Better Regulation:
Improving California's Rulemaking Process

Little Hoover Commission

October 2011

State of California

LITTLE HOOVER COMMISSION

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The Honorable Connie Conway
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Dear Governor and Members of the Legislature:

The Little Hoover Commission has spent the last year looking at the way state agencies develop regulations. Its conclusion: In order to better protect its citizens and encourage economic development, California must improve its regulatory process.

California has taken an important first step with the signing of SB 617 into law, which will start the process of improving how regulations are made. But there is more work to do. Last year, in a joint letter, Senator Robert Dutton and Assemblymember Felipe Fuentes urged the Commission to look specifically at the use of economic analysis in the rulemaking process as well as oversight.

The Commission's recommendations in this report are aimed at encouraging more communication with all affected parties earlier in the rulemaking process. This can help agencies develop a range of alternative solutions to meeting the regulatory goal. Using a standard set of economic analytic tools – calibrated to the scope of the proposed regulation – agencies then can determine which alternative both meets the stated goal of the regulation and produces the desired social benefits, while avoiding unnecessary costs to regulated parties and society.

Regulations implement laws passed by the Legislature and signed by the Governor designed to benefit Californians, either by protecting public health and worker safety or ensuring fairness in the marketplace, or enhancing quality of life by protecting water, air and land. Major regulation often also incurs costs that are an unavoidable consequence of achieving the desired benefits as set out in legislation.

An efficient regulatory process can achieve those benefits while minimizing or avoiding unnecessary costs, and where possible, finding the least costly alternative to producing those benefits. A good economic impact assessment can give decision makers a measure of the benefits as well as an estimate of the costs over the life of the regulation.

The Commission recommends greater oversight to ensure that agencies use economic impact assessments to better inform the regulatory decision-making process. The Commission recommends forming an Office of Economic and Regulatory Analysis, ideally located in the Department of Finance, for this oversight task. This office also should have the role of developing guidelines for economic impact assessments appropriate for regulatory proposals of different scopes. For major regulations, those creating a cost of $25 million a year or more, the office should ensure that the agency proposing the regulations conducts a rigorous cost effectiveness test of alternative approaches or a cost-benefit analysis if necessary. For oversight as well as quality

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control, the office should be responsible for setting up external peer reviews of such analyses.

The Commission believes that the cost of these actions will be offset by a more efficient and transparent rulemaking process, as well as the avoided costs of failed rulemaking efforts. On a broader scale, the state's economy will benefit from better, more effective regulation and reduced uncertainty.

The Commission's inquiry was prompted by concerns expressed to the Commission that California's rulemaking system was inconsistent across different agencies and that it lacked transparency and accountability. Business leaders told the Commission that these weaknesses fuel a lack of confidence in the process. Business owners with firsthand experience with the process expressed the view that the regulators do not adequately understand the impact of their actions. Though the Commission focused on the regular rulemaking process, it also heard concerns about the abuse of emergency regulations and underground regulations, concerns that also undermine the legitimacy of the state's regulatory structure.

The Commission found that although the Administrative Procedure Act requires agencies issuing regulations to do an economic impact analysis of proposed rules, few agencies do so in a systematic, rigorous way. Only a few agencies have economic analysis units; most rely on subject experts to assess benefits and costs. Witnesses told the Commission that the state lacks a process to determine whether a regulation is working or is still needed. Many agencies do not attempt to develop alternatives with the help of regulated and other interested parties before a regulation is released for public comment. Qualifying language added to the Administrative Procedure Act leaves ample room for departments to avoid doing substantive impact assessments without consequence.

No oversight agency checks the adequacy or completeness of the required economic impact assessment, making the analysis "illusory and ineffective," according to testimony from the Office of Administrative Law.

More consistent use of economic analysis can help address these concerns by ensuring that regulators engage stakeholders earlier in the process to identify and develop alternative solutions, and that these alternatives are assessed using standard economic methodologies. Greater oversight of agency rulemaking processes, by ensuring that credible economic impact assessments are used in the development of regulations, can bolster confidence in California's regulatory system.

For the system to work, it is essential that California's regulatory process not only be fair, transparent and accountable, but that the process is seen as such by stakeholders – both regulated and not. The Commission does not seek less regulation or more regulation, but better regulation. California has much to champion and to protect – public health, consumer safety, its extraordinary natural resources as well as the economic well-being of its people. The Commission's recommendations build on the Legislature's work in passing SB 617. The Commission and its staff look forward to working with you on this important task.

Sincerely,

Daniel Hancock
Chairman

The Commission adopted the report on a 5-1 vote. A dissenting opinion, when completed, will accompany the report.

BETTER REGULATION:
IMPROVING CALIFORNIA'S RULEMAKING PROCESS

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Executive Summary

California's regulatory agencies are known nationwide as trailblazers that set benchmarks that the nation as a whole often follows. Over the years, such regulations have produced huge benefits for Californians in consumer safety, food security, worker protection, energy efficiency and air and water quality.

The state's large population and its dynamic and complex economy require a sophisticated, coordinated and thoughtful approach to developing the regulations our society needs to ensure fairness and protect California's quality of life.

It is unfortunate on several levels then, that California's approach to developing regulations is uneven, lacks coordination and, despite an independent agency to enforce the Administrative Procedure Act, lacks the kind of thorough oversight that ensures efficiency and accountability. The way California state departments develop regulations varies widely, particularly in their use of economic analysis to determine what burden a proposed regulation will have on a person or business affected by it.

California has been reluctant to adopt and use analytical tools employed in other states and at the federal level. This has produced a regulatory approach that can focus intensely on solving problems in a single arena without taking into consideration the broader context or consequences of the solution it imposes or developing regulations that maximize benefits in a systematic way.

In the course of the Commission's study, it saw examples of where these shortcomings either resulted in failed rulemaking efforts, the potential imposition of costly conditions that could force painful tradeoffs, or regulations undermined by an economic analysis that did not account for real-time changes in the economy.

An oversight system put in place to ensure that agencies weighed alternatives to solving a problem and used an economic impact assessment to choose the least burdensome solution simply does not work. The department checks a box on a form. The box is examined to see that it is checked. But no one checks to see if the department did its homework in assessing the impact or choosing the least burdensome alternative.

These shortcomings have costs to the state, in time and money, as well as in the state's reputation for fairness and the legitimacy of the regulatory process. These shortcomings also have costs to the state's economy.

During the course of the study, the Commission learned of examples of flawed rulemaking processes. In one instance, the department developing the regulations failed to account for economic impacts and created a duplicate and conflicting regulatory structure over an industry regulated by a different department. In another case, a department was developing regulations based on a law that was broad and opaque, which further complicated the rulemaking process. The department held extensive workshops with stakeholders who initially supported the work, but who ultimately withdrew their support near the end of the process, resulting in the department missing its deadline to file a final version of the regulation. This department did contract with outside researchers to conduct an economic impact assessment, though the analysis was not shared with the public or used in the public discussion of the proposed regulation. In each case, the results of the original process were tossed out and the processes started over, though lessons learned are now being applied by the state departments to avoid a repeat.

Economic Analysis Tools

Several types of economic methods can be employed to understand the potential impacts of a regulation. A more detailed description of analytical approaches is provided in the Background chapter of this report. Some of the most common types of tools are listed below in ascending order of rigor:

STD. Form 399 Economic Impact Statement. The most basic analysis a California agency can perform consists of completing the STD. Form 399 Economic Impact Statement. A copy of Form 399 is included in Appendix C. The form provides a method for organizing and reporting essential regulatory economic impact data (e.g., costs to business, number of businesses affected, estimated benefits to Californians).

Cost-Effectiveness Analysis. Cost-Effectiveness Analysis (CEA) offers a framework for identifying the most financially efficient policy choice. CEA examines various policy options for obtaining a desired result, and creates a ratio of cost to an effectiveness measure (e.g., tons of emissions eliminated). CEA allows analysts to avoid the need to put a dollar figure on benefits.

Cost-Benefit Analysis. Cost-Benefit Analysis (CBA) attempts to examine the costs and benefits of policies and identify the alternative that yields the largest net benefits for society. This approach is the most extensive, costly and susceptible to challenges, as it requires answering multiple hypothetical questions, conducting difficult monetization of intangible benefits and costs and relying on data or assumptions that may have inherent problems associated with the information.

The Commission also found that the rules for developing regulations do not apply to every department equally. The State Water Resources Control Board, for example, complies with the Administrative Procedure Act when it develops regulations such as its frost protection measures to prevent harm to endangered fish species, but is exempt from the act when developing conditions for water quality permits. The board currently is embroiled in a contentious set of permit renewals regarding storm water runoff, which threatens water quality. As a non-point source of water contamination, storm water runoff requires a different approach than used in the past for point-source water contamination. Industry, small cities, water treatment districts and the California Department of Transportation have expressed concern that the approach the board is proposing will be vastly expensive with little in the way of cleaner water to show for it. The permit process does not require the board to assess the economic impact of the new requirements.

To the degree that California can increase confidence in the regulatory process by improving transparency and accountability of its regulatory processes, it must do so. The state must be able to demonstrate across departments that the way it develops regulations is fair and efficient in order to buttress the legitimacy of the regulations its departments produce.

One area critical to this goal is greater use of economic analysis in the development of regulations – already required by the state's Administrative Procedure Act – and greater oversight of the process to ensure adequate assessments and consistency across agencies. Though economic analysis should not be the determining factor in developing regulations, the work of building the analysis should force state agencies to engage with all interested parties early in the rulemaking process, develop and assess alternatives, and create a richer body of information to put before the board members and department directors who ultimately make the decision. Such analysis also can articulate and measure the benefits of a proposed regulation, providing greater context for the public as well as decision makers.

In recommending greater use of economic analysis, the Commission encourages a focus on prioritizing alternatives by their cost-effectiveness. This would tend to result in the selection of the alternative that best provides the benefit intended in the legislation but is least burdensome to regulated stakeholders and to the people of California. The emphasis on cost-effectiveness assessments is not to short shrift discussion, or assessment, of benefits. In most cases, however, the benefit, often with specific targets, is laid out in the legislation that the proposed regulations are to implement. All regulations should be required to show how a preferred approach would produce the desired benefits.

Non-regulated stakeholders, particularly environmental groups and labor advocates, have expressed concern about the potential abuse of economic analysis to undermine the goals of regulation, and its ability to create "analysis paralysis." In interviews and during a Commission advisory committee meeting, they reserved a specific wariness for cost-benefit analysis, which they said can understate the value of such benefits as clean water and air and human health, while allowing industry to overstate its costs.

The Commission recognizes that some parties within an industry have an incentive to game the process by withholding information or inflating estimates of the cost of compliance. It recognizes, too, the view that not all benefits, or costs, can be assigned an accurate dollar value and neatly fit into a cost-benefit model. It recommends the state focus more on cost-effectiveness assessments of alternatives that meet the goals of the legislation the regulation is trying to implement. A formal cost-benefit analysis is time-consuming and expensive and should be reserved for special cases or where required by legislation. For regulatory packages that have a significant impact on the economy, the state should have its economic impact assessments peer-reviewed by a panel of anonymous outside experts.

The Commission recommends that the state start the process of strengthening its rulemaking process by establishing a small Office of Economic and Regulatory Analysis, that would reestablish the regulatory analysis function which once existed in the now-defunct Trade and Commerce Agency. The primary duty of this small group would be the review of economic impact assessments for proposed regulations. This function could be assigned to the Department of Finance, which already has the task of assessing the fiscal impact of new regulations, or to the Office of the Governor or the Bureau of State Audits, which would provide independence from the executive branch entities overseen. In re-establishing this function, the state can learn from the example of the U.S. Office of Information and Regulatory Affairs, which is located in the White House's Office of Management and Budget. The small cost associated with re-establishing this function would be more than offset by reducing the costs of failed regulatory processes, by reducing lengthy challenges on methodology and the potential to improve confidence in the rulemaking process.

One of the first tasks of California's Office of Economic and Regulatory Analysis would be to set guidelines for economic impact assessments that would be used across departments to ensure consistency and fairness. The guidelines should be designed to accommodate a range of scales for regulatory involvement, with the most rigorous reserved for the most significant proposed regulations. The state should recruit an

advisory body of economists and experts from other disciplines with regulatory experience to help draft the guidelines. The guidelines should build on, but not be restricted by, work already done in California by the California Energy Commission and the California Air Resources Board, as well as the U.S. Office of Management and Budget's Circular A-4.

Separate from the Form 399 filing process, staff performing the regulatory review function should have the authority to check in with departments as they are drafting regulations to ensure that the agencies are following the appropriate guidelines for the level of economic impact analysis required, and that they are making every effort to engage with all interested parties inside and out of government before the rules are put out for public comment. As part of the review function, this staff should determine what level of economic impact assessment is needed on the front end. When the economic impact assessment is complete, as part of the Form 399 process, the regulatory review staff should make a determination whether the assessment is adequate.

The Office of Administrative Law, which ensures that agencies follow the Administrative Procedure Act through the rulemaking process, should be required to send back final versions of proposed recommendations that have not done the necessary economic impact assessment as determined by the Office of Economic and Regulatory Analysis.

The regulatory reviewers also should be the key information hub for the Governor and cabinet members to ensure that they are aware of

Legislature Moves to Reform Regulatory Process

Senate Bill 617 (Calderon and Pavley) makes changes to California's regulatory development and oversight framework. Crafted with the support of the California Chamber of Commerce and the California Manufacturers and Technology Association, the bill passed both the Senate and Assembly with bipartisan support and was signed into law. The bill proposes amending the Administrative Procedure Act. These changes include:

- Requiring agencies to perform a standardized economic analysis for major proposed regulations. Agencies may use data derived from existing state, federal, or academic publications to conduct the analysis. The Department of Finance will develop the analytical methodology and evaluate impact assessments. Regulations qualify as major rules if the impact on California businesses and individuals is expected, by the agency, to exceed $50 million.
- Expanding on guidelines for the assessment of alternatives. Agencies must use analyses of possible rules to "*determine that the proposed action is the most effective, or equally effective and less burdensome, alternative in carrying out the purpose for which the action is proposed or the most cost-effective alternative to the economy and to affected private persons…*"
- Requiring agencies to describe the monetary and nonmonetary benefits (e.g., environmental, social equity, public health) of proposed regulations.
- Providing the Department of Finance with full access to the data used to perform economic analyses.
- Supplementing requirements to avoid nonduplication and inconsistency of rules.
- Requiring the Department of Finance to report to the Legislature on the performance of agencies in adhering to new analytical requirements.

The bill was announced at a press conference in conjunction with AB 29 (Pérez), which establishes the Governor's Office of Economic Development in statute.

Source: Chapter 496, California Statutes of 2011.

significant regulations in the works, and to point out where proposed regulations have the potential to conflict with existing regulations developed by other state agencies.

For significant regulations, those with the potential to incur annual costs of $25 million or more, the regulatory reviewers should work with the department developing the regulation to ensure that alternative approaches are considered and that those alternatives are assessed through a rigorous cost-effectiveness test.

