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On the Economic Analysis of Regulations at Independent Regulatory Commissions

Would Greater Use of Economic Analysis Improve Regulatory Policy at Independent Regulatory Commissions?

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RESOURCES FOR THE FUTURE

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Arthur Fraas and Randall Lutter*

I. Introduction

Recent legislation has prompted federal regulatory agencies inside and outside the executive branch to develop numerous new major regulations. The Wall Street Reform and Consumer Protection Act alone contains more than 300 provisions expressly stating that rulemaking is required or permitted, although there is uncertainty about the number of rules because some provisions give regulatory agencies authority but not an obligation to issue a rule, some provisions may result in multiple rules, and rules may be used to implement yet other provisions that do not explicitly require or grant rulemaking (Copeland 2010). In summer 2010, the Commodities Futures Trading Commission (CFTC) released a list of 30 *areas* of rulemaking to implement the Wall Street Reform and Consumer Protection Act (CFTC 2010). The CFTC, like other "independent" regulatory commissions, develops and issues regulations outside the process of regulatory planning and review of the 1993 Executive Order 12866, continued in President Obama's Executive Order 13563, "Improving Regulation and Regulatory Review" (President Obama 2011). These executive orders, like President Reagan's 1981 Executive Order 12291, extend to regulatory agencies whose heads serve at the pleasure of the President, such as the Environmental Protection Agency and the Food and Drug Administration, but not to agencies intended to be independent of the President, whose heads can be removed only for cause. These independent agencies include the Consumer Product Safety Commission (CPSC), the Nuclear

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Regulatory Commission (NRC), the Federal Trade Commission (FTC), the Securities and Exchange Commission (SEC), and the Federal Reserve Board. Regulations from these independent regulatory commissions (IRCs) are typically developed without adherence to the Executive Order 12866, which requires that major regulations be subject to an analysis of benefits and costs.

Here we address the practice of regulatory impact analysis at IRCs. We explore whether information available to the public about the expected consequences of regulatory decisions by IRCs is comparable to or less specific than that made available by executive branch agencies issuing comparable regulations.

We focus on only those agencies identified by the federal Office of Management and Budget (OMB) as having issued major final regulations over the past 10 years. We ignore other independent regulatory commissions and agencies, including some identified as such by statute (i.e., the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Federal Maritime Commission, the Mine Enforcement Safety and Health Review Commission, the National Labor Relations Board, the Occupational Safety and Health Review Commission, and the Postal Rate Commission) (Paperwork Reduction Act, Section 3502(5)). We do not consider regulatory actions by some agencies that are clearly important, such as the International Trade Commission, whose mission includes administering the U.S. trade remedy laws within its mandate in a fair and objective manner. We do not assess whether final regulations recently issued by these agencies might rise to the level of “major,” nor do we explore the quality of any economic analysis they may conduct in support of regulations.

Our conclusion, based on this admittedly quick and limited survey, is that the analysis conducted by the IRCs is generally the minimum required by statute.[1] IRC final rules generally address the requirements of the Regulatory Flexibility Act and the Paperwork Reduction Act. In many instances the IRCs appear to be issuing major regulations without reporting any quantitative information on benefits and costs—apart from the paperwork burden—that would routinely be expected from executive branch agencies covered by Executive Order 12866. Instead, they offer only a qualitative discussion of the benefits and costs. The IRCs present this discussion without any formal review of alternatives. Their analyses generally do not estimate possible unintended effects and do not consider behavioral change. And perhaps most

[1] An exception, discussed below, is analysis of rules issued by Nuclear Regulatory Commission.

importantly, with the exception of the estimates of paperwork burden prepared to meet the requirements of the Paperwork Reduction Act, they generally do not analyze economic effects in a manner intended to meet any identifiable standards for such analysis.

The rest of this paper is organized as follows. Section II presents an overview of analytic support for major IRC regulations, including statutory requirements, the identification of “major” rules, and the Office of Management and Budget’s reports to Congress. In Section III, we present some case studies of selected IRCs. Section IV provides a discussion and our conclusions.

II. Overview of Analytic Support for Major IRC regulations

Based on our experience at the Office of Management and Budget and other agencies, we believe that economic analysis provides a useful framework for evaluating the effects of a rule in a systematic way. Such analysis requires the identification of the basic problem that the rule is supposed to address and provides for a methodical exploration of alternative approaches to address that problem. The adoption of a formal benefit-cost or cost-effectiveness analysis offers a concise and relatively rigorous way of presenting information on the expected effects of a rule to decisionmakers, Congress, the regulated community, and the public.

A rich academic literature describes the economics of regulation. Alfred Kahn (1970–71) offered an authoritative review, and George Stigler (1971) suggested that economic regulation (of prices, quantities, and entry) had no redeeming value. Later, Stephen Breyer (1984) emphasized the continuing need for reform. Arrow et al. (1996), in an authoritative and widely cited article, articulated the importance of economic analysis for ensuring serious consideration of the efficiency implications of policy decisions and informing the public about the likely effects of regulatory decisions. Hahn and Dudley (2007) reviewed measures of the quality of regulatory analyses conducted by executive branch agencies. More recently, Harrington et al. (2009) have offered in-depth analyses and prescriptions for improving regulatory impact analyses. Ellig and Morrall (2010) provide summary “scorecards” of adherence to basic analytic principles. Fraas and Lutter (2010) evaluate the extent to which a set of regulatory impact analyses for major Environmental Protection Agency (EPA) regulations complies with a specific set of requirements for economic analysis of regulations taken from the Office of Management and Budget’s 2003 Circular A-4 setting out standards for such analysis.

