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IN FOCUS

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Cost-Benefit Analysis in Federal Agency Rulemaking

Since the 1970s, federal agencies have been required to consider the costs and benefits of certain regulations that are expected to have large economic effects. Under current requirements, most agencies are to design regulations in a cost-effective manner and ensure that the benefits of their regulations justify the costs.

Cost-benefit analysis of regulations is primarily required by Executive Order (E.O.) 12866, which was issued in 1993 and remains in effect. E.O. 12866 is one of the analytical requirements that are part of the federal rulemaking process, which includes other executive orders, guidance documents from the Office of Management and Budget (OMB), and statutory requirements.

This In Focus provides a brief overview and discussion of the key cross-cutting executive orders and statutes that require cost-benefit and other types of regulatory impact analysis in the federal rulemaking process.

Cost-Benefit Analysis vs. Regulatory Impact Analysis

Cost-benefit analysis involves describing the potential costs and benefits of a regulation in quantified and monetized—that is, assigned a dollar value—terms when possible, and otherwise in qualitative terms. Then, the potential costs and benefits of a rule are compared, with regard to both the quantified and qualitative considerations. The analysis federal agencies engage in during the rulemaking process often includes both quantified and non-quantified effects.

The phrase *regulatory impact analysis* is sometimes used interchangeably in general discussion with the phrase *cost-benefit analysis*. However, *regulatory impact analysis* is actually a broader, more encompassing term that includes cost-benefit analysis and other types of quantitative and qualitative analysis, such as cost-effectiveness analysis and distributional analysis.

Overview of Regulatory Cost-Benefit Analysis Requirements

The principal requirements of the federal rulemaking process were established by the Administrative Procedure Act (APA) of 1946. The APA itself does not include an explicit requirement for cost-benefit analysis, however. Rather, the primary cross-cutting requirement for agencies is in E.O. 12866, which requires covered agencies to conduct cost-benefit analysis for "economically significant" rules. E.O. 12866 also requires a less-detailed assessment of costs and benefits for a broader category of rules ("significant" rules), and it contains a number of considerations ("principles") relating to costs and benefits for all rules. OMB has expanded on the executive order's requirements by issuing various guidance documents, most significantly *Circular A-4*, which OMB issued in 2003.

Congress has enacted a handful of statutes with more narrowly applicable requirements for regulatory impact analysis. These include the Regulatory Flexibility Act, which requires agencies to consider the effects of their rules on small businesses; the Paperwork Reduction Act, which requires agencies to estimate the paperwork burden their rules will impose; and the Unfunded Mandates Reform Act, which requires agencies to consider whether their rules will impose an unfunded mandate on state and local governments.

The Role of Cost-Benefit Analysis in Regulatory Decisionmaking

Generally, the role of cost-benefit analysis in federal rulemaking is not necessarily for the analysis to be determinative or dispositive. That is, agencies do not typically make decisions solely on the outcome of their cost-benefit analyses. Other factors will likely be part of an agency's regulatory decision, such as statutory mandates and considerations, as well as the political and policy priorities of the current Administration. Regulatory impact analysis, including cost-benefit analysis, may be viewed as one of the key inputs into federal agencies' regulatory decisions.

Executive Order 12866

As noted previously, the principal analytical requirement for most agencies' regulations is in E.O. 12866.

Section 1 of E.O. 12866, entitled "Statement of Regulatory Philosophy and Principles," references the consideration of costs and benefits for all rules. For example, it encourages agencies to design their regulations "in the most cost-effective manner to achieve the regulatory objective" and to ensure that the benefits of a regulation justify the costs.

Section 6(a)(3)(B) of the order requires agencies to assess the potential costs and benefits of "significant" rules and to submit this assessment along with each rule to OMB's Office of Information and Regulatory Affairs (OIRA) for review. "Significant" rules are those that may

> (1) have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants,

> user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive order.

Although the order indicates agencies should conduct an assessment of costs and benefits for significant rules, the key requirement for cost-benefit analysis in E.O. 12866 is in Section 6(a)(3)(C), which requires a more rigorous and detailed cost-benefit analysis for "economically significant" rules. "Economically significant" rules are those that fall into the first category of "significant" above (e.g., rules that have a $100 million effect on the economy).