For significant regulations where the science is new and technologies that will be used for remediation either do not exist or are not widely used and data is scarce, the regulatory reviewers should work with the department to make sure that the state is using the most appropriate methodology for its analysis. Where necessary, the reviewers and the department should form outside expert advisory panels for this process, as the California Air Resources Board did for the economic analysis of its 2010 revised scoping plan for implementing the Global Warming Solutions Act of 2006 (AB 32).

A cost-effectiveness test approach to evaluating alternatives should be emphasized especially where the desired social benefit and targeted goal is spelled out in statute. The guidelines also should include proper methodologies for a more formal cost-benefit analysis in the event such an analysis is required by legislation.

The Commission's recommendations are consistent with SB 617 (Calderon and Pavley), passed by the Legislature in September 2011 with bipartisan support and signed by the Governor, which calls for strengthening the Administrative Procedure Act and updating requirements for regulatory impact analysis.

In addition, the state should revisit regulations in the event of unintended consequences that create unexpected harm, the emergence of new technology that makes an existing regulation obsolete, or a fundamental change in the economy that, in a new context, creates an unforeseen regulatory burden.

To the extent regulatory reform can build confidence and enhance communication, transparency and accountability, such reform can improve the foundation for economic growth and bolster the legitimacy of the state's regulatory structure, protecting public health, consumers, workers and the environment. Done well, regulatory review should result in fewer failed rulemaking processes, saving state agencies and stakeholders alike time and money as departments implement the goals of the Legislature.

The Commission's goal is not to create less or more regulation, but rather better regulation – rules developed through a transparent and interactive process that meet the statutory purpose and that place the least burden necessary on Californians and the California economy.

Recommendations

Process:

Recommendation 1: The state should require departments promulgating regulations or rules that impose costs on individuals, businesses or government entities to perform an economic assessment that takes into account costs that will be incurred and benefits that will result.

- The economic assessment must be completed well before the proposed regulation is released for public comment.
- Departments must demonstrate how the proposed regulatory action will meet the statutory purpose of the regulation.
- Departments promulgating the regulation should be required to reach out to regulated and interested parties in the development of the economic assessment prior to the regulation's release for public comment.
- The Legislature should change statutes that exempt certain agencies from provisions in the Administrative Procedure Act that require an economic impact assessment of proposed regulations unless agencies can demonstrate why an exemption is justified.

Recommendation 2: The state should require departments proposing a major regulation to perform a high-quality, rigorous economic analysis.

- A major regulation is a regulation that would impose an annual cost of $25 million or more.
- At the minimum, the economic analysis should be a cost-effectiveness assessment of alternatives that meet the statutory purpose of the regulation to determine the lowest cost alternative to meeting this goal, prior to the release of the regulation for public comment (possibly the alternative that maximizes net social benefits).
- Proposed regulations that impose a substantially higher burden on an affected industry or industries, or have the potential to materially reshape the state's economy, should be subject to a cost-benefit analysis that includes an assessment of costs as well as social benefits.

- The department promulgating a major regulation should be required to make a substantial effort to engage all regulated and interested parties in the development of alternatives that would satisfy the statutory purpose of the proposed major regulation prior to its release for public comment. This should not prevent the department from developing additional alternatives, or refining its economic analysis, on the basis of information provided through the public comment process.
- The state should require a department that is promulgating a major regulation to demonstrate that its preferred alternative is the most cost-effective approach to meeting the major regulation's statutory purpose or explain why another alternative was chosen, or, in the case of a more substantial regulation that calls for a cost-benefit analysis, demonstrate that the chosen regulatory approach maximizes net social benefits.
- The department must respond to comments about its analysis of the alternatives, including the selected alternative, made during the public comment period.

Recommendation 3: The state should create guidelines that set out standards and the appropriate use of different types of economic assessment methodologies and data quality that can be used to properly describe and analyze the economic impact of new regulations. The use of these guidelines should be mandated by the Administrative Procedure Act.

- The guidelines should reflect the scale appropriate for the proposed regulation's impact, reserving the most rigorous and in-depth economic analysis for the most economically significant regulations.
- California's guidelines should be informed by:
  - ✓ Guidelines outlined in the U.S. Office of Management and Budget's Circular A-4.
  - ✓ Guidelines developed by the U.S. Environmental Protection Agency set out for this purpose.
  - ✓ Guidelines developed by the California Environmental Protection Agency and the California Energy Commission.
  - ✓ The experience and expertise of an expert economic advisory panel created for this purpose that can set such guidelines in the context of California's legislative and regulatory histories.
- The guidelines should be able to account for and integrate the development of new economic analysis tools and models and

should be updated to reflect new analytical approaches that meet the approval of an expert economic advisory panel.

- Cost-benefit analyses and cost-effectiveness assessments of alternatives for significant regulations must be subjected to a formal peer review by independent and anonymous experts, selected by the Office of Economic and Regulatory Analysis prior to the public comment period, and results of the reviews must be made available to the public.

Oversight:

Recommendation 4: To improve the quality of regulations promulgated by California agencies, and to ensure the process of developing regulations is consistent and transparent, the Governor should form an Office of Economic and Regulatory Analysis.

- This office should be responsible for:
  - ✓ Forming an expert economic advisory panel to develop the guidelines for economic assessments, and to serve as an independent arbiter in determining whether a regulation can be defined as a major regulation.
  - ✓ Ensuring that a high-quality, rigorous cost-effectiveness assessment of alternatives has been completed before a major regulation is released for public comment.
  - ✓ Requiring a department promulgating a major regulation to update or revise its economic analysis in the event it is determined that the assessment is materially flawed by data deficiencies, serious miscalculations, modeling deficits or other shortcomings; a material change in economic conditions, or the emergence of a new technology creates a better alternative to meeting the statutory purpose.
  - ✓ Monitoring whether unrelated regulations promulgated by different agencies cumulatively affect an industry sector and monitoring whether regulations from different agencies conflict, complicating compliance efforts.
  - ✓ Agencies should communicate through an Internet-based platform to promote public participation and transparency. Public comments should be filtered through the Web site and material relevant to the rulemaking process should be posted.
- The Office of Administrative Law should be required to send back a regulation that has not complied with regulatory or economic

assessment requirements, or in the case of a major regulation, the requirement for a cost-effectiveness analysis of alternatives, as determined by the Office of Economic and Regulatory Analysis.

Recommendation 5: The state should create a look-back mechanism to determine whether regulations are still needed and whether they work. The state should:

- Require new regulations to contain a sunset date for review for effectiveness and evaluation of unintended consequences.
- Give the Office of Economic and Regulatory Analysis the authority to revisit existing major regulations in the event of a fundamental change in conditions, such as the development of transformative technology, a substantial change in economic conditions, demonstration that the regulation is not having its intended effect, or the emergence of superseding regulations at the federal level that require linkage, integration or synchronization.

Introduction

In conversations with local and regional business leaders and economic development specialists in late 2009 as part of the Commission's study of state-level economic development activities, the Commission heard repeatedly about California's regulatory environment and the need for greater clarity and consistency in how regulations were developed.

After the Commission issued its 2010 report, *Making Up For Lost Ground: Creating A Governor's Office of Economic Development*, and the subsequent opening of the Governor's Office of Economic Development, the Commission continued to explore concerns about the state's regulatory development process. The Commission heard that while most businesses and public entities covered by regulations recognize regulations as essential to a fair, safe and stable society, many felt that California's regulatory process was inconsistent, often unbalanced and lacked transparency and accountability. These factors have undermined confidence in the system.

Often when regulated entities complain about regulation, what they really mean is a statute that they find particularly onerous. That is a matter beyond the scope of this study. At other times, however, it is the regulation and the process that developed it that they object to. At the regulatory level, department staff, as well as regulated and unregulated stakeholders, often struggle to find regulatory solutions to legislation that lacks focus.

The Commission also heard complaints about the overlap of state, federal and local regulations, and the difficulty business owners had in planning expansions and investments because of it. "It would be nice to know at the start what the rules are instead of being hit with surprises all along the process," Casey Houweling, who expanded his sustainable tomato and cucumber green house operations in Oxnard, told the Commission.[1]

The State Water Resources Control Board may have one set of conditions, while the nine regional boards may impose conditions of their own, but at least all are state entities. Navigating the process can be equally daunting for air quality regulations as the California Air Resources Board is a state agency, though local air boards, with their

own priorities are not. Their goals, however, are to improve measureable benefits for the public good.

The Study Process

The Commission embarked on this study in June 2010 to see what changes could be made in the regulatory process to improve transparency and accountability, consistency and predictability.

In a bipartisan request, Senate Minority Leader Robert Dutton and Assemblymember Felipe Fuentes in July 2010 asked the Commission to focus specifically on how regulatory agencies developed and used economic assessments in developing new rules. A copy of this request is included in Appendix D. The Commission also had been encouraged to take up the topic by the California State Board of Food and Agriculture, which expressed concern that growers and ranchers faced layers of state, federal and local regulations that sometimes conflict.

The conclusions and recommendations in this report are based on written and oral testimony presented in two public hearings and a public advisory committee meeting, all held in Sacramento, as well as extensive interviews and staff research.

The Commission held the first hearing on October 28, 2010, to learn about the landscape of economic analysis in the development of regulations and to hear from regulated groups, including representatives from the building and agriculture industries. The Commission also heard from economists from the City and County of San Francisco and the State of Arizona about their regulatory review practices.

The second hearing, on January 27, 2011, focused on different approaches to economic analysis, the state's regulatory oversight practices and how two agencies used economic analysis in developing proposed regulations. The Commission also heard from an owner of a Fresno transportation firm who had been affected by diesel particulate regulations. Hearing witnesses are listed in Appendix A.

On August 26, 2011, the Commission held an advisory committee meeting to learn more about the concerns and perspectives of non-regulated stakeholders, specifically environmental groups and labor representatives, about the use of economic impact analysis in the development of regulations. Participants in this meeting are listed in Appendix B.

Throughout the study, Commission staff received valuable input through extensive interviews and meetings with experts in economic analysis, the rulemaking process and regulatory review practices at the city, state and federal levels. The process involved interviews with current and former state employees who have been involved in the process both at the rulemaking level and at the review and oversight level. Their input was important and invaluable. The research process also relied on interviews with outside economists, many of them academics, who had participated in California's regulatory process and could provide informed and independent perspectives.

Though the Commission greatly benefited from the contributions of all who shared their expertise, the findings and recommendations in this report are the Commission's own.

Hearing agendas, written testimony submitted electronically for each of the hearings, as well as this report are available online at the Commission's Web site, www.lhc.ca.gov. The Commission hearings are archived on the California Channel, accessible at www.calchannel.com.

Background

Regulation in California has developed in surges coinciding with population booms, rapid changes in the economy and the introduction of new technologies. In the mid-1800s, it was the Gold Rush that brought hordes of treasure seekers and later, hydraulic mining that washed away hills and silted rivers. Competition for water between miners and California's burgeoning agriculture industry led to a regulatory system for water. The arrival of the railroad industry led to the creation of the Railroad Commission, later the Public Utilities Commission, which in time also regulated investor-owned telegraph and later telephone companies as well as natural gas and electric utilities. The railroad opened broader markets for California agriculture; growing demand led to new farming methods including the use of new fertilizers and pesticides, and the first pesticide law in 1901.

California is the nation's largest agricultural producer and exporter as well as home to the country's largest manufacturing sector. Its cities boast advanced research medical centers as well as a healthcare industry equipped with sophisticated technology. Its electricity comes from natural gas-fired plants, hydroelectric dams, coal, renewable sources such as geothermal, wind and solar and nuclear reactors.

California's regulatory codes have grown to embrace education, food safety, drinking water, mine ventilation, discarded tires, nursing homes and hospitals, insurance, home insulation and much more. The goals are to protect public health, worker safety and ensure fairness in the marketplace, as well as quality of life by protecting water, air and land.

Environmental regulations have received the most attention because environmental protection is an area in which California has been a bellwether for the nation. As well, because of the huge size of California's economy and population, environmental regulations tend to impose the greatest costs on identifiable industries. In aggregate terms, such costs can be large, particularly in the short term. Health and environmental benefits, meanwhile, are spread over a large and diffuse population and contribute immensely to a quality of life many residents take for granted, often accruing over decades.

Post-War Growth Drives New Regulatory Models

World War II marked the start of a growth boom in California that reshaped the state, setting in motion a regulatory revolution that ultimately was adopted at the federal level. By 1940, California's population had reached 7 million. That year, the state had registered 2.8 million vehicles, which drove a total of 24 billion miles.[2]

California was a major embarkation point during World War II and a key nexus of the industrial war effort. G.I.s passing through vowed to return after the war. They settled in new neighborhoods and drove new cars. The defense boom that started during the war continued into the 1950s with the space and high technology industries, creating a broad economy that included oil and chemical production and a busy, port-based transportation industry. The federal Central Valley Project opened up the San Joaquin Valley to irrigated farming on a vast scale, expanding growing seasons. The State Water Project, approved in 1959, helped both agriculture and the continued expansion of Southern California's suburbs.

Rapid growth and the collective impact of cars, industry and geography created an air pollution problem, particularly in the Los Angeles basin. By 1943, people in Los Angeles experienced their first smog attacks, marked by limited visibility, difficulty breathing and burning eyes. Within two years, the city had started its first air pollution control program in its health department. By 1947, the year Governor Earl Warren signed the Air Pollution Control Act, Los Angeles County established an Air Pollution Control District, the first of its kind in the nation.

Two decades later, the California Air Resources Board was formed through the merger of the Bureau of Air Sanitation and the Motor Vehicle Pollution Control Board. California's lead anticipated the federal Clean Air Act, passed in 1970. California's air board is the only one of its kind, allowed because it predates the federal law.

With the passage of the California Global Warming Solutions Act (AB 32) in 2006, the Legislature gave the board the statutory assignment of leading the development of regulations that will reduce California's greenhouse gas emissions to 1990 levels by 2020, roughly a 15 percent reduction from 2008 levels and an estimated 30 percent reduction from projected 2020 levels.[3] California again found itself on the forefront, this time with a goal both ambitious and controversial.

California's water protection laws took shape along a parallel timeline. Outbreaks of disease in the 1940s, along with the contamination of fishing and recreational waters caused by industry and population growth, prompted Californians to reassess pollution control, until then largely undertaken at a regional and local level. Recognizing the need for a state-level approach to water pollution control and recognizing too that it was a regional and local issue, the Assembly Committee on Water Pollution recommended sweeping reforms, including the creation of the State Water Pollution Control Board. The committee's work led to the passage in 1949 of the Dickey Water Pollution Act that established nine regional boards responsible for water pollution control in key watersheds.

Growing awareness of the health and environmental hazards posed by contaminated water and the increased pressure on water and wildlife resources from population and economic growth led to the passage of California's landmark Porter-Cologne Clean Water Act in 1969, that established a template for the nation following the enactment of the federal Clean Water Act in 1972.