Statutory Requirements

Before evaluating the discretionary economic analysis of regulatory decisions conducted by IRCs, we review the statutory requirements for regulatory analyses by these agencies. All IRCs conduct rulemaking subject to a variety of statutory requirements, some of which are general and apply to all agencies, and some of which are specific and apply only to a particular agency. The general statutory requirements include the Congressional Review Act, the Regulatory Flexibility Act, and the Paperwork Reduction Act. The Administrative Procedure Act (APA) provides the overarching framework for Federal rulemaking. The APA requires Federal regulatory agencies to support their rulemaking decisions—that is decisions cannot be "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with Federal law." We review the general statutory requirements (other than the APA) briefly in turn.

Congressional Review Act (CRA)

The CRA requires federal agencies to submit their rules to Congress for review and establishes procedures for Congress to review and disapprove rules before they take effect[2] (5 U.S.C. § 802(a)). The CRA also requires the agencies to submit the final rules to the Comptroller General (i.e., the General Accountability Office, GAO) for review. GAO is required to report to Congress whether an agency, in promulgating a major rule, has complied with the procedural steps spelled out in §801(a)(1)(B)(i) through (iv) of the CRA.[3] GAO reviews whether the agency has (1) prepared a cost-benefit analysis; (2) carried out the analysis required by the Regulatory Flexibility Act §§603–605, §607, and §609; (3) conducted the actions required by the Unfunded Mandates Reform Act; (4) complied with other relevant statutory or executive order requirements, such as the Administrative Procedures Act, the Paperwork Reduction Act, Executive Order 12866, and Executive Order 13132; and (5) identified the statutory authorization for the rule.[4] GAO does not analyze or comment on the substance or quality of rulemaking.

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[2] OMB's Administrator of the Office of Information and Regulatory Affairs determines whether a rule is classified as major. The CRA provides an expedited review process for disapproval of major rules in the Senate.

[3] See http://www.gao.gov/legal/congress.html.

[4] Note that the independent regulatory agencies are not subject to the provisions of the Unfunded Mandates Reform Act, or of Executive Order 13132.

Regulatory Flexibility Act (RFA)

The RFA requires agencies to analyze the effects of their rules on small businesses, government jurisdictions, and nonprofit organizations. If the agency determines that the rule will have a significant effect on a substantial number of small entities, it must evaluate and consider less burdensome regulatory alternatives for the affected entities. The RFA establishes a set of procedural requirements (including a proper consideration of alternatives); it does not require a substantive change in agency action. Compliance with the RFA is subject to judicial review (5 U.S.C. §603 and §604.)

Paperwork Reduction Act

The PRA requires a centralized review for federal agency information collections to ensure that they have practical utility, minimize burden, and are not duplicative of collections from other agencies. The PRA established the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget to carry out this centralized review (44 U.S.C. §3503). As a part of a submission for OIRA approval, the PRA requires the agency to estimate (to the extent practicable) the burden in terms of time, effort, and financial resources required to complete the information collection (44 U.S.C. §3504(c)(5), and 5 CFR §1320.11).

Statutory Requirements for Specific Independent Regulatory Commissions

Although we are unable to conduct a comprehensive review of statutory requirements for all IRCs, we have endeavored to address those of a few in a systematic way. We looked for final rules issued by several commissions and read the preambles of rules that we uncovered to see whether they referred to statutory requirements.

Securities Exchange Commission (SEC). SEC statutes require the commission, when engaging in rulemaking, to “consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, (whether) the action will promote efficiency, competition, and capital formation” (74 FR 4582).

Commodity Futures Trading Commission (CFTC). Section 15(a) of the Commodity Exchange Act requires the commission to consider the benefits and costs of its rules. In its recent proposed rule to establish a comprehensive new regulatory framework for swaps and security-based swaps, CFTC states,[5]

> By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it simply requires that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the [Commodity Exchange Act].

The Inspector General for the CFTC released a report on April 15, 2011, that includes as an appendix a three-page CFTC memo dated September 29, 2010, entitled "Guidance on and Template for Presenting Cost-Benefit Analyses for Commission Rulemakings" (CFTC 2011). While this document describes the need to identify a "counterfactual" benchmark scenario against which to calculate costs and benefits, it falls short of the detailed standards for economic analysis of regulations adopted by OMB.

Identification of Major Rules

The current process for designating rules as "major" relies on "self-designation," or nomination by the independent regulatory agencies. The IRCs designate rules as major when reporting to Congress and GAO, without any effective third-party oversight. GAO does not have that responsibility. The Office of Information and Regulatory Affairs at OMB has responsibility for the definition of "major"[6] but it addresses whether an IRC's particular rule is major only if asked for clarification by the IRC, or when an affected party raises the issue in the White House and the question finds its way to OIRA. Of course, without doing at least rudimentary economic analysis, it would seem difficult for an IRC to determine whether a rule is major. The Food and

[5] For example, Registration of Swap Dealers and Major Swap Participants (75 FR 71379) and Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting from the Dodd-Frank Act, Proposed Rule, 76 FR, No. 42, March 3, 2011, 11701.

[6] Congressional Review Act, PL 104–121, Subtitle E §804.

Drug Administration and the Environmental Protection Agency typically address this problem by conducting a limited analysis of costs, even for regulations that are not designated as major or economically significant under Executive Order 12866.

Given that haphazard process, it is likely that major rulemakings slip through the cracks without being designated as major. Three recent rules have come to our attention because they relate to areas of interest to researchers at Resources for the Future. In one case, SEC conducted no meaningful analysis; in the other—a proposed rule—its analysis met explicit goals, but just barely. The third is a final rule from the Consumer Product Safety Commission (CPSC).

