

MERCATUS CENTER  
GEORGE MASON UNIVERSITY

Mr. Cass Sunstein  
Administrator  
Office of Information and Regulatory Affairs  
Eisenhower Executive Office Building, 1650 Pennsylvania Avenue, NW  
Washington, DC 20503

Mr. Sunstein,

For nearly a decade, the **Mercatus Center at George Mason University** has led a research program that examines both market-based solutions for achieving regulatory goals and methods for improving the overall performance of the regulatory process and agency management. In this spirit, we offer three suggestions for improving regulations that respond to the President's directive (January 30, 2009). For the best tools to achieve public goals through the regulatory process, we suggest combining GPRA goals into regulations. For the relationship between OIRA and the agencies we suggest requiring a greater burden of proof and analysis for more restrictive regulations. Lastly, for the role of the behavioral sciences in formulating regulatory policy, we suggest bringing independent agencies into the regulatory review process.

In addition to these suggestions, I would like to direct you to a special report Mercatus has published on regulatory reform in the 21<sup>st</sup> century. In this publication our scholars address many pressing regulatory reform issues for the new administration, including performance accountability and technology regulation: "21<sup>st</sup> Century Regulation: Discovering Better Solutions to Enduring Problems" (<http://www.mercatus.org/PublicationDetails.aspx?id=25730>).

**I. For the Best Tools for Achieving Public Goals Through the Regulatory Process: Incorporate Performance Management into Regulatory Analysis**

The Government Performance and Results Act (GPRA) requires all federal agencies, including regulatory agencies to: 1) articulate the outcomes they produce for the public; 2) develop ex post measures that track progress; and, 3) conduct program evaluation to verify how much of the measured benefit is attributable to the agency's actions. Yet scholarly research finds that regulatory agencies are less likely than other agencies to

measure outcomes or use performance information to allocate resources or manage employees.<sup>1</sup>

As a result, regulations can be promulgated without a clear idea of how (or whether) they are related to the performance goals the agencies are expected to achieve. Further, there is no follow-up plan to verify the actual *ex post* effects of these regulations.

Applying GPRA principles to help guide regulatory analysis will make agencies more accountable for the outcomes of their regulations.

Accountability measures would include:

- Identify the outcome(s) the regulation is supposed to produce for the public
- Explain how these outcomes are related to one or more of the goals in the agency's GPRA strategic plan
- Measure benefits of regulations as percentages of the GPRA outcomes the regulation is expected to achieve.
- Identify measures/indicators that will be used *ex post* to identify how much of the outcome the regulation produced
- Lay out a plan for retrospective evaluation of the amount of outcome the regulation achieved
- Track and report on progress annually in their GPRA-mandated annual performance reports
- Require independent as well as executive branch agencies to take these steps

## **II. For the Relationship Between OIRA and the Agencies: A Nudge for Regulatory Options**

For a number of years, OIRA has worked to have agencies adopt market oriented and less restrictive regulations. Beginning with the Executive Order written under President Reagan and now with the current EO, the President is requesting analytical requirements to “identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public.” In addition, circular A-4 provides several paired comparisons to show agencies the types of regulation that should be viewed as preferable.

For a number of reasons, OIRA's effort has not been very successful. First of all, OIRA does not have sufficient resources to adequately enforce the President's demands. Secondly, institutional barriers within the agencies inhibit dynamic approaches to

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<sup>1</sup> Jerry Ellig and Jerry Brito. “Toward a More Perfect Union: Regulatory Analysis and Performance Management.” Forthcoming *Florida State University Business Review*, Volume 8; Henry Wray. “Performance-Based Regulations.” Working Paper, Mercatus Center at George Mason University, August 2008.

regulatory solutions. These institutions, necessarily bureaucratic, are not mandated to forgo restricted regulations when they are not justified by cost-benefit analysis. Moreover, in fear of worst case scenarios or egregious incidences that fall under their jurisdiction, agencies have a great incentive to error on the side of caution and over-regulate. Thus despite being given wide latitude by courts under decisions like *Chevron* to apply new interpretations to existing statutes, agencies are, expectedly, generally conservative in their statutory interpretation.