Soon after, in response to the nation's energy crisis, California formed the California Energy Commission in 1974 as the state's primary energy policy and planning agency. Among its duties is forecasting future energy needs and promoting energy efficiency and energy conservation through education and regulation, which establish standards for such products as building materials and electrical appliances. Through its efforts, California has been able to keep per capita electricity use flat for three decades, while individual consumption in the rest of the nation has increased by 40 percent.[4] As part of the greenhouse gas reduction effort, the energy commission has been tasked by statute with increasing the use of alternative and renewable fuels and new technologies to transform California's fuel and vehicles, through a combination of education and regulation.

Today, more than 200 state departments propose an average of just over 700 rulemaking packages a year, although those packages may contain as many as 30 regulations each.[5] In many cases, these proposed regulatory packages implement standards set by state or federal statute, while in other cases agencies develop their own standards to address policy goals set by the lawmakers. The following table shows which agencies had the most rules approved based on filings from 2000 through 2010 to the Office of Administrative Law. Each of the agencies listed submitted at least 200 regulatory actions to the Office of Administrative Law Notice Register over this time period.

Office of Administrative Law Approvals of Agency Regulatory Proposals from 2000 Through 2010

Agency	Approved Rules
Department of Food and Agriculture	660
Fish and Game Commission	307
Department of Insurance	244
Air Resources Board	210
Fair Political Practices Commission	184
Department of Health Services	161
Department of Toxic Substances Control	103
Office of Environmental Health Hazard Assessment	36
Department of Fish and Game	25

Source: Reference Attorney staff. Office of Administrative Law. Summer 2011. Written communications.

How Regulations Are Developed

The California Administrative Procedure Act outlines rulemaking procedures and standards for state agencies. The act originally was designed to provide the public with a meaningful opportunity to participate in the development of regulations before they are adopted.

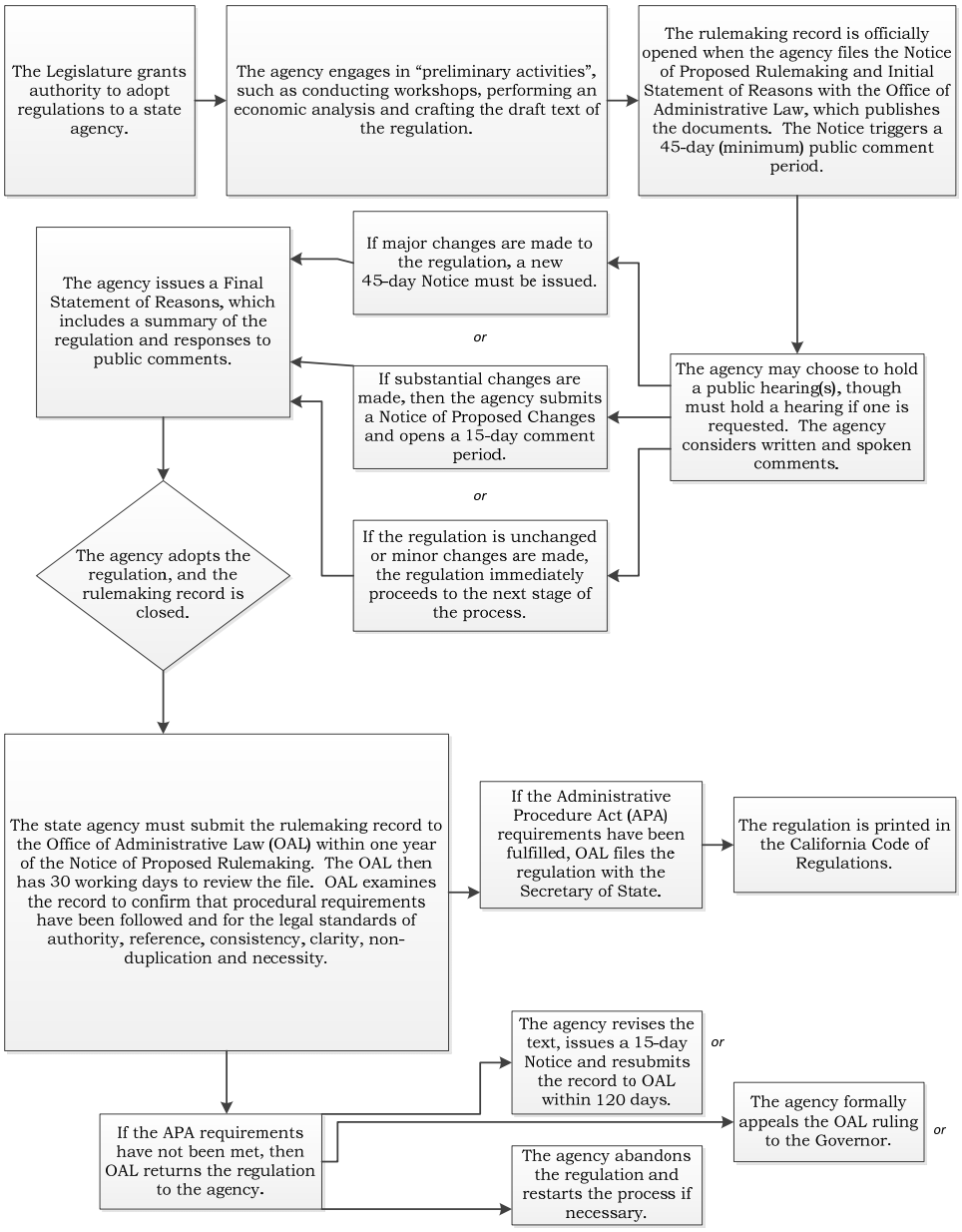
California's regulatory process, guided by the Administrative Procedure Act, is overseen by the Office of Administrative Law (OAL), an independent office within the executive branch of state government led by a Governor-appointed director subject to termination without cause. OAL is responsible for reviewing administrative regulations proposed by more than 200 state agencies for compliance with the Administrative Procedure Act, transmitting final regulations to the Secretary of State, and publishing proposed regulations in the California Regulatory Notice Register and final regulations in the California Code of Regulations. The following flowchart describes the regulation development process.

Creation of OAL

The California Administrative Procedure Act was originally adopted in the 1940s – and overseen by the Office of Administrative Law (OAL), created by Governor Edmund G. Brown, Jr. in 1979 under pressure from Republicans and the business community to address what was described as overregulation by agencies at that time. Forming OAL was the compromise that resulted from legislative proposals that sought to give the Legislature the ability to review and modify regulations issued by executive branch agencies and departments.

Sources: Debra Cornez, Acting Director, Office of Administrative Law. December 30, 2010. Personal communication. Also, California Performance Review. Section GG41. 2004. Also, David Siders. October 11, 2010. "The Buzz: Is Jerry Brown for or Against Regulatory Review?" The Sacramento Bee.

Regulation Development Flowchart



Source: Office of Administrative Law. 2006. "How to Participate in the Rulemaking Process." Sacramento.

With a staff of nearly 20, OAL "ensures that agency regulations are clear, necessary, legally valid and available to the public."[6] Specifically, OAL ensures that each step in the development process is executed properly and follows the Administrative Procedure Act. The office also verifies whether a rule is written properly and adheres to legal standards. Questioning agencies on the substantive content of regulations, however,

is not a role of OAL. The six main legal standards OAL applies are the following:[7]

1. ***Authority*** – The law that permits or obligates an agency to engage in a regulatory activity.
2. ***Reference*** – The statute or court decision that the agency implements by pursuing the regulatory activity.
3. ***Consistency*** – The regulation must be free from conflict with existing law.
4. ***Clarity*** – A regulation must be written in an easily understandable fashion.
5. ***Nonduplication*** – A regulation must not overlap with another statute or regulation.
6. ***Necessity*** – The regulation is needed to carry out the purpose of a law.

OAL also accepts petitions challenging alleged "underground regulations," which are rules issued (for example, by manual, letter or unwritten policy) by state agencies or departments that should have been vetted through the public rulemaking process. The OAL does not have authority to review the economic analysis that was done by an agency, other than to check whether the agency submitted the Form 399, which asks about the economic and fiscal impact of a regulation.

The typical path of a regulation can be traced from the time a statute requiring regulations for implementation is chaptered into the state's legal codes to the final step of filing the regulation with the Secretary of State. Agencies begin their work by engaging in a variety of preliminary activities, such as filing the Form 399 with the Department of Finance, which notes what implementation and enforcement costs the regulation will entail for the state government and an estimate of costs it will impose on regulated parties. A copy of the Form 399 is included in Appendix C.

The department developing the regulation opens the rulemaking record when it releases a public Notice of Proposed Rulemaking, with an Initial Statement of Reasons and text of the regulation. A minimum of 45 days is then provided for public comment, and one or more public hearings are held if warranted or requested. If the agency makes significant changes to the regulation, then a new 15-day comment period is opened. A Final Statement of Reasons, along with a summary of responses to public comments, is published when the agency adopts the regulation and closes the rulemaking record.

The final rulemaking record must be submitted to the Office of Administrative Law within one year of the initial public notice. The OAL then is given 30 working days to review the regulatory package. If the regulation receives OAL approval, then the regulation is filed with the Secretary of State and printed in the California Code of Regulations.

When OAL rejects a regulation, an agency makes necessary changes to the text, puts out a 15-day notice for public comment and once the comment period is over, the agency resubmits the regulation to OAL within 120 days of the notice. Alternatively, agencies can appeal to the Governor if they disagree with the OAL's decision. The OAL has rejected more than 150 rulemaking files since 2000, out of roughly 7,500 files submitted during that period. Files may contain several separate regulations.[8] "Emergency" regulations follow a similar path, but the notice and public comment periods are significantly shorter. For example, the public is given five calendar days to comment on a proposed emergency regulation.[9]

Economic Analysis of California Regulations

California's Administrative Procedure Act (APA) requires departments that promulgate regulations to assess the economic impact of those regulations. The act, however, is not explicit about what constitutes an adequate review. With a few important exceptions, notably the California Energy Commission, state agencies are not required by statute to follow any particular protocol for making that economic impact assessment, though some departments have developed their own protocols. The act further requires the Department of Finance to make a determination about whether the approach of that assessment is reasonable – not rigorous or accurate, but reasonable. The finance department's main concern is on the immediate fiscal impact of a new regulation, specifically whether the new regulation will cost the state money to implement or impose an unfunded mandate on local government.

A handful of sections within the APA, however, require economic and fiscal impact information to be included in regulation proposals:[10]

- State agencies shall provide 1) the reasons for adopting, amending, or repealing regulations; 2) a description of reasonable alternatives to the proposed change that would lessen its impact on small businesses, and why those alternatives were rejected; and 3) the reason why the proposal would not have an adverse economic impact on business.[11]
- State agencies shall consider a proposal's adverse economic impact on California business enterprises and individuals. This

includes the unreasonableness of reporting and compliance requirements, impacts on industries, ability to compete with other states, impacts on the creation or elimination of jobs, creation of new businesses, elimination of existing businesses, and expansion of existing businesses.[12]

- If a proposal may have a significant, statewide adverse impact directly affecting business, it shall identify types of affected businesses, any costs they will incur in compliance, and proposals to exempt or partially exempt certain businesses from compliance.[13]
- "State agencies shall determine that no alternative to the proposed regulation would be more effective in achieving its objectives, or would be as effective and less burdensome to affected private persons, and an explanation for rejecting any alternative that would lessen the adverse economic impact on small businesses."[14]

In addition, the California Health and Safety Code provides that the California Environmental Protection Agency and its departments shall consider, before adopting any major regulation, whether there is a less costly alternative or combination of alternatives to achieve the same end. This applies to proposals with an annual economic impact on the state's business enterprises exceeding $10 million.[15]

Not all regulations are subject to OAL approval. Energy efficiency regulations related to building materials and construction practices are reviewed by the California Building Standards Commission. The Administrative Procedure Act also does not cover all departments and agencies, exempting agencies outside of the Executive Branch, the California Public Utilities Commission and some decisions regarding water quality permits (including statewide and region-wide permits) made by the State Water Resources Control Board.[16]

The Porter-Cologne Clean Water Act requires the state and regional water boards to consider economic consequences when they set water quality objectives. A state 2006 Court of Appeal decision, *City of Arcadia v. State Water Resources Control Board*, gives the board considerable latitude in determining how they consider costs, however.[17]

Form 399 and the Department of Finance

To provide guidance to agencies in meeting the requirements of the above economic and fiscal impact provisions of the Administrative Procedure Act, the state includes instructions in the State Administrative Manual on how to complete a Form 399, which has been incorporated into the

rulemaking process. The Form 399 is an Economic and Fiscal Impact Statement required to be completed by agencies during the rulemaking process. The form consists of two sections: 1) Economic Impact Statement and 2) Fiscal Impact Statement. The act requires only that the Fiscal Impact Statement be completed.[18]

The first portion of the form, the Economic Impact Statement, was created by Executive Order W-144-97 under Governor Pete Wilson in 1997. The Order required all agencies to complete this component and submit it to the Regulatory Review Unit within the California Trade and Commerce Agency. The unit, a five-person oversight and guidance group, was created through legislation during the 1995-1996 session, but later was eliminated along with the agency, which had become the Technology, Trade and Commerce Agency. The Department of Finance took over the economic impact statement approval duties, though its staff focuses on budget impacts. In practice, the department rarely rejects 399 forms.[19] The economic impact section of the Form 399 remains to this day, though its enforceability has been questioned due to its link to an Executive Order rather than a statute.[20]

In a letter to Senator Robert Dutton in February 2010, California Legislative Analyst Mac Taylor noted: "California does not have a centralized regulatory review process, does not focus on ensuring that the benefits of regulations are equal to or greater than their costs, and lacks a detailed set of technical guidelines to guarantee that high-quality economic analyses of the effects of regulations are uniformly prepared by state entities."[21]

Economic Analysis Practices at California Agencies

While agencies are required to complete the Form 399, the extent to which the form is completed and whether an actual analysis is done varies widely. Very few agencies have an established economic analysis office or unit; a preliminary examination of more than 30 agencies revealed only three formal economic analysis departments. One of these three agencies, the Department of Water Resources, though it issues regulations, is generally not considered to be a regulatory entity. Most agencies do not employ economists, and affected industries often are a major source of cost data. See Appendix E for a description of economic analysis approaches at 30 California agencies.

Some agencies make an effort to involve affected businesses early in the regulation development process through workshops and other less formal channels. Still, some stakeholders have stated that many agency-driven economic impact assessments generally do not attach dollar values to the impacts.[22] Quality economic analyses that are performed often are

done too late in the regulation development process to inform decision-making in any meaningful way. Moreover, policy alternatives often are chosen before an analysis is conducted.

The process can suffer from gamesmanship; regulated parties in some industries may calibrate their level of engagement in the rulemaking process by assessing their chances to fare better by appealing to political leaders, trying to get a better result through the public comment process or taking on the issue later through the court system.

Because of the lack of a statewide approach, the California Environmental Protection Agency and the California Energy Commission stand out for having developed their own guidelines.