SEC: Climate Change Rule

In February 2010, SEC issued “Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule” (SEC 2010a). The document was intended to provide guidance to public companies regarding the commission’s existing disclosure requirements as they apply to climate change matters. The guidance makes clear that disclosures should cover policy developments regarding climate change (SEC 2010a, 6295). It states that registrants whose businesses may be vulnerable to extreme weather or climate-related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure statements (SEC 2010a, 6297). This rule, despite its apparently broad scope, is not accompanied by any quantitative or qualitative discussion of regulatory flexibility, the paperwork burden, or costs and benefits generally. The lack of any discussion of the paperwork burden is curious, in light of the scope of the Paperwork Reduction Act. The PRA generally requires agencies to estimate the burdens of information collection and defines collection of information to include requiring the disclosure of facts or opinions to third parties or the public (PRA, Section 3502 3(a)). A recent article in the legal trade press suggests that the SEC action has had an effect opposite from that intended—a decline and not an improvement in clarity among companies that report (Smith 2010).

SEC: “Conflict Metals” Rule

In November 2010, SEC released a proposed rule addressing “conflict metals”—minerals mined in central Africa whose trade may finance violent conflicts in that strife-torn area (SEC 2010b). The proposed rule would require regulated firms to keep records and to commission a certified, independent, private sector audit of a “conflict minerals report” that identifies the auditor and is furnished as part of the report. Further, the issuer would be required to include in the conflict minerals report a description of products it manufactured or contracted to be manufactured containing conflict minerals that are not “Democratic Republic of Congo conflict free," the facilities used to process those conflict minerals, those conflict minerals' country of origin, and the efforts to determine the mine or location of origin with the greatest possible specificity. The issuer would be required to exercise due diligence in making these determinations in the conflict minerals report. SEC estimated the total annual increase in the paperwork burden for all affected companies to comply with the proposed collection of information requirements to be approximately 153,864 hours of company personnel time, in addition to approximately $71.2 million for the services of outside professionals (SEC 2010b, 72). SEC also provides a "cost-benefit analysis" that is purely qualitative (SEC 2010b, 80–88), along with a similarly qualitative discussion of effects of any burden on competition and promotion of efficiency, competition, and capital formation (SEC 2010b, 88–90). SEC conducted an initial analysis under the Regulatory Flexibility Act (SEC 2010b, 90–95). In its notice, SEC solicited comments under the Small Business Regulatory Enforcement Fairness Act regarding whether the rule should be classified as major (SEC 2010b, 95–96). Since this is only a proposed rule, the analysis in support of it may change before its issuance as a final rule. Regardless, the analysis appears not to go beyond statutory requirements.

CPSC: Product Safety Information Database Rule

In December 2010, CPSC issued the "Publicly Available Consumer Product Safety Information Database; Final Rule" (CPSC 2010a). This rule establishes content, procedure, notice, and disclosure requirements of a new, publicly available consumer product safety information database. The CPSC reported an estimated 37,129 hours of annual reporting burden for this rule, while acknowledging that it had not yet developed forms for consumers or manufacturers (p. 76865). Further, it based its estimates on its experience with its incident report forms for fiscal year 2009 (p. 76865). The CPSC does not develop estimates of costs and benefits other than those related to the reporting burden.

Reasons to think this rule could be "major" include potentially costly behavioral change resulting from the following:

- broad and vague regulatory definitions (e.g., the rule defines "report of harm" to mean any information submitted according to specified procedures regarding "*any risk* of injury, illness or death"; emphasis added);
- lengthy procedures to identify and protect "confidential information," such as trade secrets; and

- lengthy procedures to identify and manage information determined to be materially inaccurate.

Indeed, a quick perusal of incident reports suggests early and potentially costly complications associated with the implementation of this rule. For example, searching on “crib” reveals a report of a child’s death in a “portable playpen with [hammock style changing table being used as a bassinet]” (incident #20110318-45390-2147481244). The coroner who filed the report describes the product in question in a way that prompts the manufacturer to respond by saying the description “suggests a product” that it had never sold, but that it had begun an investigation. In this instance the dissemination of information to the public appears to have prompted a response that is costly compared with the reporting of the same information to the CPSC and the (purported) manufacturer, which likely suffered a decline in reputation and potentially in sales.

OMB Reports to Congress

Scorecard for IRCs

Table I presents summary data for the IRCs on benefit and cost information and analysis compiled from OMB’s Reports to Congress. From 2003 to 2010, the Federal Reserve Board, the Federal Communications Commission (FCC), and SEC accounted for a preponderance of the major rules issued by IRCs. These summary data suggest that only a few of the rules issued by FCC and the Federal Reserve Board included information on benefits and costs. On the other hand, most of the SEC rules provided at least some benefit-cost discussion, including quantitative cost estimates. Only a few of the SEC rules provided quantitative benefit estimates, however. The remaining listed agencies—CPSC, Federal Energy Regulatory Commission (FERC), FTC, NRC—issued only a few major rules; the OMB report suggests that they generally provide some benefit-cost discussion with quantified cost estimates.[7] Two of the six major rules issued in this period by these safety and economic agencies were supported by quantitative benefit estimates.

[7] Note that NRC issues a major rule each year revising its licensing fees. These “transfer” rules account for the bulk of NRC rulemaking activity over this period and we do not include them in our review.

Comparison with Analysis of Major Rules under Executive Order 12866

As shown in Table II, the recent experience of regulatory agencies belonging to the executive branch is different. For those regulations that were major and not transfer regulations, agencies' analyses included a discussion of benefits and costs in 94 percent (31 of 33) of the rules finalized in fiscal year 2009 and in 97 percent (33 of 34) of the rules finalized in 2010. For both years, the agencies were able to provide some quantitative benefits estimates for a solid majority of these rules (19 of 33 in 2009, and 20 of 34 in 2010). The agencies provided information on quantitative measures of costs for more than 75 percent of these rules.