Specifically, Section 6(a)(3)(C) states that agencies should assess the costs, benefits, and "reasonably feasible alternatives" to the planned rule. The assessment is to include "to the extent feasible, a quantification" of costs and benefits that are anticipated from a regulation, as well as the costs and benefits of "potentially effective and reasonably feasible" alternatives.

OMB Circular A-4

In September 2003, OMB finalized *Circular A-4* on "Regulatory Analysis," which states that it was "designed to assist analysts in the regulatory agencies by defining good regulatory analysis … and standardizing the way benefits and costs of Federal regulatory actions are measured and reported." The circular recommends that an analysis include elements such as

- a statement of the need for the proposed action, including any statutory or judicial directive;
- an examination of alternative approaches; and
- an evaluation of qualitative and quantitative benefits and costs of the proposed action and the main alternatives.

The circular also provides guidance on when varying analytical approaches may be appropriate (e.g., when to use cost-benefit analysis vs. cost-effectiveness analysis). *Circular A-4* remains the current OMB guidance for agencies preparing analyses under E.O. 12866.

Other Developments Related to E.O. 12866

In 2011, President Barack Obama issued E.O. 13563, which emphasized his Administration's support for E.O. 12866. E.O. 13563 encouraged agencies to choose regulatory alternatives that "maximize net benefits" and to tailor their regulations "to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations."

In January 2017, President Donald Trump issued E.O. 13771, which established a "one-in, two-out" requirement for agencies to eliminate equivalent costs associated with at least two previously issued rules when issuing a new rule. E.O. 13771 also created a regulatory budgeting program, which involved setting cost caps for agencies' new regulations. Although this order shifted focus more onto regulatory costs, it did not directly amend or repeal E.O. 12866. On January 20, 2021, President Joseph Biden repealed E.O. 13771 and issued a presidential memorandum "reaffirm[ing] the basic principles" of E.O. 12866.

E.O. 12866 and Independent Regulatory Agencies

The analytical requirements in E.O. 12866 apply to most regulatory agencies, but they do not apply to the statutorily designated "independent regulatory agencies" that are listed in Title 44, Section 3502(5), of the *U.S. Code* and include, for example, the Federal Reserve Board and the Federal Communications Commission. However, the independent regulatory agencies may be required to conduct regulatory impact analyses under their own authorizing statutes or under the cross-cutting statutes discussed below.

Presidents have chosen to exempt these agencies from E.O. 12866, because Congress designed them to be independent of the President and, by extension, OIRA and OMB. In recent years, some Members of Congress and others have supported extending the analytical requirements of E.O. 12866 to the independent regulatory agencies.

Other Statutory Requirements for Cost-Benefit and Regulatory Impact Analysis

Congress has also enacted various statutory requirements for agencies to consider specific regulatory impacts.

The Regulatory Flexibility Act (RFA) of 1980 requires agencies to conduct regulatory flexibility analyses for proposed and final rules that will have a "significant economic impact on a substantial number of small entities" (defined as small businesses, governmental jurisdictions, and certain nonprofit organizations). For proposed rules, such an analysis is referred to as an "initial regulatory flexibility analysis," and for a final rule, it is a "final regulatory flexibility analysis." These analyses are to include elements such as a description and estimate of the number of small entities to which a rule would apply and "a description of the steps the agency has taken to minimize the significant economic impact on small entities."

The Paperwork Reduction Act (PRA) of 1980 established a requirement for agencies to estimate the paperwork burden resulting from regulations and other actions that result in a collection of information. The PRA is not a rulemaking statute per se, as its primary purpose is to empower OMB to monitor and reduce the government's overall paperwork burden. However, many rules contain a reporting or disclosure requirement, which would trigger the PRA's requirements for estimating paperwork burden and obtaining OMB approval for the information collection.

Title II of the Unfunded Mandates Reform Act of 1995 added requirements for agencies (other than independent regulatory agencies) to analyze costs resulting from regulations imposing federal mandates upon state, local, and tribal governments and the private sector. This analytical requirement is triggered when a rule may result in the expenditure of over $100 million (adjusted annually for inflation) in any one year. If an agency anticipates such a mandate, it is to conduct an assessment of quantitative and qualitative costs and benefits and other economic effects of the mandate.

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