Economic analysis at the California Environmental Protection Agency is primarily guided by the Economic Analysis Program (EAP), and the California Air Resources Board (ARB) has been charged with implementing the program. The main goal of the EAP is to ensure that consistent standards are applied to economic analysis endeavors in EPA entities. Part of this program is the provision of guidance documents for conducting an economic analysis and for completing the Form 399. A 130-page document issued in 2007, *Cost Analysis of ARB Regulations*, describes the board's economic analysis methodologies. An economic model commonly used by ARB is the Environmental Dynamic Revenue Analysis Model, commonly referred to as EDRAM. This sophisticated model accounts for all the economic relationships between consumers, producers and government entities in California. ARB not only performs economic analyses for proposed air related regulations, but the board's staff also offers its analytical expertise to other departments within EPA, such as the Department of Toxic Substances Control.

The California Energy Commission, within the California Natural Resources Agency, has three divisions that use robust economic analysis programs: Fuels and Transportation; Efficiency and Renewables; and, Electricity Supply Analysis.

The commission was created by the Warren-Alquist Act of 1974, which lays out the mission and authorities of the commission as well as guiding principles for how economic analysis should be included in the commission decision-making process. The 2001 *California Standard Practice Manual – Economic Analysis of Demand-Side Programs and Projects* also helps to steer economic analysis at the commission. In its early days, the energy commission had a centralized office of economic analysis. After the office was eliminated, economic analysis duties were split up and assigned to specific divisions.

Economic Analysis Methodologies

Several types of economic analysis tools can be employed to understand the potential impacts of a regulation. The most common types include the following:

Cost-Benefit Analysis. Cost-benefit analysis attempts to examine the costs and benefits of policies and identify the alternative that yields the largest net benefits for society as a whole. Although the name of this tool implies relative simplicity, the analytical process is complex. This approach is extensive, costly, and susceptible to challenges, as it requires answering multiple hypothetical questions, conducting difficult monetization of intangible benefits and costs, and relying on data or assumptions that may have inherent problems associated with the information. The framework, however, provides a thorough and rigorous review that produces clear and comparable alternatives that are expressed with dollar signs.

Cost-Effectiveness Analysis. Cost-effectiveness analysis (CEA) offers a relatively simple framework for identifying the most financially efficient policy choice. CEA examines various policy options for obtaining a desired result and creates a ratio of cost to an effectiveness measure (e.g., tons of emissions eliminated). The most cost-effective policy will be associated with the lowest average cost per unit of effectiveness. CEA allows analysts to avoid the need to put a dollar figure on benefits, often a difficult process. Some decisions may not require a quantified picture of benefits. For instance, legislators may enact a law that bans a specific chemical but states that an agency must devise the most cost-effective strategy for phasing out the chemical. CEA provides a solid tool to identify the best regulatory approach.

Econometrics. Econometrics studies the statistical relationship between economic variables through the use of regression techniques. For instance, a researcher may hypothesize that increases in education level boost income, and they then may try to estimate the statistical relationship between education level and income. Education would represent the *explanatory* variable in this equation, and income would represent the *dependent* variable. Most equations would contain more than one explanatory variable.

A more complex, but often more useful, form of econometrics is simultaneous-equation modeling. This type of approach is necessary when there are two-way flows of influence between explanatory and dependent variables. Expensive, time-consuming, and dependent on good data, econometric analysis is not well-suited to all types of policy decisions.

Economic Impact Analysis. Economic impact analysis (EIA) allows analysts to predict the impacts that business sector changes may exert on an economy. EIA relies on input-output analysis, the analytical framework that presents a detailed picture of the economy by depicting the relationship between economic sectors and the relationship between these economic sectors and consumers. For example, household demand for new housing creates a need for construction companies. These builders require inputs from other industries, such as the timber industry, to produce homes.

When a business increases its activities, these impacts also generate indirect impacts for businesses that sell their goods or services to these firms. People who work in the relevant sectors may receive increases in their income as a result of these activities and may pump a portion of this income back into the economy. "Multipliers" can be calculated for each sector in the economy, which allows the measurement of these economic ripple effects. The two main concerns with its significant role in many public decisions are the significant sensitivity of results to data inputs and assumptions and the lack of insights the tool provides into costs.

The range of available tools and the need to understand when to use what form of economic analysis calls for a systematic approach. The federal government has a centralized system in place to provide guidance to agencies and oversight of economic analysis of federal regulations.

Sources: James Sanchirico, Professor, Environmental Science and Policy, University of California, Davis. January 27, 2011. Written testimony to the Little Hoover Commission. Also, Robert Stavins, Professor of Business and Government, Harvard University, and Todd Schatzki, Vice President, Analysis Group. Boston. January 10, 2011. Written testimony to the Little Hoover Commission. Also, Anthony Boardman, David Greenberg, Aidan Vining and David Weimer. 1996. "Cost-Benefit Analysis – Concepts and Practice." Upper Saddle River, New Jersey. Prentice-Hall. Also, Damodar Gujarati. 1988. "Basic Econometrics." New York, New York. McGraw-Hill.

Negotiated Rulemaking

Negotiated rulemaking, otherwise known as "reg-neg", offers an alternative to traditional "notice-and-comment" rule development processes. Agencies employ a neutral facilitator in a negotiated rulemaking to assist in brokering a consensus regulatory decision among all stakeholders. Negotiated rulemaking proponents suggest that this approach provides more defensible and effective outcomes and ultimately lends efficiency to the regulatory framework by reducing court challenges.

The Negotiated Rulemaking Act of 1990 encouraged the use of negotiated rulemaking at the federal level and clarified the technique. President Clinton's Executive Order 12866 also encouraged negotiated rulemaking as an agency strategy. The popularity of this strategy, however, has faded substantially at the federal level over the past decade. The reasons for this decline include a general lack of support from the Office of Information and Regulatory Affairs, which may be due in part to the negative impact of negotiated rulemaking on the influence of the office. Opponents of negotiated rulemaking have suggested that this technique often fails to produce stronger lasting outcomes and that less formal early structured dialogue yields better results. Costs, which average approximately $100,000 per negotiated rulemaking, also have impeded its popularity.

Several academics and practitioners with expertise in negotiated rulemaking have stated that negotiated rulemaking may provide an effective regulatory tool for states, in cases where the proposed rule is not overly complex and impacts a manageable number of stakeholders. Moreover, an evaluation of the negotiated rulemaking experience of the California South Coast Air Quality Management District for the development of rules for chromic acid emissions from metal plating companies presents a 2002-2003 negotiated rulemaking success in this state. Three states have adopted formal negotiated rulemaking acts, and at least six have crafted laws that encourage its use.

Sources: Cary Coglianese, Professor of Law, University of Pennsylvania Law School. August 23, 2011. Personal communication. Also, Jody Freeman, Professor of Law, Harvard Law School. August 23, 2011. Personal communication. Also, Ronald M. Levin. 2011. "Rulemaking Under the 2010 Model State Administrative Procedure Act." Vol. 20. Widener Law Journal. Also, Jeffrey S. Lubbers. 2008. "Achieving Policymaking Consensus: The (Unfortunate) Waning of Negotiated Rulemaking." 49 (987). South Texas Law Review. Also, Daniel P. Selmi. April 2005. "The Promise and Limits of Negotiated Rulemaking: Evaluating the Negotiation of a Regional Air Quality Rule." Legal Studies Paper No. 2005-9. Loyola Law School.

In its analysis, the energy commission uses a life-cycle approach to costs and benefits. As building materials, appliances and other devices become more energy-efficient, the commission often faces diminishing marginal returns in new rounds of standards, though some new appliances, such as big-screen televisions, provide new areas in which to seek energy savings. The commission is considering changing the definition of what it considers cost-effective to include a broader measure of benefits, such as the long-term benefits of a regulation to society.

Unlike most of the other regulation-generating state entities, the energy commission funnels proposed rules through two different regulatory oversight bodies, the Office of Administrative Law and the Building Standards Commission. The type of rule dictates the relative influence of OAL and the Building Standards Commission in the development process.

Criticism Fueling Reform Attempts

The regulatory process has never been free of criticism, either from regulated interests that feel the regulations are overly burdensome or from non-regulated interests that express the view that the regulations do not go far enough. An increasing body of research, however, both in the United States and in far-more-heavily regulated

Europe, is focusing on systemic weaknesses in the regulatory process and how to make improvements.

A recent study by the Institute for Policy Integrity at New York University's School of Law, the first nationwide assessment, gave California a D for its approach to developing regulations.[23] The non-partisan institute is dedicated to improving the quality of governmental decision-making. The institute, in its evaluation of California, cited a lack of scope and rigor in the analysis performed by departments, lax procedural standards, few trained economists and a burdensome OAL review process that came too late. It advocated the use of economic analysis to support regulation protecting health, the environment and consumer safety. "The grade is not only surprising given the state's long history with regulatory review, but it is especially disconcerting considering the power and responsibilities of California's agencies," the institute found.[24]

Institute for Policy Integrity's Key Findings for Reform

- States directly regulate 20 percent of the economy. Poorly designed regulations threaten economic growth and fail to efficiently protect the environment, public health and safety.
- Powerful tools exist for states to promote rational and efficient regulatory decisions.
- Most states choose the wrong tools or wield them ineffectively.
- In many states, regulatory review only creates another access point for private interests who oppose new regulations; very few states use the review process to calibrate decisions and get the most out of regulatory proposals.
- Almost no states have mechanisms to check if necessary regulations are missing or to coordinate inter-agency conflicts.
- Almost no states have balanced or meaningful processes to check the ongoing efficiency of existing regulations.
- With exceedingly few (if any) trained economists, limited time, and strained budgets, most state agencies struggle to assess only the basic costs of regulations and completely forgo any rigorous analysis of benefits or alternative policy choices.
- Based on a 15-point scale, no state scores an A; the average grade nationwide is a D+; seven states score the lowest possible grade of a D-.
- By following a simple, step-by-step course of reforms (transparency, training, inter-state sharing, resource prioritization, new guidance documents, revised statutes and ongoing reevaluation), all states can improve the rationality and effectiveness of their regulatory systems.

Source: Institute for Policy Integrity. November 2010. "52 Experiments with Regulatory Review. The Political and Economic Inputs into State Rulemakings." New York University School of Law.

Federal Economic Analysis of Regulations

The federal government uses a system of regulation development that makes far greater use of economic analysis and includes a regulatory review process that is based in the White House. The Office of Information and Regulatory Affairs (OIRA) was created by Congress in 1980 under the Office of Management and Budget (OMB), which is an agency

within the Executive Office of the President. OIRA was originally established under the Carter Administration to review all collections of information by the federal government and to develop and oversee the implementation of government-wide polices in areas such as statistical policy, information technology, privacy and data quality.[25]

The office also became responsible for reviewing draft regulations under Executive Order 12291, issued in 1981 by President Ronald Reagan. Executive Order 12866, issued in 1993 by President Bill Clinton, further refined OIRA regulatory oversight powers. The Clinton Executive Order outlined the guiding principles agencies must follow today when developing regulations, including encouraging the use of cost-benefit analysis, risk assessment and performance-based regulatory standards. The Order shifted emphasis away from ensuring that benefits exceeded costs to ensuring that benefits justified a regulation's overall costs. The Executive Order also established the regulatory planning process for each agency, delegated authority to OIRA to coordinate agency rulemaking efforts with the priorities of the President and expanded the role of OIRA as the central reviewer and gatekeeper for all "significant" rulemakings (i.e., regulations with a potential annual economic impact of $100 million or more).

Quantified Social Impacts of United States Agencies

The federal Office of Information and Regulatory Affairs (OIRA) regularly assesses the degree to which United States regulatory agencies create benefits and costs for businesses and citizens throughout the nation. An examination of federal regulatory data for the October 1999 to September 2009 period, which was provided in a 2010 OIRA report to Congress, reveals a picture of the relative impacts of agencies.

Estimates of the Total Annual Benefits and Costs of Major Federal Rules by Agency, October 1, 1999 - September 30, 2009 (in millions of 2001 dollars)

Agency	Number of Major Rules	Monetized Benefits	Monetized Costs
Department of Agriculture	6	$906 - $1,315	$1,014 - $1,353
Department of Energy	8	$6,251 - $8,500	$3,328 - $3,856
Department of Health & Human Services	20	$21,895 - $44,435	$4,651 - $6,232
Environmental Protection Agency	30	$81,903 - $533,066	$25,789 - $29,227

Source: Office of Information and Regulatory Affairs at the White House Office of Management and Budget. 2010. "2010 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local and Tribal Entities." Washington, D.C. Pages 11-13.

Regulatory Review in Other States

The Institute for Policy Integrity at the New York University School of Law found that many states often perform poorly in regulatory economic analysis efforts when compared to the federal government due to chronic underfunding for this function.[26] Agencies frequently comply partially, or not at all, with existing economic analysis requirements. Vague statutory language and a lack of oversight are often to blame for these circumstances. A 1998 study of the states found that in Virginia, for example, agencies complied with review requirements in less than 20 percent of cases. In addition, although 32 states claimed in a survey to consider whether agencies adequately complete analyses for proposed rules, only ten states established an independent entity to review the content of the economic assessments.[27]

A study by the Institute for Policy Integrity provides a snapshot of state regulatory review strategies:[28]

Oversight

- 46 states grant the Legislature at least some authority to review regulations.
- 30 states grant the Governor's office or another executive agency the power to review rules.
- 12 states have an independent entity that wields review authority.

Analysis

- 45 states require some form of economic analysis.
- 38 states require economic analysis beyond fiscal impacts.
- 21 states require analysis of social costs and benefits.
- 9 states have set threshold triggers to identify significant regulations.

Although a Commission examination of states did not reveal any state that executes every component of its regulatory framework effectively, a number of states stand above the rest in this regard. Some key examples are sketched below:

Arizona

The Governor's Regulatory Review Council (GRRC) provides regulatory oversight in Arizona. The GRRC is composed of seven members who meet monthly and has a staff of four.[29] At least one member must

represent the public interest; at least one must represent the business community and at least two members must be chosen from lists created by the House Speaker and the Senate President. Although a moratorium on new regulations is currently in effect, agencies typically submit new rules to council staff after the agency reviews public comments on the proposed rule and makes necessary changes. The council then has 90 days to review the regulatory package. Most new regulations and alternatives must be examined with an eye for economic costs and benefits, and the probable benefits of any rule must outweigh its probable costs.

The GRRC also examines public appeals for review of impact statements as well as analyses produced by stakeholders that compare the impact of rules on the competitiveness of Arizona businesses to businesses in other states. Each agency must review all of its rules every five years, provide updated economic impact statements and submit a summary report of its findings to the GRRC.[30]

Colorado

Agencies must submit a copy of each proposed rule to the Department of Regulatory Agencies, which is housed within the Office of Policy, Research and Regulatory Reform. If the department's executive director finds that a rule may have a significant economic impact, then the department may ask the agency to conduct a cost-benefit analysis, which must include at least two alternatives to the proposed rule.[31] The agency must also perform a cost-benefit analysis of each alternative. The data and research used to conduct the analysis must be made public.[32] If an agency is not directed to perform a cost-benefit analysis and a member of the public or business requests an economic examination of a proposed rule, the agency is required to prepare a less rigorous regulatory analysis.