There are also personal choice heuristics which will tend to favor status quo regulatory structures. One of these, discussed in Nudge, is aptly termed the “status quo bias,” which refers to the tendency that people have to continue to do the same things, even when better options are known. It is simply less costly to stay with a decision that has worked in the past than to decide upon a new decision.

Both Executive Order 12866 and Circular A-4 could be more effective if they nudged agencies toward adopting less restrictive regulatory options. If an Executive Order ranked options by desirability and agencies were forced to defend, in sequential fashion, a movement up the “scale” of options, it would make it more difficult to defend a technology requirement (command and control) and easier to defend, for example, providing information. Thus, rather than instructing agencies to choose their most preferred option, which then becomes their default, and analyze more and less restrictive options, this changes the default starting point to the least restrictive option.

A list of such options could be generated by Executive Branch economists and might, in general, look something like this: voluntary guidance; industry self-regulation; disclosure requirements; government provided information; performance standards; economic incentives (fees and taxes); quantitative limits with trading mechanisms (“cap and trade”); and, finally, technology-based command-and-control regulation. Agencies should be required to justify each step based upon cost-benefit analysis.

### **III. The Role of the Behavioral Sciences in Formulating Regulatory Policy: Extending Regulatory Review to Independent Agencies**

One shortcoming of Executive Order 12,866 is that administrations have not sought to apply it to independent agencies. These agencies, therefore, do not generally engage in regulatory analysis unless required by specific legislation, and such legislative requirements lack the specific guidance on elements and methods laid out in Executive Order 12,866 and OMB Circular A-4.

Independent agencies should be required to seek regulatory review. As institutions driven by rules and mandates, agencies will not seek valuable review of their regulations unless required to do so. While this will no doubt delay regulations from implementation, regulatory review is an essential element of a regulatory process that insures against incoherent, and at times disastrous, regulations. When choosing between an expedient process that produces at times good regulations and at times bad regulations to a process

that allows sufficient time for sufficiently satisfactory regulations, the choice should be self evident. Indeed, with an administration dedicated to government “that works”, regulatory review is essential.

Whether independent agency regulations can be subject to presidential review has sometimes been a controversial question. However, the Department of Justice and several scholars have concluded that they can in fact be made subject to Executive Order 12,866 (or any economic executive order) either because the constitutional question can be resolved in favor of presidential authority over all agencies, or because the statutory language limiting presidential control over independent agency heads can be interpreted broadly enough to allow some form of regulatory review. No matter how the question is resolved, it is important that we extend the benefits of regulatory analysis to independent agencies.

In the event that the Obama administration chooses not to subject agencies to Executive Order 12,866, GPRA offers a route to require at least some regulatory analysis from independent agencies. Unlike Executive Order 12,866, GPRA applies to *all* agencies and, as we note above, the performance management framework that GPRA embodies shares a nexus with regulatory analysis. While this is not the same as formal regulatory analysis subject to OIRA review under Executive Order 12,866, GPRA’s performance management mandates allow OMB to expect at least some regulatory analysis from independent regulatory agencies. Additionally, while Executive Order 12,866’s regulatory analysis requirements generally apply only to “significant” regulations, the analytical framework embodied in GPRA is applicable to all regulations that serve as tools to reach an agency’s strategic goals. OMB’s Circular A-11, which instructs agencies on how to comply with GPRA, already underscores OMB’s expectation of proper regulatory analysis when regulation is involved.

We hope you find these suggestions useful and we wish you the best of luck.

Sincerely,

Richard A. Williams, Ph.D.

Managing Director Regulatory Studies Program and  
Government Accountability Project

[REDACTED]

[REDACTED]

Mercatus Center at George Mason University

[REDACTED]

Arlington, VA 22201