Among those regulations that were transfer rules (e.g., to manage the Medicare or Medicaid programs), in fiscal year 2009, 22 of 33 were issued with estimates of budget effects but no benefit-cost analysis. This measure of performance improved to 32 of 32 in fiscal year 2010.

III. Selected IRC Regulatory Analyses: Some Case Studies

There are reasons to question the quality of the limited economic analysis that IRCs issue in support of their regulations. Unlike the regulatory agencies belonging to the executive branch, the IRCs that conduct economic analysis do not have to meet any particular external standards, such as the standards of OMB Circular A-4, which does not apply to the IRCs. Further, with the exception of the Nuclear Regulatory Commission (discussed below), we have not been able to identify any IRC with established standards for economic analyses.[8] As a result, it is not clear what standards the limited economic analyses are intended to satisfy.

OMB's report to Congress echoes these concerns, stating, "OMB does not know whether the rigor of the analyses conducted by these agencies is similar to that of the analyses performed by agencies subject to OMB review" [9] (OMB 2010, 27). To get a better sense of the analysis

[8] Some executive branch regulatory agencies, such as EPA and the Department of Transportation, have issued such guidelines to supplement OMB Circular A-4. In December 2010, EPA issued its revised guidelines for economic analysis of regulations, saying that the agency would use the guidelines to evaluate the economic consequences of its regulations and policies (EPA 2010).

[9] OMB's draft report to Congress for FY2011 hits a slightly stronger note: "We emphasize that for the purposes of informing the public and obtaining a full accounting, it would be desirable to obtain better information on the benefits and costs of the rules issued by independent regulatory agencies. The absence of such information is a continued obstacle to transparency, and it might also have adverse effects on public policy." See OMB's Draft 2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities, 30.

done by the IRCs for these rules, we examine analyses in support of some rules completed in the past two years.

Board of Governors of the Federal Reserve

The OMB report indicates that the Board of Governors of the Federal Reserve promulgated 10 major final rules during fiscal years 2009 and 2010. OMB lists only 2 of these rules as having any discussion of benefits and/or costs. Only 1 of these—a joint rule with the Federal Trade Commission (discussed below)—is reported as having any quantified estimates of costs, and none developed a quantitative estimate of benefits. However, a review of these rules indicates that they all include sections responding to the requirements of the Regulatory Flexibility Act and the Paperwork Reduction Act. The RFA discussion in these rules is qualitative and meets only the most generous definition of "analysis." Nevertheless, these discussions do provide some description of the burden associated with the rule and in some instances conclude that the final rule will have a "significant economic impact on a substantial number of small entities" (see, e.g., 74 FR 5390). The discussion of the PRA for the Board rules includes a quantitative burden estimate, as required.[10] However, only the joint Board-FTC rule provides a monetized estimate of the paperwork cost.

Two of the rules issued by the Board in 2010 deserve further attention because they help illustrate the possible gains from doing an economic analysis. In the first final rule, issued on April 1, 2010, the Board implemented a provision in the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act, or CCA) establishing certain restrictions on the terms and conditions for gift cards. The CCA also established certain disclosure requirements for these terms and conditions. The CCA gift card provisions were to become effective on August 22, 2010 (15 months after enactment).

An important issue discussed in the final rule was the appropriate compliance date. The proposed rulemaking had solicited comment on the costs of meeting the compliance date, and regulated firms' comments provided estimates of the cost of replacing the existing inventory of card stock—with some regulated firms suggesting very high costs for meeting the proposed

[10] The Board is one of the few agencies with delegated authority under the PRA. Thus the Board does not submit its information collection requests to OMB for review and approval.

deadline of August 22, 2010.[11] Because of these transition costs, industry commenters urged the Board to exempt all physical cards already in the marketplace and in distribution.

The April 1 final rule required full compliance by August 22, 2010. The rule stated that the "purpose and intent of these new provisions would be most effectively carried out by requiring full compliance" by the statutory date (75 FR 16609). The rule also expressed the concern that there could be significant consumer confusion if gift cards sold after August 22, 2010, did not conform to the substantive protections afforded by the CCA.

The rule did not present an analysis of this issue. It did provide a final Regulatory Flexibility Analysis with a qualitative discussion of reasons that the rule would not have a significant effect on a substantial number of smaller entities. The final rule also provided estimates of the additional paperwork burden, per the requirements of the PRA. The PRA estimates appear to have been developed using back-of-the-envelope calculations.[12]

After the Board issued its April 1 rule, Congress amended the Credit Card Act to delay the effective date for certain provisions pertaining to gift cards produced prior to April 1, 2010. To implement this amendment, the Board issued an interim final rule on August 17, 2010, delaying until January 31, 2011, the compliance date for gift cards produced before April 1. In its RFA, the Board noted that the delayed effective date would reduce the burden and compliance costs for smaller entities by providing relief from the requirement to remove and destroy noncompliant cards and replace them with compliant cards. The interim final rule, like the earlier final rule, does not provide an estimate of the cost savings or the burden reduction associated with the extension of the compliance date[13] (75 FR 50686-50687).

In fact, the costs of alternative compliance dates can be calculated with conventional analytic methods. If the Board had developed an estimate of the cost of replacing the old stocks of gift cards (with recovery and destruction of the pre-April 1 stocks), such an estimate and the supporting analysis could have served to inform Congress and the public about the merits of extending the usable life of the old cards.

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[11] The firms suggested that costs could be as high as $20 million to $50 million per card issuer (75 FR 16608).

[12] The basis for the estimates for burden per respondent appears simply to be best professional judgment.