Florida

Florida officials forced agencies to conduct full cost-benefit analyses of regulations from 1975 to 1995. An examination of this policy, however, revealed staggering costs associated with this rigorous economic tool's requirements. The state then decided to switch to a cost-effectiveness standard, and the necessary change was applied to the Florida Administrative Procedure Act.[33] Florida agencies must review all of their rules every two years primarily to clarify and simplify rules and to delete obsolete or ineffective rules.[34]

Indiana

Indiana's approach is heavily influenced by Governor Mitch Daniels' previous experience as director of the White House Office of Management and Budget (OMB) under President George W. Bush. Governor Daniels established the Indiana OMB in 2005 by Executive Order. The office is charged with assessing the impact of any new regulation or rule on Indiana businesses. The 2005 Executive Order requires agencies to conduct cost-benefit analyses on all new regulations and directs agencies to determine the least intrusive and most efficient regulatory choice for a proposed rule or regulation.[35] In developing their cost-benefit analyses, agencies are required to demonstrate need for a new regulation, either in terms of market failure or promoting public safety and include an estimate of how many individuals and businesses would be affected by the proposed rule. The Indiana OMB may accept the analysis, suggest revisions or reject it.

New York

New York formed its Governor's Office of Regulatory Reform through Executive Order in 1995. Agencies regularly conduct cost-benefit analyses of proposed regulations; at the very least, they have to detail expected costs for every new rule. New York is one of the few states that provides agencies with a detailed manual for conducting robust economic assessments.[36] The New York office has the authority to ask an agency to develop new rules, conduct cost-benefit and impact analyses, and work with agencies to determine whether certain regulations should be eliminated. The office works with an executive council of agency leaders to ensure that the state pursues substantive program priorities.

Virginia

Agencies must submit newly crafted regulations to the Department of Planning and Budget before formally proposing a rule. Moreover, the department conducts its own economic analysis of rules.[37] Six employees work in the economic and regulatory impact division of the department. They use a variety of economic techniques, which include cost-benefit analysis. Analysts consider non-quantifiable benefits derived from detailed qualitative assessments when necessary, and the department also attempts to address social equity concerns in its analytical methods.[38] Each newly elected Governor in Virginia must issue an Executive Order regarding regulatory review policies under their administration.

Agencies must communicate with the department through an Internet-based Regulatory Town Hall to promote public participation and transparency.[39] Public comments are filtered through the Web site and materials relevant to the rulemaking proceedings are posted. In an effort to enhance efficiencies in the regulation review framework, the state has instituted a "fast track" process for promulgating noncontroversial rules and for repealing certain types of regulations.[40] This approach frees up resources for complex and controversial rules.

City Level Economic Assessment

One major California city has applied economic analysis to significant proposed policies for the past seven years, and another is just beginning to pursue these endeavors.

San Francisco. San Francisco opened the Office of Economic Analysis (OEA) seven years ago within the Office of the Controller. The OEA was created through a 2004 voter initiative, sponsored by the city's chamber of commerce. The office is staffed by two economists and examines all local legislation that may exert a significant economic impact on the city. The term "significant" has been interpreted broadly to mean any proposal that affects the goals, strategic priorities, or broad policy directions of the overall San Francisco economic strategy. The staff economists determine which legislation will require examination, and the office must then return a report to the Board of Supervisors within 30 days unless the President of the Board grants an extension. The board cannot consider or hold hearings on any proposed legislation until it has received the office's report on the impact of the legislation. The board may waive this requirement by a two-thirds vote if it finds that the public interest requires immediate consideration of a piece of legislation. The office typically produces 10 to 15 reports each year. Funding for the office is expected to range from $250,000 to $500,000 each year and must be approved by the mayor and board.

Los Angeles. The Los Angeles City Council approved the formation of an Office of Economic Analysis (OEA) in 2010. OEA operations are run out of the Office of the City Administrative Officer. Organizations such as the Los Angeles Area Chamber of Commerce, the Los Angeles County Business Federation and the Los Angeles County Economic Development Corporation voiced their support for the formation of the OEA and each played a role in bringing the council's attention to the need for a more rigorous assessment of potential legislation. The office has been funded initially with $250,000 from District 13, which is represented by Council President Eric Garcetti. Economists conducting work for the office will be hired from a pool of preapproved vendors to work on specific studies the council selects. The city council unanimously approved a panel of 13 consultants on July 1, 2011, to provide services as part of a one year pilot program. Los Angeles city officials have expressed an interest in developing a fully staffed Office of Economic Development with civil service economists who will be able to analyze all significant legislation.

Sources: Ted Egan, Chief Economist, San Francisco Office of Economic Analysis. San Francisco. October 28, 2010. Written testimony to the Little Hoover Commission. Also, City and County of San Francisco Office of the Controller. 2004. Statement on Proposition I. Also, Los Angeles City Council. Budget and Finance Committee. July 14, 2010. File No.09-2722. Also, Howard Fine. July 14, 2010. "City to Better Analyze Economic Impact." Los Angeles Business Journal. Also, Los Angeles City Council. July 1, 2011. Continuation Agenda.

Gaps in Process and Oversight

California's regulatory system, long considered a bellwether for the rest of the nation, is out-of-date. The state's failure to adopt analytical tools now commonly in use in other states and at the federal level has produced an uneven regulatory approach that increasingly focuses intensely on slivers of activity, only rarely pulling back to consider regulations in the context of other regulatory actions or considering their full impact.

In its study of California's regulatory system, the Commission identified two areas that present barriers to better regulation: process and oversight. Better regulation can be defined as regulation that achieves desired goals, maximizing social benefits while avoiding unnecessary costs and placing the lowest possible burden on the economy and society. The specific goals often are established by state or federal statute, but also can be developed by a regulatory department charged with remediation, such as achieving compliance with national clean air or water standards.

Process: Inconsistent Across Agencies

Though an economic impact assessment is required by the Administrative Procedure Act, the state lacks a process to ensure consistency across agencies in methodology and rigor. The current process imposes additional costs on regulated parties too often without weighing the consequences or considering alternatives that might be as or more effective and less burdensome, as required by the Administrative Procedure Act. The result is greater uncertainty and delay in the implementation of needed regulation and eroded confidence in the legitimacy of California's regulatory structure.

Key issues are how costs are determined and when affected stakeholders – both regulated and unregulated – are brought into the conversation to discuss real estimates of those costs. Once a regulation is formulated, it enters a public process that can last up to a year, or longer, a process that includes a public comment period during which interested parties can share their views or express concerns about the regulation.

When and how economic analysis is done differs widely across agencies and departments. The Administrative Procedure Act includes a number of requirements for economic impact analysis, but they are weak and not enforced. For example, no standard set of economic analysis tools is required and there is no penalty for failing to do an adequate analysis.

Two regulatory agencies are recognized for having trained experts doing their economic assessments, and are known for having a systematic approach as well as a very open process that can be easily tracked by the public. The California Air Resources Board uses a protocol it developed as part of its mission to meet the requirements of the federal Clean Air Act. The California Energy Commission follows guidelines contained in the 1972 Warren-Alquist Act that created the commission. But the two approaches are not coordinated with each other, nor are changes evaluated by any state-level oversight entity.

As California has no standard protocols for what constitutes a sufficient assessment of economic impact, these agencies and all other state agencies are not specifically required to develop proposed alternatives that could satisfy the legislative intent, which then could be ranked according to their cost-effectiveness. Some departments do only cursory evaluations of the economic impact of a proposed regulation where others, such as the California Air Resources Board, may do a full-fledged cost-benefit analysis of more than one alternative that is peer-reviewed.

With a few important exceptions, California departments that promulgate regulations do not do a thorough economic analysis of the impact of proposed regulations, the Commission heard repeatedly.

While some agencies seek the input of regulated entities and other stakeholders as they design proposed regulations prior to the regulation's release for public comment, many agencies rely on the public comment period as the main opportunity for input.

According to witnesses and others affected by regulation, the public comment period required by the Administrative Procedure Act is insufficient as a forum to tackle and resolve issues as complex and important as cost-effectiveness assessments of alternative approaches.[41] The current process and calendar do not provide opportunities for interested stakeholders or others to offer alternatives for serious consideration and evaluation. This has led to a perception that some regulatory departments do not give adequate weight to comments submitted during this period, as required by the act, and often decide on a preferred solution before getting all the facts. The result can be the rejection or withdrawal of a proposed regulation after the expense of considerable time and money, or worse, the approval of a poorly drawn,

overly costly regulation that may not be the most efficient way to address the problem the regulation was intended to fix. The delay involved in either case adds uncertainty on the part of businesses that potentially might be covered by the regulation and postpones action on a problem the Legislature decided was a priority.

Some, but not all, departments try to address this through a public workshop process, where regulatory staff and in some cases, decision-makers, can work through issues with interested parties, both regulated and not, before a regulation is released for public comment.

Many of the complaints the Commission heard about regulations and the regulatory process could have been more accurately directed at statute and the legislative process. In some cases, actions that are allowed or proscribed are specifically detailed in statute, as is the case with many of the labor laws enforced by the Department of Industrial Relations. In other cases, stakeholders simply disagree with the policy direction set by legislation that regulators are obligated to implement. In addition, legislation in its final form can be overly broad and vague, leaving regulators with the task of developing specific rules to implement the statute, with the attendant challenge of developing economic impact assessments of those specific rules.

An economic analysis developed by two economists at University of California at Los Angeles for the Department of Toxic Substances Control in 2010 concluded that they could only set out an informed framework for discussing the costs and benefits of regulations implementing the Green Chemistry Initiative given the strategy's broad and prospective nature, and that the statute, AB 1879 (Feuer), represented a unique law not implemented anywhere else.[42] The economists were able to discuss short run cost impacts to manufacturers, the role of innovation, the likelihood of falling compliance costs over time, as well as the expected net health benefits of safer products. Specific cost estimates, however, would have to wait, they said, until further in the process of developing a program for regulating "chemicals of concern" and finding alternatives for them for products. The analysis was submitted as an attachment to the department's Form 399, but not made public or posted on the department's Web site, a missed opportunity to integrate the analysis into the broader discussion.

Though the California Air Resources Board has one of the state's most well-developed approaches to using economic analysis in regulatory rulemaking, its analyses have not been free from criticism. In response to concerns expressed about its analyses for the draft scoping plan for implementing AB 32 (Nunez), the Global Warming Solutions Act of 2006, and its regulations for diesel particulate contamination, the board took a

series of steps to strengthen its study process. For the Air Resources Board's second economic analysis of its AB 32 scoping plan, the board enlisted the help of an outside group of economic and policy experts, who also provided advice on allocating cap-and-trade credits as part of its greenhouse gas reduction plan. A subcommittee of the panel advised the board's staff on methodology and other research issues that had been previously highlighted as weaknesses by an external peer review panel. The board also has hired a research fellow with the specific role of ensuring that the board is up-to-date on air-quality research methodologies, addressing criticism made by outside experts in its diesel particulate regulations as well as its AB 32 regulations.

Both actions – seeking input from outside experts before taking on an analysis of a regulation where the science is new and data is scarce and making a concerted effort to scour the research arena for the most appropriate analytical methodologies – are practices from which the state as a whole could benefit if implemented more broadly. At this point, however, these actions are voluntary and specific to a single government entity.

Oversight: Filing Form an 'Illusory' Check

The state lacks systematic oversight to ensure that adequate economic analysis has been performed as part of the rulemaking process.

The lack of standards for what constitutes a sufficient economic impact assessment leaves departments open to developing their own tests, producing an inconsistent approach to analysis across agencies that can lead to regulations that have not been adequately assessed for the impact they place on regulated entities or more broadly, the economy, or to fail to adequately articulate and measure the benefits of a proposed regulation. The Air Resources Board and the California Energy Commission are the state's best examples of rulemaking bodies taking a systematic approach to determining the economic impact of proposed regulations. But there is no oversight to ensure that their methods are the most optimum or up-to-date, nor whether changes they make to their methods are desirable, appropriate or consistent with other approaches.

As there are no standardized guidelines for economic analysis in the Administrative Procedure Act, no oversight body is tasked with developing what constitutes adequate, high-quality cost-effectiveness or cost-benefit analysis. This increases the ability of stakeholders opposed to the regulation (or its policy goals) to challenge a department's analysis and methodology, creating the likelihood of delay.

The state lacks an oversight mechanism equipped to ensure that regulations developed by different agencies do not conflict, or cumulatively create an unworkable burden on a regulated entity.

As well, California lacks an oversight mechanism that can review regulations that have been adopted to determine if they have been effective in meeting their goals and whether new approaches have emerged that would be more cost-effective, or to weed out those that are ineffective or conflict.

Departments proposing regulations file Form 399 with the Department of Finance both when releasing a new rule for public comment, and when the comment period is complete and the rule is submitted for final approval. Though the form also asks departments to discuss whether alternatives to the rule have been considered, as well as what costs and benefits might result from the rule, the Department of Finance instructions to departments are limited to the fiscal impact and state mandate sections.[43] Failure to file the form, or to properly complete the form will prevent the regulation from being approved by the Office of Administrative Law.

"It is important to note that the APA requires only that the rulemaking agency comply with the (finance) department's instructions regarding the fiscal impact estimates set forth in section 11346.5(a)(6), and that there is no such requirement as it relates to the Economic Impact Statement portion of the STD. 399," according to testimony to the Commission from the Office of Administrative Law.[44]

The result is that no one really looks at the part of the Form 399 regarding the economic impact assessment or cost estimates, William Gausewitz, former director of the Office of Administrative Law and now a lawyer in private practice, told the Commission.[45]

Others, in and out of government, say that the lack of attention paid to the Form 399's questions on economic impact means that departments do not take the requirement for an economic analysis seriously.

"The fact is, state agencies rarely do a detailed, item-by-item economic impact analysis of their proposed regulation(s). The vast majority of regulatory submittals are usually accompanied by 'boiler plate' language indicating that 'the agency has determined that there will be no significant economic impact'," Robert Raymer, a senior engineer and technical director for the California Building Industry Association, testified to the Commission.[46]

The Administrative Procedure Act (APA) would seem straightforward in requiring state agencies to "assess the potential for adverse economic impact on California business enterprises and individuals, avoiding the imposition of unnecessary or unreasonable regulations or reporting, recordkeeping, or compliance requirements."[47] Yet other provisions in the act qualify or limit this requirement insofar as reporting activity on the department's Form 399, the Commission was told. Electing not to engage with stakeholders at the pre-notice stage, for example, allows agencies to state that it is "not aware of any cost impacts" or that the department has "not been made aware of alternatives." A department is "not required to artificially construct alternatives, list unreasonable alternatives or justify why it has not described alternatives."[48]

No section of the APA specifically requires a department to consult with parties who may be affected by a proposed regulation prior to issuing the public notice, though there is a provision to engage the public prior to the public notice if a regulation is complex or involves a "large number of proposals that cannot easily be reviewed during the comment period."[49]

An important procedural step of the impact analysis is an APA requirement that the rulemaking entity must determine that the regulatory action adopted represents the least burdensome effective alternative. The process, however, relies heavily on the public, including regulated stakeholders, to step forward during the public comment period to provide examples of less burdensome, more effective alternatives when they exist and to identify unnecessary costs.

