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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.

Today, 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 comprises 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: A Note on Terminology

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 a broader 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 in Section 553 of the Administrative Procedure Act (APA) of 1946. The APA itself does not include an explicit requirement for cost-benefit analysis. Rather, the primary cross-cutting requirement for agencies is in E.O. 12866, which requires covered agencies to conduct analyses for rules that hit a certain economic threshold—currently, a rule will trigger the requirement if it is expected to have "an annual effect on the economy of $200 million or more." 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 first issued in 2003 and updated in 2023.

Congress has enacted a handful of statutes with more narrowly applicable requirements for regulatory impact analysis. These include the Regulatory Flexibility Act (5 U.S.C. §§601-612), which requires agencies to consider the effects of their rules on small businesses; the Paperwork Reduction Act (44 U.S.C. §§3501-3521), which requires agencies to estimate the paperwork burden their rules will impose; and the Unfunded Mandates Reform Act (2 U.S.C. §§1532-1538), which requires additional analysis if a rule is likely to impose an unfunded mandate on state, local, and tribal governments.

The Role of Cost-Benefit Analysis in Regulatory Decisionmaking

Generally, the role of regulatory impact 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 regulatory impact 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 should generally be viewed as one of several inputs into federal agencies' regulatory decisions.

Executive Order 12866

As noted, 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 covered agencies to assess the potential costs and benefits of "significant" rules and to submit this assessment along with each proposed and final rule to OMB's Office of Information and Regulatory Affairs (OIRA) for review. Amended in 2023, the current definition of *significant* applies to rules that may

> (1) have an annual effect on the economy of $200 million or more (adjusted every 3 years by the Administrator of OIRA for changes in gross domestic product); 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, territorial, 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 legal or policy issues for which centralized review would meaningfully further the President's priorities or the principles set forth in this Executive order, as specifically authorized in a timely manner by the Administrator of OIRA in each case.

E.O. 12866 states that covered agencies should assess costs and benefits for all significant rules, but the E.O. requires a more rigorous and detailed cost-benefit analysis for a rule falling into category (1) of the definition of *significant* (i.e., rules that may have a $200 million effect on the economy). Prior to 2023, these rules had been referred to as "economically significant" rules, and the threshold was an annual effect on the economy of $100 million (and not adjusted for inflation). In April 2023, President Biden issued E.O. 14094, which raised the threshold to $200 million and added an inflation adjustment every three years. These rules are now referred to as 3(f)(1) rules in reference to the section of the E.O. where they are defined.

The specific analytical requirement in the E.O. for 3(f)(1) rules is in Section 6(a)(3)(C), which 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. Agencies are then required to make this information public once the rule is published in the *Federal Register*.

OMB Circular A-4

OMB issued *Circular A-4* in 2003 "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 recommended that an analysis include elements such as a statement of the need for the proposed action, 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 provided guidance on when varying analytical approaches may be appropriate (e.g., when to use cost-benefit analysis vs. cost-effectiveness analysis).

In 2023, the Biden Administration revised Circular A-4 for the first time since it was issued in 2003 during the George W. Bush Administration. OMB held a public comment period and issued the revised circular in November 2023 along with supporting documentation responding to public comments and peer review. Among other changes, the amended circular provided more guidance to agencies about how to analyze distributional effects of regulations and how to account for effects that are difficult to monetize. It also lowered the recommended discount rates agencies are to use when estimating the value of costs and benefits over time.

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 exempted these agencies from E.O. 12866 on the grounds that 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 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 final rules, 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 requires agencies to estimate the paperwork burden resulting from regulations and other actions that will 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.

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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