[13] The Board did not revise its burden estimates from those provided in the April 1 final rule.

Board of Governors of the Federal Reserve–Federal Trade Commission

The Board and FTC jointly issued a rule establishing terms and conditions and disclosure requirements to implement the risk-based pricing provision of the Fair and Accurate Credit Transactions Act of 2003.[14] The final rule requires creditors to provide a notice of the use of risk-based pricing—based on a consumer credit report—to customers in instances where the creditor extends credit on terms materially less favorable than available to other customers[15] (75 FR 2724).

The preamble to the rule includes a section titled "Regulatory Analysis" consisting entirely of the two sections presenting the two agencies' PRA and RFA analyses. The RFA section provides an unremarkable qualitative discussion of the effects of the rule on small entities. Both the Board and FTC conclude that the final rules will not have a significant economic impact on a substantial number of small entities (75 FR 2750). The PRA section develops an estimate of paperwork burden in terms of burden hours in a manner similar to the PRA burden estimates provided by other Board rules.[16] The distinguishing feature is that FTC—but not the Board—provides a monetized cost estimate of $252,048,000 per year for the paperwork burden for the (portion of the) regulated community subject to its regulation. It is apparently this monetized paperwork estimate that earns a "yes" for quantification of costs in the OMB report to Congress.

In summary, we find that the actual performance for the Board is perhaps not quite as negative as suggested by the OMB report to Congress. Although there is no formal analysis of benefits and costs, the preambles provide some qualitative discussion of the expected benefits and costs and include sections addressing the RFA and PRA. The RFA sections provide qualitative discussions that would satisfy only a generous definition of "analysis." The PRA sections provide what might best be characterized as back-of-the-envelope estimates of the paperwork burden in hours—but these estimates are not converted to cost estimates. In the joint

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[14] This act amends the Fair Credit Reporting Act.

[15] The final rule also provides some alternative approaches for determining "materially less favorable" and some limited exceptions to the rule requirements.

[16] The section includes the agencies' conclusion that the estimate found in the PRA sections of other Board rules, 40 hours, represents a reasonable estimate of the average time required to modify existing database systems (75 FR 2748).

Board-FTC rule, FTC provided a monetized estimate of the paperwork burden; the Board did not provide a corresponding cost estimate for its much smaller share of the paperwork burden.

Nuclear Regulatory Commission

NRC issued one major final rule in 2009, addressing power reactor security requirements (NRC 2009). The rule establishes and updates generically applicable security requirements similar to those imposed by NRC orders issued after the terrorist attacks of September 11, 2001. It also adds several new requirements developed as a result of insights gained from implementation of the security orders, review of site security plans, implementation of the enhanced baseline inspection program, and NRC evaluation of force-on-force exercises. The NRC's regulatory analysis concluded that the costs of the rule were justified in view of the qualitative benefits (NRC 2006, 1). NRC determined that the final rule would result in a total one-time cost to all nuclear power plant sites of approximately $116 million, followed by total annual costs of $39 million. The average nuclear power plant site would incur a one-time cost of approximately $1.78 million, followed by annual costs of approximately $595,000. In addition, NRC stated that the rule would result in a one-time cost to NRC of approximately $2.6 million. NRC did not expect to incur substantial annual costs as a result of the rule. NRC concluded that the rule would provide safety and security-related benefits, but its analysis described these in entirely qualitative terms.

The regulatory impact analysis accompanying this rule is fairly robust in its treatment of costs. It estimated costs using both three percent and seven percent discount rates. It developed these cost estimates based on an analysis of the requirements of each provision of the rule. It identified a baseline and considered all the costs of compliance, not simply the paperwork costs.

The quality of the analysis may reflect the institutional context in which it was prepared. NRC is unusual and possibly unique among the IRCs in having formal guidelines for regulatory analysis. The current guidelines explain that although the NRC, as an independent regulatory commission, is not required to comply with Executive Order 12866 that: "this fourth revision of the Guidelines reflects the intent of Executive Order 12866, in part, because of the Commission's previously expressed desire to meet the spirit of Executive Orders related to regulatory reform and decisionmaking" (NRC 2004, 1). In our judgment, the quality of the analysis of this rule is similar to that for rules issued by the Department of Homeland Security addressing similar security issues.

Securities and Exchange Commission

The preamble for an SEC rule includes four sections that arguably constitute an economic analysis. In addition to the RFA and PRA sections are sections titled "Cost/Benefit Analysis" and "Consideration of Promotion of Efficiency, Competition, and Capital Formation." Regarding the benefit-cost analysis, the SEC explains that it "is sensitive to the costs and benefits imposed by its rules" (74 FR 4577). The section on efficiency, competition, and capital formation responds to provisions in the SEC statutes that require the commission, when engaging in rulemaking, to "consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, [whether] the action will promote efficiency, competition, and capital formation"[17] (74 FR 4582).

We reviewed two major SEC rules revising requirements for the disclosure of information to investors. We also reviewed the SEC rule amending Regulation SHO, which adopts a short sale–related circuit breaker restricting the prices at which securities may be sold short.[18]

In the preambles for all the SEC rules reviewed for this paper, SEC has provided largely qualitative discussions on the RFA and efficiency, competition, and capital formation. The RFA discussions recognize the concerns raised about the effects of the rulemaking, in some cases identify alternatives that might address these concerns, and present the rationale for the commission's final decision. Similarly, each efficiency section offers qualitative discussions of the expected benefits of the rule and the reasons for the commission's conclusion that the final rule promotes efficiency, competition, and capital formation.

The PRA sections in these SEC major rules develop estimates of burden in terms of hours and cost. These estimates appear to be more rigorous than those developed by the Federal Reserve Board for its regulatory actions.

