (1997) *An Agenda for Federal Regulatory Reform* (AEI and The Brookings Institution).

<sup>88</sup> See Jacobs, Scott H., Deighton-Smith, Rex, Huigen, Hans, and Buchwitz, Rebecca (1997) "Regulatory Quality and Public Sector Reform," Chapter 2 in The OECD Report on Regulatory Reform: Thematic Studies (OECD: Paris).