When the Office of Administrative Law (OAL) reviews the rulemaking record, it checks filings made throughout the process, including the final statement of reasons and the stated finding that the action chosen was the least burdensome. In doing so, the office relies on the department's summary and response to comments, though it checks to ensure that the department has considered comments about alternatives from affected stakeholders. But the act provides that a regulation should not be invalidated on the basis of the content of a department's notice of rulemaking or cost estimates, as long as there has been substantial compliance with those requirements.[50] Moreover, the OAL is not allowed to use its judgment over that of the department in terms of the substantive content of the adopted regulations.

"The economic impact analysis required by the California Administrative Procedure Act is illusory and ineffective because it allows an agency to make a perfunctory, after-the-fact, assessment of impact that is more symbolic than real," the OAL's acting director and assistant chief counsel, Debra Cornez, and senior counsel Michael McNamer told the Commission. "Consequently, it is not effective in achieving the purpose

of informing the decision-making process with empirical knowledge to make the process more transparent and accountable."[51]

These shortcomings in process and oversight can lead to failed efforts to get proposed regulations through the rulemaking process, as seen in the case of an initial regulatory package on rules covering inedible kitchen grease and rendering pulled in late 2010 by the Department of Food and Agriculture. The package since has been retooled, with key pieces separated into separate proposed regulations. To prevent regulatory overlap, the department is working more closely with other departments that regulate entities that would be covered by the proposed rules and has held a series of workshops with interested parties before releasing the revised proposed regulations for public comment.

The lack of consistency can be seen in how the state's approach treats regulations that are subject to the Administrative Procedure Act and other forms of department-developed rules for regulated entities, at times within the same entity. The State Water Resources Control Board, for example, is required to produce economic impact assessments on regulations, as it did in 2011 for its vineyard frost protection regulations to help preserve threatened and endangered fish species in the Russian River watershed. The board, however, is exempt from the same requirements in developing statewide water quality permits covering storm water contamination for municipalities, industry and other state departments that also have significant impacts on society and the economy.

Conclusion

California's regulatory departments use a public rulemaking process to develop regulations to implement policy goals set out by statute, designed to improve the overall welfare of the state. These policy goals often target the benefit, and in what amount, the regulation should achieve, though statutes also can be vague or broad in articulating these goals. In either case, the task of developing regulations to achieve these goals is left to regulators and the public rulemaking process.

The Administrative Procedure Act states that agencies submitting a regulation for approval assess the economic impact of the proposed regulation on affected parties, which can include businesses, school districts, community colleges, other state agencies and other governments and such interested parties as environmental groups and labor advocates. Such an assessment can bring to light information before the public comment period begins that can improve a regulation to better achieve the regulation's intended goals while avoiding unnecessary

costs and placing a lower burden on regulated parties and the economy as a whole. The process of building a credible economic impact assessment necessarily involves engaging the affected parties, improving the chances that alternatives may be introduced and evaluated.

In practice, however, regulations too often are developed in isolation by a department's technical staff, then released for public comment. California's process lacks any requirement to bring in the affected public before a rule is released for public comment. This prevents parties who stand to be impacted by the regulation – regulated and unregulated – from offering their expertise about real world conditions or suggesting better approaches before a proposed regulation is released for public comment. It also makes the process heavily dependent on the public comment period for input from beyond the department to identify better alternatives, shortcomings in a regulation or potential difficulties in implementation that might limit its effectiveness.

Estimates of cost or the burden on regulated parties must be stated as part of the rulemaking process, but weaknesses in oversight by control agencies allows agencies' declarations to go unexamined. Such gaps allow the act of filing a Form 399 with the Department of Finance, which is reviewed by the Office of Administrative Law, to create the appearance of oversight that ensures an economic impact assessment has been done. The lack of an economic impact assessment also represents a missed opportunity to articulate and estimate the benefits of a proposed regulation, which also provides important context for decision-makers.

In the agencies that use economic analysis, there is no oversight or coordinating body to establish a consistent approach – tailored to the scope of the regulation – across agencies or to ensure that the most appropriate and up-to-date methods are used.

When these weaknesses lead to a poorly drawn regulation being rejected, the department has expended both public and private time and money, delaying action on the problem to be solved, fueling uncertainty and risking reduced confidence in the department's rulemaking capacity. The situation is worse when poorly developed regulations are approved: Such regulations may place an undue burden on regulated parties, needlessly wasting resources, and contribute to the perception that California's regulatory process is inconsistent and lacks accountability, which can reduce confidence in the regulatory system.

Toward Better Regulations

In recent decades, California's regulatory activities have both grown in scope and complexity, in large part because of how its residents work, travel, eat and relax and the impact of those activities on each other and on the environment.

The past dozen years have brought immense change for California, marked by two economic booms and two sharp recessions. Little wonder that there is uncertainty about what changes are ahead. At the same time, California still has work ahead to meet federal clean air and water compliance standards to reverse environmental deterioration. And it must do so even as state and local governments try to maintain and expand public infrastructure to keep pace with growing populations, and protect consumers and patients from ever-more-quickly evolving worlds of healthcare, commerce and education. Change, for good and bad, is both constant and unavoidable.

The far-reaching goals that California regulations set out to implement are the state's attempt to shape and direct change with the justification that the desired potential benefits to the many outweigh, or at least offset, costs borne often by specific industries or groups. Done correctly, the process of developing regulations can inform decision-makers and stakeholders through analysis, communication and education. This process should produce an approach that produces the desired benefits while minimizing or avoiding unnecessary costs, finding the most cost-effective alternative and give affected parties adequate time to adapt.

The economic analysis should not be the final determinant of whether a regulation should be approved, as some fear it would be. The Commission believes strongly that the role of the regulators is to implement the Legislature's policy goals and they need clear and efficient regulations to do so. The value of the analysis is in raising issues, identifying tradeoffs and alternatives, and ensuring that stakeholders, regulated and not, are engaged in the process before the proposed regulation is released for public comment. James Sanchirico, a professor of environmental science and policy at University of California, Davis, and a non-resident fellow at Resources for the Future, told Commissioners that an economic assessment, using one of a number of standard approaches, has proven consistently valuable as a way to organize different kinds of information, whether science, epidemiology or

sociology, to assess and prioritize alternatives, and identify and weigh tradeoffs.

California must address the weaknesses in how it develops regulations to improve consistency, transparency and accountability in the process. Only by doing so can it bolster confidence in the process and reduce confusion and uncertainty.

As a first step, the state should require all departments that promulgate regulations, or statewide permits that have a significant cost impact on regulated parties, to make an economic assessment of that impact and make that assessment public before it submits its Initial Statement of Reasons for the regulation. This assessment should include the estimated cost of the impact on regulated parties and ideally, a measure of the benefits. Values for costs and benefits can change over time, with compliance costs dropping over time with the introduction of new technology or production methods. The agency should engage with regulated entities, or their representatives in industry or trade groups, as well as non-regulated stakeholders, to develop this cost estimate before proposed regulations are released for public comment.

At both the pre-release stage and during the public comment period, the agency should actively solicit reasonable alternatives to meeting the stated goal of the regulation. If the alternative selected by the agency is not the most cost-effective, the agency should be required to justify its choice. If an agency makes significant changes in its proposal before it is released for public comment, it should re-engage stakeholders rather than rely on feedback received during the public comment period to improve a proposed rule.

Though many of these steps are outlined in the Administrative Procedure Act, as the testimony from the Office of Administrative Law Acting Director Debra Cornez and Senior Counsel Michael McNamer points out, subsequent changes and qualifications to the act have limited its effectiveness.[52] The Legislature should eliminate these qualifications to strengthen the act's provisions and clarify its meaning. In doing so, the Legislature should make explicit that proposed regulations that fail to meet these provisions will not be approved.

The Commission recognizes that not all regulated entities are willing to share cost information they may feel is proprietary and, if disclosed, could give competitors an advantage. This can be particularly difficult in industries where many businesses are small, private, often family-owned enterprises. As well, some regulated entities may try to game the process, not engaging with regulators until the public comment period. This allows them to size up competitors' strategy, gauge political winds

and enlist legislative support. This can frustrate the best efforts to reach out to stakeholders.

In other cases, as in the development of the Air Resources Board's diesel particulate regulations, staff can make a considerable effort, and meet repeatedly with truck fleet owners, but from the fleet owners' perspective, still lack an understanding of the impact of a proposed regulation on a business and the income of a family who depends on it.[53]

The Commission does not intend for agencies to submit regulations only in the cases where estimated benefits demonstrably exceed estimated costs. In an Executive Order that updated the approach of the Office of Information and Regulatory Affairs, President Clinton made the point that the benefits must *justify* the costs, but do not necessarily have to exceed costs.[54] The Commission recommends that agencies emphasize assessing alternatives to meeting a regulatory goal and prioritizing the most cost-effective approaches in developing their proposed regulation.

In its assessment of various analytical methods, the Commission concluded that a cost-effectiveness approach is far more appropriate to assessing potentially costly regulations than cost-benefit analysis, particularly because it accepts as a given the benefits of the proposed regulation, usually set by statute, and it forces examination of reasonable alternatives. Also, for the purposes of ranking various alternatives by their cost-effectiveness, assigning a dollar value to a desired benefit is not necessary. From this perspective, the benefits of saved lives, conserved energy or reduced water and air contamination, speak for themselves and can be expressed in natural units, such as avoided deaths or available beach swimming days. Regulatory agencies should be required, however, to explain how a proposed regulatory approach will produce these benefits.

By contrast, cost-benefit analysis not only is time-consuming and expensive, but many of the methods for monetizing various benefits, whether health or environmental protection, can produce widely varying estimates, depending on assumptions about discount rates and appropriate time horizons. Despite decades of work by economists to build models for estimating environmental benefits, many environmentalists say that formal cost-benefit analyses tend to undervalue environmental benefits. Environmental groups and labor representatives told the Commission that cost-benefit analysis often provides advantages to industry groups that can afford to gather more data and muster persuasive cost estimates compared to government researchers or non-profit groups.[55] This concern extends more broadly to any analysis that relies heavily on industry-supplied cost estimates. Such industry cost estimates often prove far greater than what an

industry faces once a regulation has been implemented, David Goldstein, co-director of the energy program for the Natural Resources Defense Council, told the Commission.[56] Lacking the resources to produce their own, labor groups and advocates for non-profit organizations often have to rely on academic research to counter analysis produced by better-financed groups, Lydia Bourne, a legislative advocate for the California Nurses Association, told the Commission.[57]

Cost-benefit analysis should be reserved for the exceptions, as when the scope of a regulation is large, and benefits, such as reducing greenhouse gas emissions, while substantial, may accrue to people beyond California or may appear over time, while the costs of transition may be localized and intense. The Legislature acknowledged this in requiring a cost-benefit analysis of AB 32 in 2006.[58]

Professor Sanchirico, who was a research fellow for Resources for the Future and has considerable experience in assessing environmental benefits, has emphasized that economic analysis tools are particularly useful for assisting in the identification and quantification of benefits that are not obvious or valued outside of traditional markets.[59]

Economist Robert Hahn, the former head of the AEI-Brookings Joint Center for Regulatory Affairs and a proponent of cost-benefit analysis as used at the federal level for environmental and other regulation, has examined the argument put forth by some opponents of economic analysis that estimates of future costs of proposed rules are inherently "anti-regulation." Professor Hahn disputes this claim and states further that a range of studies have found that benefits are overstated as frequently as costs.[60]

During the study, the Commission heard from environmental groups who expressed the concern that more emphasis on economic impact assessments could lead to "analysis paralysis," allowing regulated industries to delay or derail regulation not to their liking.[61] The goal must be not to create delay or to hand one side an advantage, but rather to force agency staff to engage with affected stakeholders to learn more about, and gauge, impacts of proposed actions as well as to learn about and consider alternatives that may achieve the same goal at lower cost. In other words, better regulation.

In terms of the state's budget, there is no question that this will require time and resources on the part of agencies that develop regulation. But these costs should be measured against the resources consumed – both by state agencies and by stakeholders – when incompletely conceived proposed regulations are developed without adequate outside input, then go forward into a public process only to fail to be approved or are

withdrawn, as with the Department of Food and Agriculture's first set of rendering regulations. Among the budget costs to be considered are time and resources spent in responding to public comments and reworking proposed rules to fix weaknesses or deficiencies that could have been addressed before a proposed regulation was released.

Unfortunately, these costs can be just as large when agencies extend considerable efforts to engage stakeholders, as the Department of Toxic Substances Control did in its unsuccessful green chemistry regulatory package and the Air Resources Board did in its diesel particulate regulations that, in part were later scaled back and delayed. Given that agencies' resources are stretched and with little likelihood of growing budgets, they will need to prioritize which regulatory packages and which regulatory programs to focus on. In this, the Legislature could help both in making its priorities explicit, and by crafting legislation that can be more easily implemented through a focused regulatory approach.

Improved transparency and greater confidence are benefits that cannot be measured in budget terms, but are critical to the credibility of the state's regulatory process and state government's reputation for fairness.

Water Board Has Economic Analysis Capacity

The State Water Resources Control Board may not be required to analyze the specific costs that could be incurred by its proposed storm water permit renewal conditions, but the process and discussion could benefit from it. Though the board faces budget constraints like other agencies and has to prioritize its efforts, the board's staff has the capacity and sophistication for solid economic analysis, as demonstrated in the work it did in developing frost protection regulations. The rules balanced the needs of the wine industry and the protection of endangered and threatened fish species in the Russian River watershed.

Before starting its formal rulemaking process in May of 2011, the board devoted more than two years to workshops with stakeholders and other meetings to develop proposed regulations aimed at protecting the fish from growers' sudden and heavy diversions of water to spray on vineyards to protect crops from frost damage. The board's revised Draft Environmental Impact Report (EIR) spent considerable time evaluating different alternatives. Attached to an appendix of the EIR containing the board's Form 399, staff included an in-depth economic assessment of the proposed regulation that details costs and impacts to the growers of the anticipated impact of various strategies.

In discussing the benefits, the economic analysis includes the protection of endangered and threatened species and potential to return them to health, in furtherance of state and federal endangered species acts, and meeting the state water board's duty to meet the public trust and reasonable use doctrines. The desired benefit – species protection – is spelled out in the law; the analysis does not try to monetize the value of the benefit or try to balance costs and benefits, nor is the analysis or the board required to. All the same, the analysis provides value in illuminating issues, identifying and assessing alternatives, increasing the information available to the board, in all, creating greater legitimacy for the process.