The cost-benefit analysis sections of these SEC rules provide quantitative estimates of the direct costs to the regulated entities of revising their procedures, processes, forms, and publications to comply. In some of the rules, there is some discussion or consideration of

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[17] Sections 3(f) and 23(a)(2) of the Exchange Act and Section 202(c) of the Advisers Act.

[18] The SEC rules are (1) Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies (74 FR 4546); (2) Amendments to Form ADV (75 FR 49234); and (3) Amendments to Regulation SHO (75 FR 11232).

alternative approaches. None of these rules provide quantitative estimates of other costs—such as increased transaction costs or a reduction in market efficiency—that might arise with these rules. One SEC rule (identified in the OMB report as providing quantified benefits) actually provides only an estimate of the regulated entities' cost savings associated with reducing the disclosure requirements to allow mutual funds to provide the statutory prospectus to investors on an Internet website (instead of printing and mailing the prospectus to all its investors). SEC rules do not provide quantified benefit estimates for other categories of benefits, such as the value of information to investors of improved disclosure or of expected improvements in the efficiency of capital markets.

The 2010 SEC rule adopting restrictions on the short sale of securities followed a 2007 rule in which the SEC removed restrictions on short sales. The 2007 decision to remove restrictions on short sales was the culmination of an eight-year rulemaking process that included extensive analysis of removing or changing existing short-sale restrictions, including the analysis of the results from a pilot test. The SEC pilot test involved a study of the effects on the market from the removal of restrictions on short sales for a sample of securities traded in the financial markets. SEC staff analyzed the data generated by the pilot and prepared a report on their findings that was made public. In addition, SEC received four academic studies analyzing the effects of the pilot test.

The staff report found little empirical justification for maintaining the short-sale restrictions; in particular, the restrictions had little effect on reducing daily volatility (75 FR 11236). And, more generally, SEC reported that the pilot results supported removal of the short-sale price restrictions in effect during the pilot (75 FR 11237).[19]

The financial crisis in 2008 and the associated increase in market volatility and the deterioration in investor confidence prompted SEC to reverse course and propose to adopt a short-sale price test or a circuit breaker rule in 2009. In its 2010 final rule, SEC concluded as follows (75 FR 11244):

[19] On the other hand, the staff study reported some evidence that the short-sale restrictions reduced intraday volatility for smaller stocks. The academic studies also suggested that the short-sale restrictions had little or no effect on price efficiency and found no evidence that they had a negative effect on price discovery. SEC pointed to this kind of information in its decision to reinstitute the 2010 short-sale price restrictions (75 FR 11243; 75 FR 11296). SEC also observed that the pilot test study was conducted in a period of relatively low market volatility and that in deciding to adopt the 2010 final rule, SEC had considered "… the recent turmoil in the financial sector and steep declines and extreme volatility in securities prices" (75 FR 11241).

> Although in recent months there has been an increase in stability in the securities markets, we remain concerned that excessive downward price pressure on individual securities accompanied by the fear of unconstrained short selling can undermine investor confidence in our markets generally. Further, we are concerned about potential future market turmoil, including significant increases in market volatility and significant price declines, and the impact of any such future market turmoil on investor confidence. Thus, we believe it is appropriate to adopt the targeted short sale price test restrictions contained in Rule 201.
>
> In summary, we have reviewed the empirical data, analyses and studies submitted and carefully considered them in connection with our determination that it is appropriate at this time to adopt in Rule 201 a short sale price test restriction combined with a circuit breaker approach.

SEC reached that conclusion after considering the analysis prepared in support of its 2007 rule removing short-sale restrictions and the additional studies submitted by commenters in response to the 2009 NPRM. On the basis of this record, it is hard to conclude that SEC made its decision in the absence of analysis. At the same time, though, it would be more comforting to find a framework of analysis that would pull together the various pieces of evidence and analysis into a more complete whole.

For most of the rules that we reviewed, the basic objective is consumer or investor protection—disclosure of information, restrictions on prices or terms and conditions. The SEC rule establishing restrictions on short sales is a major exception because it is directed toward the concern that short sales (in some circumstances) contribute to systemic risk in the financial markets and the kind of collapse in the financial markets that we experienced in 2008. The evaluation of low-probability, high-consequence events poses a significant challenge in developing a quantitative benefit-cost analysis. This challenge is not unique to the IRCs; it also exists for analysis of some rules by executive branch agencies like the Department of Homeland Security. And just as for DHS rules, a formal economic analysis can help identify alternative approaches and allow conclusions about the cost-effectiveness of various alternatives.

IV. Discussion and Conclusions

We have heard the argument that IRCs are regulating in matters that differ significantly from the “social regulation” of the executive branch agencies and that the guidance and economic analysis applied to social regulation are not a good fit for the economic issues faced by the IRCs. We recognize that IRCs face a disparate range of regulatory issues. Nevertheless, we can identify several areas where we think economic analysis would bring an important perspective to IRC regulatory policy decisions.

First, like some agencies in the executive branch, some IRCs are charged with protecting human health and safety. As we have seen with NRC, the OMB economic analysis guidelines apply equally well to these IRC regulatory actions. But the same types of analysis could be applied to other IRC rules as well. For example, in December 2010 the Consumer Product Safety Commission issued its Standards for Full-Size Baby Cribs and Non-Full-Size Baby Cribs. (CPSC 2010b). CPSC estimated a total one-time cost to child care centers of $97 million nationwide for replacing all of their full-size cribs, and a one-time cost of $290 million nationwide for replacing all of their non-full-size cribs. CPSC determined that the effect on child care centers, family child care homes, and places of public accommodation could be significant and provided a 6-month effective date with an additional 18-month compliance period for these entities to meet the standard. Nevertheless, the final rule does not include a cost-benefit analysis or an analysis of the cost-effectiveness of the rule in reducing infant deaths or injuries.

Second, there are always transition issues with the adoption of more stringent rules (e.g., the compliance date issue for the Board of Governors of the Federal Reserve's rule on gift cards, discussed above), and these issues are always amenable to economic analysis.

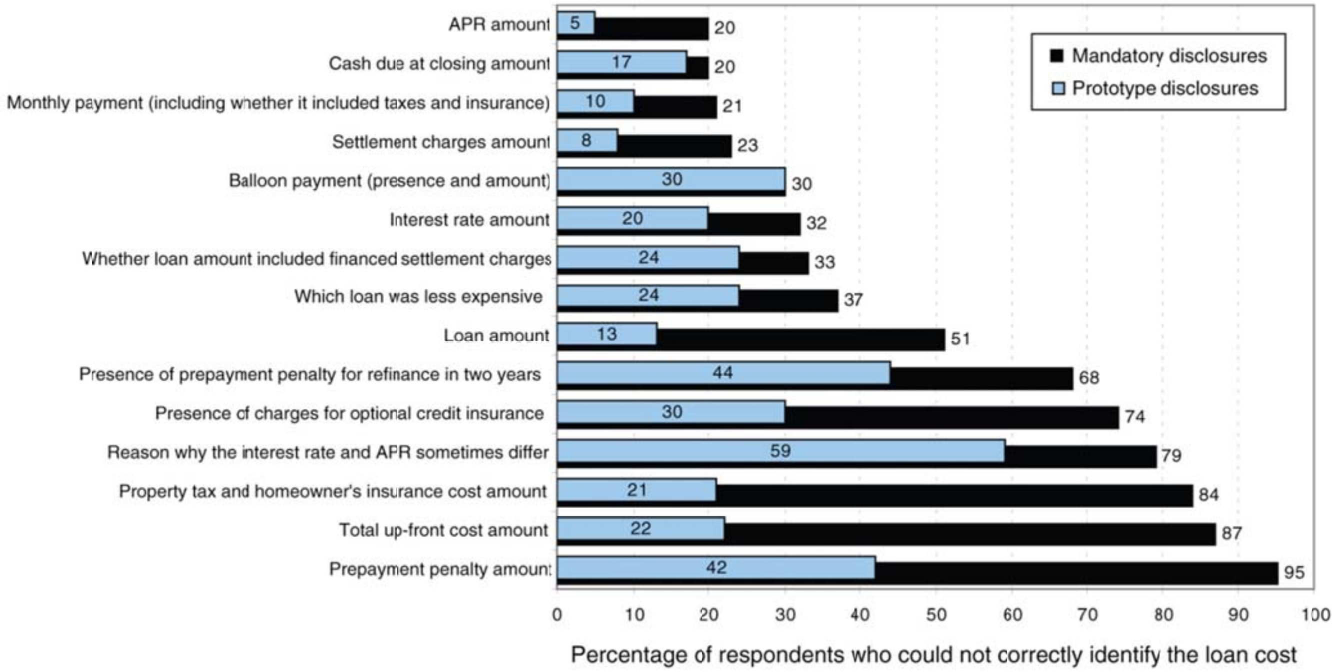
Third, we believe there is a longstanding general consensus among economists that the government should avoid the regulation of prices and production in competitive markets. In addition, entry by new firms into private markets should be regulated only where necessary to protect health and safety or the environment. This basic economic principle guided the deregulation efforts in transportation industries, like airlines and trucking, and it should carry over to guide the remaining economic IRCs, such as FCC and FERC. In addition, we believe this principle applies with equal force to restrictions on pricing and terms and conditions in the consumer finance and financial (investment) industries.

As a result, any government regulation setting caps or floors for prices or specifying terms and conditions or limiting entry of new firms ought to face a high hurdle in justifying such regulation. The accompanying economic analysis for such rules should provide substantive, quantitative support and a credible justification for such government intervention. Although OMB's A-4 guidance may not provide much direction in this area, there is an extensive economic literature outlining the basic elements for economic analysis of the effects of government intervention in setting restrictions on prices, terms and conditions, and entry in such markets.

Fourth, mandatory information disclosure, a regulatory strategy intended primarily to address the market failure of information asymmetry, may be hard to analyze fully, but recent regulatory issues illustrate how informative careful analysis of such regulations can be. One example is research prepared by FTC staff on the effectiveness of information disclosure forms in improving borrowers' comprehension when taking out mortgages. Before the recent recession, such forms were required in all mortgage transactions; available evidence, including results from a randomized assignment study, suggested very low rates of understanding of basic concepts like annual percentage rates, loan amounts, and prepayment penalties. (The figure on the next page is taken from a report on this research as it appeared in the *American Economic Review*.)

The FTC research stops well short of an analysis of the benefits, in dollar terms, to borrowers of improved understanding resulting from better information disclosure. Further, it is silent on whether any behavioral changes might spring from improved comprehension. We believe, however, that measures of effectiveness of information disclosure on improved comprehension and understanding in the targeted populations could be used to develop measures of cost-effectiveness like those called for by Executive Order 12866 and OMB Circular A-4.

Finally, and perhaps most importantly, economic analysis of executive branch regulations has served to promote accountability by allowing Congress and the public to get information about the likely effects of regulations, at least as estimated by the agencies issuing those regulations. Extending the practice of such analysis to independent regulatory commissions would similarly constitute a step toward allowing Congress and the public to understand the effects of regulatory decisions by these agencies.



Source: Lacko and Pappalardo 2010.

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Tables and Figures

See following pages.