Sources: California State Water Resources Control Board. Division of Water Rights. May 20, 2011. "Revised Draft Environmental Impact Report-Russian River Frost Protection Regulation." Appendix D: Form 399 Economic and Fiscal Impacts of the Proposed Frost Regulation. State Clearinghouse #2010102053. Sacramento. Also, California State Water Resources Control Board. Frost Protection – Russian River Watershed Activities.
http://www.waterboards.ca.gov/waterrights/water_issues/programs/hearings/russian_river_frost/

Not all agencies are covered by the Administrative Procedure Act and its requirement for economic impact assessment. Some, like the State Water Resources Control Board, are only partially covered by the act; exempted are its water quality control permitting activities, through which it enforces the federal Water Pollution Control Act.[62] The exemption, however, does not bar the water board from assessing economic impacts. In its 2009 study, "Clearer Structure, Cleaner Water: Improving Performance and Outcomes at the State Water Boards," the Commission recommended using cost-effectiveness tests to prioritize the best alternatives for meeting water quality standards once the board had scientifically determined those standards, and reiterates that recommendation here.[63] Such analysis can provide important information to decision-makers, in this case water board members who face difficult and complicated choices in often highly-politicized climates.

The Porter-Cologne Water Quality Control Act of 1969 requires the water boards to consider the economic consequences of regulations when they set water quality objectives, and states that "waters of the state shall be regulated to attain the highest water quality which is reasonable, considering all demands being made and to be made on those waters and the total values involved, beneficial and detrimental, economic and social, tangible and intangible."[64] The statute, however, provides little guidance on how water boards should weigh economic considerations. The federal Clean Water Act prohibits using excessive cost as a reason for not implementing a water quality standard, a point brought up by environmental groups during an advisory committee meeting, and is not something the Commission is recommending.

Essential Components of Regulatory Economic Analysis and Review

Robert Stavins of Harvard University and Todd Schatzki of the Analysis Group provided written testimony for the January 2011 public hearing for this study. They identified six key elements of economic assessments of proposed regulations. These elements are:

- ***Independence*** – Analysts must be free of agency and other political influences and approach reviews with objectivity.
- ***Transparency and Thorough Documentation*** – Data sources and economic methodologies should be open to public scrutiny to increase analytical reliability and accountability.
- ***Integration in the Rule Development Process*** – Economic assessments must be significantly woven into the rule development process early to inform and enhance regulatory planning.
- ***Tailoring to Specific Regulatory Contexts*** – Each regulation will be affected by a unique set of environmental conditions, such as dynamically changing regional economies. These circumstances suggest that one-size-fits-all economic review strategies will not effectively assess proposed regulations.
- ***Expertise and Rigor*** – Analyses must be performed by trained professionals and rooted in sound economic methods and data to provide value to the rule development process.
- ***Sufficient Funding*** – Inadequately funded systems of analysis will yield assessments that lack quality and create delays in the process that further strain resources.

Source: Robert Stavins, Professor of Business and Government, Harvard University, and Todd Schatzki, Vice President, Analysis Group. Boston. January 10, 2011. Written testimony to the Little Hoover Commission.

Regulatory Review: Guidance and Oversight

In written testimony to the Commission, economists Robert Stavins of Harvard University and Todd Schatzki of Analysis Group, a Boston, Mass., consulting firm, made the case that economic assessment of proposed regulations "offers a valuable opportunity to avoid imposing regulations that are not worthwhile and to improve the quality and effectiveness of regulations that are pursued."[65]

Left to make their own decision on whether and how to undertake such assessments, however, "some agencies may either fail to perform them or may do so without sufficient rigor or in an inconsistent manner," Stavins and Schatzki wrote.[66] To address this, many governments require that new regulations be evaluated from an economic perspective prior to being implemented. Some governments, including the federal government, have developed specific standards for such assessments and mechanisms for independent review. The benefits of better regulation resulting from this approach helps to explain the motivation by five U.S. presidential administrations – Democrat and Republican alike – to ensure appropriate economic assessment of new federal regulations. It does so through the Office of Information and Regulatory Affairs, a unit within the Executive Branch's Office of Management and Budget (OMB).

"When performed carefully and impartially, proper regulatory assessment is neither 'pro-regulation' or 'anti-regulation,' but supportive of *good* regulation – that is, regulation that provides net benefits to society. Thus, while regulatory assessment has sometimes been used to stop the development of regulations whose costs would exceed their benefits, it has also led to new regulations and increased the stringency of proposed regulations (and provided valuable political support for these actions)," Mr. Stavins and Mr. Schatzki wrote.[67]

The federal government reviews agency-developed regulations with a staff of about 50 career civil servants in the Office of Information and Regulatory Affairs.[68] The office also assesses cost-benefit analyses of federal regulatory actions of significant impact, of more than $100 million a year.[69] Most of the staff members have backgrounds in public administration or public policy, possess familiarity with economics and are equipped with strong analytical skills. A foundational document for their work, and the economic analysis work of federal agencies, is known as the Office of Management and Budget Circular A-4, defined as a "best practices" document and guide for regulatory analysis by agencies.[70]

John Graham, now the dean of Indiana University's School of Public and Environmental affairs, headed OIRA from 2001 to 2006 under the

George W. Bush administration. Dean Graham said that OIRA functions mainly as a reviewer and that the real economic analysis of a regulation is done at the agency level, a process made easier by the clarity provided through the Circular A-4 guidelines. Briefly, OIRA fulfills its roles in the following ways:[71]

- OIRA can make suggestions and submit comments to a regulatory agency both before a rule is released for public comment and again before the rule is made final.
- OIRA verifies that agencies have been responsive to public comments.
- OIRA sends the regulatory package to other governmental entities (e.g., other regulatory agencies, White House Council of Economic Advisors) to gather input. This practice often identifies overlapping or conflicting regulations.
- If OIRA finds a problem with a proposed regulation, it can send it back to an agency, which can start a negotiating process that can work its way up through channels, ultimately to the agency secretary and the director of the Office of Management and Budget.

California has experience with this kind of oversight, through the Regulation Review Unit that resided in the Trade and Commerce Agency, later the Trade, Technology and Commerce Agency. Created in 1995,[72] the unit was defunded in 2002. The agency was disbanded in 2003.

The unit, with a staff of five, had a significant oversight and advisory role, with its primary task being the examination of regulations and the economic impact statement on the Form 399 to determine whether the agency adequately assessed the economic and business impacts which may result from the regulations and whether the agency had considered alternatives and selected the least-burdensome approach.

Under the 1993 legislation that created it, SB 1082 (Calderon), the Secretary of Trade and Commerce had the authority to evaluate the findings and determinations of any state agency that proposed regulations, and could submit comments into the public record. The agency secretary was required to brief the Governor and members of the cabinet on potential impacts of regulation on the state's economy, businesses and job base.

The unit worked with both regulated parties and the staff of regulatory agencies to improve information about the impact of regulations. The unit developed a regulatory review process that prioritized its resources to proposed regulations of the greatest complexity or potential economic

impact. Staff analysts checked the weekly California Regulatory Notice Register for new proposed regulations. After reading the text of a proposed regulation, the proposing agency's initial statement of reasons for the regulation and the initial Form 399, the staff made a determination of whether the proposed rule had the potential to make a significant impact on the economy, businesses or employment and should be considered for review by the unit.[73]

Regulations selected for review were given a thorough analysis. To gain a broader perspective on the proposed regulation and its potential impact, the unit would reach out to parties potentially affected by the regulation and interview outside experts. In about a fifth of the regulations reviewed, the unit would submit comment letters that often led to changes in the wording or requirements of a regulation before it was sent for approval to the Office of Administrative Law. The unit also, without submitting comment letters, helped agencies improve their proposals through recommendations to improve the economic impact assessment, correcting deficiencies in filings or putting regulatory staff in touch with sources of information and assistance.[74]

Today, the most visible vestige of the unit is the economic impact question section on the Form 399, the answers to which are seldom examined or challenged.

Coupled with the work of the regulation review unit, Governor Pete Wilson's Office of Planning and Research staff held a series of regulatory roundtables during 1996, through which it identified 3,900 redundant or outdated regulations which the Governor sought to repeal. In a 1997 Executive Order, Governor Wilson asked all agencies to schedule a sunset review of all existing regulations by 1999,[75] a request that ultimately

Best Practices for Better Regulation

In its study of all 50 states and the District of Columbia and Puerto Rico, researchers at the Institute for Policy Integrity at New York University Law School distilled 15 best practices for regulatory review and agency decision-making.

- *Regulatory review requirements should be realistic given resources.*
- *Regulatory review should calibrate rules, not simply be a check against them.*
- *Regulatory review should not unnecessarily delay or deter rulemaking.*
- *Regulatory review should be exercised consistently, not only on an ad hoc basis.*
- *Regulatory review should be guided by substantive standards, to ensure consistency and to increase accountability.*
- *At least part of the review process should be devoted to helping agencies coordinate.*
- *At least part of the review process should be devoted to combating agency inaction.*
- *Regulatory review should promote transparency and public participation.*
- *Periodic reviews of existing regulations should be guided by substantive standards.*
- *Periodic reviews of existing regulations should be balanced, consistent, and meaningful.*
- *Impact analyses should give balanced treatment to both costs and benefits.*
- *Impact analyses should be meaningfully incorporated into the rulemaking process.*
- *Impact analyses should focus on maximizing net benefits, not just on minimizing compliance costs.*
- *Impact analyses should consider a range of policy alternatives.*
- *Impact analyses should include a meaningful and balanced distributional analysis.*

Source: Institute for Policy Integrity. November 2010. "52 Experiments with Regulatory Review. The Political and Economic Inputs into State Rulemakings." New York University School of Law. Pages iii-iv.

failed to gain much traction. Other states, however, have been more successful. Among them, Arizona requires each agency's regulations to be reexamined every five years by the Governor's Regulatory Review Council. Such reviews account for roughly 70 percent of the office's workload.[76] Currently, Arizona has a partial moratorium on new regulations.

Based on California's previous experience with regulatory review, and the example of the federal government's Office of Information and Regulatory Affairs and similar efforts in a dozen other states, the Commission recommends establishing an updated regulation review function in California that can provide both oversight and assistance to regulatory agencies in assessing the economic impact of their proposed regulations.

This function should be located in an established control agency, ideally the Department of Finance. In addition to its budget responsibilities and oversight role, the department has demonstrated its ability to be a consultant to state departments through performance evaluations done by its Office of State Audits and Evaluations. This function, organized as a new Office of Economic and Regulatory Analysis, would be responsible for much of the functions previously performed by the former Trade and Commerce Agency's regulation review unit, specifically reviewing the economic impact analysis for regulatory proposals that had potentially significant impacts on jobs or the economy, or complex regulatory packages that required new approaches to evaluating their potential impact, such as the Green Chemistry Initiative or the AB 32 implementation scoping plan. For greater accountability and transparency, this office also would have the responsibility for ensuring the adequacy of a department's economic impact assessment when the department filed its Form 399.

More fundamentally, the office would have the lead role in helping agencies build their capacity to conduct their own economic impact assessments, and establish standards for what constitutes a level of economic analysis for a given scope of regulation. By knowing what regulations each department is developing, it can be alert to conflicts or overlaps in regulatory efforts as well as determine whether new regulations conflict with existing rules.

The office also should coordinate reviews, or look-backs, of existing regulation to ensure that regulations are efficiently meeting their goals and to determine whether new alternatives have emerged that are less burdensome.

A preliminary task for the office would be developing standardized guidelines for agencies to use for economic analysis. For this task, the

state should turn to an advisory council made up of independent economists and regulatory experts, some of whom should have specific experience in California's regulatory arena. Their work should draw on, but not be limited to, the federal government's OMB's Circular A-4 as source material as well as the existing guidelines from the California Energy Commission and the California Environmental Protection Agency. Rather than consolidating existing guidelines, however, the effort should be geared toward developing up-to-date guidelines that best fit California's needs, and provide the flexibility to be further updated as analytical methodology improves.

This may mean eliminating some existing California guidelines. It is important to note that while the OMB Circular A-4 is relatively short at 48 pages, the U.S. EPA has its own set of procedures for economic analysis that runs to hundreds of pages.[77] The federal Environmental Protection Agency's manual goes into some depth on guidelines for cost-benefit analysis, both because this approach is complex and expensive and because it typically relies on outside consulting firms to do the actual analysis.

California's Air Resources Board has a set of draft guidelines of 130 pages for cost analysis of ARB regulations, while the California Energy Commission's *California Standard Practice Manual for Economic Analysis, Demand-Side Programs and Projects* totals 33 pages, including appendices. Agencies should not be precluded from developing their own guidelines for their own specific needs, as long as they are consistent with those of the Office of Economic and Regulatory Analysis.

The guidelines should cover cost-benefit analysis to make available a set of standards in situations when regulatory agencies are required to do full cost-benefit analysis. The emphasis of the office, however, should be on developing methods for making cost-effectiveness assessments of reasonable alternatives.

In general, formal cost-benefit analysis should be reserved for major regulatory packages, those where proposed rules impose a substantial burden on a particular industry or industries, or have the potential to materially reshape the state's economy, such as the regulatory scoping plan to implement AB 32. The federal government defines a major regulation as one that imposes annual costs of greater than $100 million on the economy. Given the complexity of California's economy, and to ensure that cost-benefit analysis is reserved for only the most significant regulatory proposals, the threshold could be set at $25 million annually, reflecting in part the federal government's $100 million threshold and the size of California's economy relative to the nation's.

When a cost-benefit analysis is required, the office could benefit from the experience of the Air Resources Board in its AB 32 implementation. As it was preparing to do its economic analysis of its final scoping plan for AB 32, the board turned to a panel of outside experts to assist air board staff with its cost-benefit analysis of its revised scoping plan for reducing greenhouse gas emissions. The group was a six-member subcommittee of the Economic and Allocation Advisory Committee, which the Air Resources Board pulled together to provide advice on how to allocate emission credits in its cap-and-trade structure. The subcommittee provided an assessment of the finished staff analysis, one that called out specific strengths and limitations of the analysis.

The role of the Office of Economic and Regulatory Analysis would be to ensure that departments follow the economic impact assessment guidelines as they developed their regulatory package. In cases like the AB 32 implementation regulations or the proposed Green Chemistry Initiative regulations, where the scope of the proposed rules is huge or the science is new, having the Office of Economic and Regulatory Analysis check in with a department on how it plans to construct its analysis should provide an opportunity to think through data challenges. It also can ensure that new methodological approaches are taken into consideration, such as the method of estimating diesel fuel particulate emissions by fuel usage developed by UC Berkeley researchers. This early involvement also can help agencies anticipate potential challenges to their analytical methodology and prepare to more fully explain their choices, especially when it means not choosing an approach others might recommend. To this end, the air board has established an academic fellowship and brought in a recent doctoral graduate to research new analytical methodologies.

"By providing a clear framework for understanding important regulatory outcomes, requirements for regulatory assessment can bring a new 'discipline and rigor' to the process of regulatory development. These process improvements typically reveal new information about the consequences (positive and negative) of proposed regulations, encourage regulators to think about alternative regulatory approaches, encourage them to think about particular industry circumstances, and generally help them identify and develop information and data that better inform regulatory decisions. Thus, in practice, the benefits of regulatory assessment may arise more from its use as a tool to improve regulatory development, rather than a 'test' to be used at the end of the process."