Table 1. Economic Analysis for Major Final Regulations, by Agency and Fiscal Year

	Item	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*Sum by agency*	*Percentages by agency*
CPSC	Number of rules	0	0	0	1	0	0	0	0	1	
	Discussion of benefits or costs				1						100.0%
	Monetized benefits				1						100.0%
	Monetized costs				1						100.0%
FCC	Number of rules	0	1	4	2	2	4	0	0	13	
	Discussion of benefits or costs		1	0	0	0	0				7.7%
	Monetized benefits		0	0	0	0	0				0.0%
	Monetized costs		1	0	0	0	0				7.7%
FERC	Number of rules	0	0	0	0	0	1	0	0	1	
	Discussion of benefits or costs						1				100.0%
	Monetized benefits						0				0.0%

	Monetized costs						1				100.0%
FED	Number of rules	1	1	0	0	0	0	3	7	12	
	Discussion of benefits or costs	0	1					0	2		25.0%
	Monetized benefits	0	0					0	0		0.0%
	Monetized costs	0	0					0	1		8.3%
FTC	Number of rules	0	0	1	0	0	0	0	1	2	
	Discussion of benefits or costs			0					1		50.0%
	Monetized benefits			0					0		0.0%
	Monetized costs			0					1		50.0%
NCUA	Number of rules	0	0	0	0	0	0	0	0	0	
	Discussion of benefits or costs										
	Monetized benefits										
	Monetized costs										
NRC	Number of rules	1	1	1	1	1	2	2	1	10	
	Discussion of benefits or costs	1	1	1	0	0	2	2	1		80.0%
	Monetized benefits	0	0	0	0	0	1	0	0		10.0%

	Monetized costs	1	1	1	0	0	2	2	1		80.0%
PBGC	Number of rules	0	0	0	0	0	0	0	0	0	
SEC	Number of rules	5	1	5	0	7	4	8	9	39	
	Discussion of benefits or costs	5	1	5		7	4	8	9		100.0%
	Monetized benefits	1	1	2		2	0	1	0		17.9%
	Monetized costs	4	1	4		4	0	4	6		59.0%
	Total	7	4	11	4	10	11	13	18	78	

Notes

Data are from various OMB reports to Congress on the benefits and costs of federal regulation. See http://www.whitehouse.gov/omb/inforeg_regpol_reports_congress.

Blanks mean inapplicable.

Years denote federal fiscal years; e.g., 2007 is from October 1, 2006, to September 30, 2007.

Rules promulgated by the FCC under the Telecommunications Act of 1996 are exempt from the definition of “major rule” (5 USC 804).

In 2006, FCC and the NRC prepared regulatory flexibility analyses; however, no Benefit/Cost analysis was prepared.

One 2010 rulemaking was joint by both the Fed and FTC.

In 2009, the Fed published a final rule for capital adequacy requirements for bank holding companies and a separate policy statement on capital adequacy for small bank holding companies. The Fed prepared a regulatory flexibility analysis for its Truth in Lending rule; but no benefit-cost analysis.

Table 2. Regulatory Impact Analysis under Executive Order 12866

	FY09	*FY10*
Final Nontransfer Rules		
Major rules[a]	33	34
Rules with benefit or cost information	31	33
Rules with monetized benefits	19	20
Rules with monetized costs	28	26

[a] Six of these nontransfer rules involved some transfers.

Five rules issued in FY10 provided illustrative information on the effects of the rule, but the information does not represent benefit-cost analysis.

	FY09	*FY10*
Final Transfer Rules		
Rules	33	32
Rules with budget effect estimates but without benefit-cost estimates	22	32
Rules with no quantitative estimates	11	0

Figures below correspond to Tables 1 and 2 above.

Figure 1.

Major Final Rules Numbers with Economic Analysis FY2003 thru FY2010

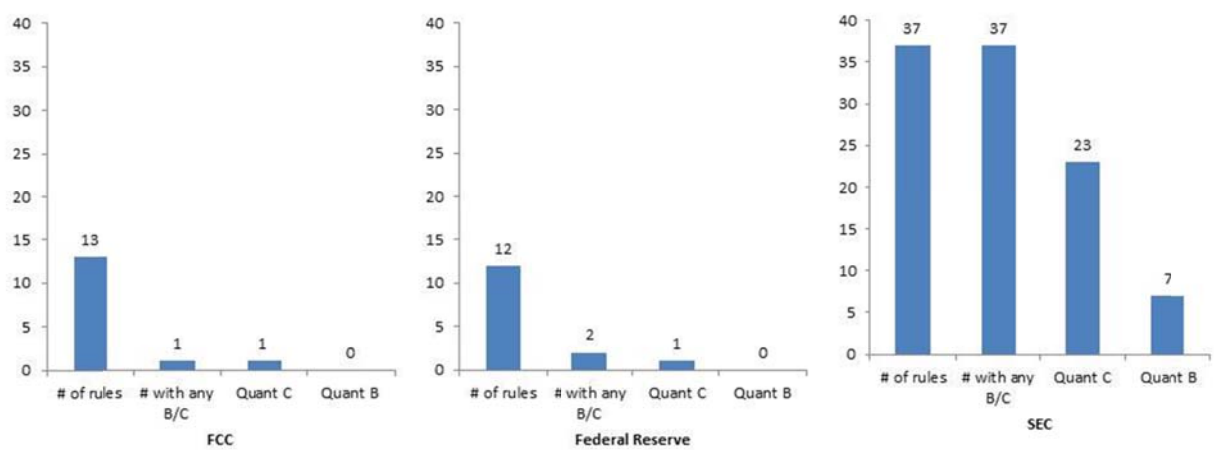

Figure 2.

Regulatory Impact Analysis Under E.O 12866 Number with Economic Analysis FY2009 and 2010