Source: Robert Stavins, Professor of Business and Government, Harvard University, and Todd Schatzki, Vice President, Analysis Group.

The expert panel's evaluation of the air board's economic analysis of its revised AB 32 scoping plan in 2010 was not an independent peer review in the formal sense, nor was it held out to be, because of the involvement of the expert panel in assisting air board staff. The new Office of Economic and Regulatory Analysis should improve on the process by requiring that any external review of an agency product be done by experts who have not been previously involved in developing the report.

Economist Adrian Moore, Vice President for Research for the Reason Foundation, told the Commission that the public comment process is not sufficient to adequately review a complex economic analysis. Mr. Moore said external peer reviews by knowledgeable and disinterested parties could provide unbiased information for the public record and drown out the political "noise" surrounding the process.[78]

For significant regulatory packages, whether the economic impact is assessed through a cost-benefit analysis or a cost-effectiveness comparison of alternatives, the Office of Economic and Regulatory Analysis should ensure that the economic assessment is reviewed by outside experts.

The Office of Economic and Regulatory Analysis, not departments, should be responsible for organizing independent peer review panels, though the office should have the flexibility to delegate the administration of the blind selection process to departments or agencies experienced with the external peer review process, as the air board did in its first peer review.[79]

The office also should ensure that all California departments post their regulatory filings on their own Web site, allowing stakeholders to follow the process and read source documents, including public comments. In this, California has two strong models in the State Water Resources Control Board and the Air Resources Board, which post extensive records of regulatory proceedings. California also could emulate the Commonwealth of Virginia, which requires regulatory agencies to post comments through an Internet-based "Regulatory Town Hall" to promote participation and transparency.[80]

Virginia's "Fast-Track" for the Development and Repeal of Regulations

In an effort to allocate scarce regulatory oversight resources more efficiently, the Commonwealth of Virginia in 2003 developed a "fast-track" regulation promulgation process for noncontroversial proposed rules and amendments. If the Department of Planning and Budget (DPB), Governor, Cabinet Secretary and Attorney General grant their approval, a regulation can circumvent the standard administrative process and be sped into Virginia law. This approach allows review staff to focus their attention on more significant and contentious rules. More than 45 percent of successful regulation amendments have emerged via the "fast-track" process from 2007 through 2010. This expedited regulatory strategy also has been applied to regulatory repeals since 2007. Agency leaders, the DPB and the Governor's Policy Director may identify rules to be considered for elimination.

Sources: Office of the Governor. Commonwealth of Virginia. June 29, 2010. Executive Order Number 14. Also, Code of Virginia 2.2-4012.1. Also, Institute for Policy Integrity. November 2010. "52 Experiments with Regulatory Review. The Political and Economic Inputs into State Rulemakings." New York University School of Law.

Conclusion

California has a large population, extraordinary natural beauty and resources, and a complex economy that is the most dynamic in the nation. It also has one of the nation's most developed regulatory structures, built over decades to protect public health, the state's consumers, its workers, its vulnerable populations and its environment.

Its regulations often have been path-breaking, leading the federal government to adopt regulations of similar scope for the nation as whole.

As California's regulatory departments develop more complex and sophisticated rules, they have relied on the expert advice of state engineers and scientists to devise regulatory solutions to problems made priorities by the Legislature or federal statutes. Through a public comment process, regulatory agencies have sought to balance regulation that meets the statutory goals and maximizes benefits while identifying and gauging the impacts the regulation may have on affected businesses, cities, schools and people. The California Administrative Procedure Act requires agencies to assess the economic impact of proposed regulations, but the act's effectiveness has been circumscribed by qualifications to it and the elimination of direct oversight to ensure agencies did their homework. Only a few agencies in California do serious economic analysis as part of their rulemaking; at many agencies, the analysis is scant or inconsistent. At the federal level, economic analysis is an expected part of rulemaking and independent oversight is routine, as it is

Commission's Recommendations Build On SB 617

The Commission's recommendations are consistent with SB 617 (Calderon and Pavley), passed by the Legislature with bipartisan support and signed into law, which calls for strengthening the Administrative Procedure Act and updating requirements for regulatory impact analysis.

SB 617 is an important step forward, but more is required to further enhance the effectiveness and legitimacy of the rulemaking process. The Commission recommends that agencies be required to make a substantial effort to engage affected stakeholders in the development of regulatory alternatives well before releasing rules for public comment. The Commission also recommends that agencies be required to justify exemptions from Administrative Procedure Act provisions and recommends independent peer review of economic assessments for significant regulations.

Additionally, the Commission recommends establishing a dedicated office within the Department of Finance to focus solely on providing regulatory oversight and charges this office with convening a panel of specialized economic experts to guide the development of standardized economic tools for regulatory assessment. The office also should have the authority to revisit regulations in the event of unintended consequences that create unexpected harm, the emergence of a new technology that makes an existing regulation obsolete, or a fundamental change in the economy that, in a new context, creates a regulatory burden unforeseen by the state.

in a dozen states.

Regulated parties in California, particularly businesses, express frustration that their voices are not heard, despite the rulemaking process's required public comment periods and often extensive outreach by regulatory staff. The Commission heard the view that regulators often do not adequately understand the impact a proposed rule will have, creating great uncertainty about the ultimate shape a regulation will take and the consequences that follow.

Requiring California's regulatory agencies to make economic analysis a serious part of their rulemaking procedures and establishing independent oversight will create important benefits that California cannot afford to do without. The biggest is simply better regulation. Others include the greater likelihood that stakeholders will feel that they and their concerns and alternatives have been heard and fairly considered. Whether or not the stakeholders agree with the final result, better communication and accountability through oversight can go a long way in increasing confidence in the process and reducing uncertainty. And these are profoundly needed steps in the right direction.

Recommendations

Process:

Recommendation 1: The state should require departments promulgating regulations or rules that impose costs on individuals, businesses or government entities to perform an economic assessment that takes into account costs that will be incurred and benefits that will result.

- The economic assessment must be completed well before the proposed regulation is released for public comment.
- Departments must demonstrate how the proposed regulatory action will meet the statutory purpose of the regulation.
- Departments promulgating the regulation should be required to reach out to regulated and interested parties in the development of the economic assessment prior to the regulation's release for public comment.
- The Legislature should change statutes that exempt certain agencies from provisions in the Administrative Procedure Act that require an economic impact assessment of proposed regulations unless agencies can demonstrate why an exemption is justified.

Recommendation 2: The state should require departments proposing a major regulation to perform a high-quality, rigorous economic analysis.

- A major regulation is a regulation that would impose an annual cost of $25 million or more.
- At the minimum, the economic analysis should be a cost-effectiveness assessment of alternatives that meet the statutory purpose of the regulation to determine the lowest cost alternative to meeting this goal, prior to the release of the regulation for public comment (possibly the alternative that maximizes net social benefits).
- Proposed regulations that impose a substantially higher burden on an affected industry or industries, or have the potential to materially reshape the state's economy, should be subject to a cost-benefit analysis that includes an assessment of costs as well as social benefits.
- The department promulgating a major regulation should be required to make a substantial effort to engage all regulated and interested parties in the development of alternatives that would satisfy the statutory purpose of the proposed major regulation prior to its release for public comment. This should not prevent the department from developing additional alternatives, or refining its economic analysis, on the basis of information provided through the public comment process.
- The state should require a department that is promulgating a major regulation to demonstrate that its preferred alternative is the most cost-effective approach to meeting the major regulation's statutory purpose or explain why another alternative was chosen, or, in the case of a more substantial regulation that calls for a cost-benefit analysis, demonstrate that the chosen regulatory approach maximizes net social benefits.
- The department must respond to comments about its analysis of the alternatives, including the selected alternative, made during the public comment period.

Recommendation 3: The state should create guidelines that set out standards and the appropriate use of different types of economic assessment methodologies and data quality that can be used to properly describe and analyze the economic impact of new regulations. The use of these guidelines should be mandated by the Administrative Procedure Act.

- The guidelines should reflect the scale appropriate for the proposed regulation's impact, reserving the most rigorous and in-depth economic analysis for the most economically significant regulations.

- California's guidelines should be informed by:
  - ✓ Guidelines outlined in the U.S. Office of Management and Budget's Circular A-4.
  - ✓ Guidelines developed by the U.S. Environmental Protection Agency set out for this purpose.
  - ✓ Guidelines developed by the California Environmental Protection Agency and the California Energy Commission.
  - ✓ The experience and expertise of an expert economic advisory panel created for this purpose that can set such guidelines in the context of California's legislative and regulatory histories.
- The guidelines should be able to account for and integrate the development of new economic analysis tools and models and should be updated to reflect new analytical approaches that meet the approval of an expert economic advisory panel.
- Cost-benefit analyses and cost-effectiveness assessments of alternatives for significant regulations must be subjected to a formal peer review by independent and anonymous experts, selected by the Office of Economic and Regulatory Analysis prior to the public comment period, and results of the reviews must be made available to the public.

Oversight:

Recommendation 4: To improve the quality of regulations promulgated by California agencies, and to ensure the process of developing regulations is consistent and transparent, the Governor should form an Office of Economic and Regulatory Analysis.

- This office should be responsible for:
  - ✓ Forming an expert economic advisory panel to develop the guidelines for economic assessments, and to serve as an independent arbiter in determining whether a regulation can be defined as a major regulation.
  - ✓ Ensuring that a high-quality, rigorous cost-effectiveness assessment of alternatives has been completed before a major regulation is released for public comment.
  - ✓ Requiring a department promulgating a major regulation to update or revise its economic analysis in the event it is determined that the assessment is materially flawed by data deficiencies, serious miscalculations, modeling deficits or other shortcomings; a material change in

economic conditions, or the emergence of a new technology creates a better alternative to meeting the statutory purpose.

- ✓ Monitoring whether unrelated regulations promulgated by different agencies cumulatively affect an industry sector and monitoring whether regulations from different agencies conflict, complicating compliance efforts.
- ✓ Agencies should communicate through an Internet-based platform to promote public participation and transparency. Public comments should be filtered through the Web site and material relevant to the rulemaking process should be posted.

- ❑ The Office of Administrative Law should be required to send back a regulation that has not complied with regulatory or economic assessment requirements, or in the case of a major regulation, the requirement for a cost-effectiveness analysis of alternatives, as determined by the Office of Economic and Regulatory Analysis.

Recommendation 5: The state should create a look-back mechanism to determine whether regulations are still needed and whether they work. The state should:

- ❑ Require new regulations to contain a sunset date for review for effectiveness and evaluation of unintended consequences.
- ❑ Give the Office of Economic and Regulatory Analysis the authority to revisit existing major regulations in the event of a fundamental change in conditions, such as the development of transformative technology, a substantial change in economic conditions, demonstration that the regulation is not having its intended effect, or the emergence of superseding regulations at the federal level that require linkage, integration or synchronization.

Appendices & Notes

- ✓ ***Public Hearing Witnesses***
- ✓ ***Public Meeting Witnesses***
- ✓ ***STD. Form 399***
- ✓ ***Letter from Senator Robert Dutton and Assemblymember Felipe Fuentes***
- ✓ ***Economic Analysis Approaches at Selected California Agencies***
- ✓ ***Notes***

Appendix A

Public Hearing Witnesses

Public Hearing on Regulatory Reform
October 28, 2010

Ted Egan, Ph.D., Chief Economist, San Francisco Office of Economic Analysis

Allen Malanowski, Chief Economist, Arizona Governor's Regulatory Review Council

Al Montna, Owner, Montna Farms, and former President, California State Board of Food and Agriculture

Adrian Moore, Ph.D., Vice President of Research, Reason Foundation

Robert Raymer, P.E., Senior Engineer/ Technical Director, California Building Industry Association

Public Hearing on Regulatory Reform
January 27, 2011

David Chidester, President and Owner, Central Cal Transportation

Debra Cornez, Acting Director and Assistant Chief Counsel, Office of Administrative Law

William Pennington, Manager, High Performance Buildings and Standards Development Office, California Energy Commission

James Sanchirico, Ph.D., Professor, University of California, Davis

Lynn Terry, Deputy Executive Officer, California Air Resources Board

Appendix B

Public Meeting Witnesses

Advisory Committee Meeting on Regulatory Reform
August 26, 2011

Lydia Bourne, Owner, Bourne & Associates, and Legislative Advocate for the California Nurses Association

Chris Busch, Ph.D., Director of Policy, BlueGreen Alliance

Cesar Diaz, Legislative Director, State Building & Construction Trades Council of California

Jamie Fine, Ph.D., Economist, Environmental Defense Fund

Laurel Firestone, Co-Executive Director, Community Water Center

Jane Kiser, Director, Research Department, SEIU Local 1000

Peter Miller, Senior Scientist, Natural Resources Defense Council

Kathryn Phillips, Director, Sierra Club California

Michael Quigley, Government and Environmental Affairs Manager, California Alliance for Jobs

Bruce Reznik, Executive Director, Planning & Conservation League

Renée Sharp, California Director and Senior Scientist, Environmental Working Group

Caitlin Vega, Legislative Advocate, California Labor Federation

Appendix C

STD. Form 399 – Economic and Fiscal Impact Statement

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT

(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2008)

See SAM Section 6601 - 6616 for Instructions and Code Citations

DEPARTMENT NAME	CONTACT PERSON	TELEPHONE NUMBER
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400		NOTICE FILE NUMBER Z

ECONOMIC IMPACT STATEMENT

A. ESTIMATED PRIVATE SECTOR COST IMPACTS (Include calculations and assumptions in the rulemaking record.)

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts businesses and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance
- ☐ g. Impacts individuals
- ☐ h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.)

h. (cont.) _____

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: _____ Describe the types of businesses (Include nonprofits.): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

3. Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): _____

5. Enter the number of jobs created: _____ or eliminated: _____ Describe the types of jobs or occupations impacted: _____

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: _____

B. ESTIMATED COSTS (Include calculations and assumptions in the rulemaking record.)

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $ _____

a. Initial costs for a small business: $ _____ Annual ongoing costs: $ _____ Years: _____

b. Initial costs for a typical business: $ _____ Annual ongoing costs: $ _____ Years: _____

c. Initial costs for an individual: $ _____ Annual ongoing costs: $ _____ Years: _____

d. Describe other economic costs that may occur: _____

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): $ _____

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: _____ and the number of units: _____

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $ _____

C. ESTIMATED BENEFITS (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: _____

2. Are the benefits the result of : ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $ _____

D. ALTERNATIVES TO THE REGULATION (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: $_____	Cost: $_____
Alternative 1:	Benefit: $_____	Cost: $_____
Alternative 2:	Benefit: $_____	Cost: $_____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

Explain: _____

E. MAJOR REGULATIONS (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.

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ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

1. Will the estimated costs of this regulation to California business enterprises exceed $10 million ? ☐ Yes ☐ No (If No, skip the rest of this section.)

2. Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

   Alternative 1: _____

   Alternative 2: _____

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 1:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 2:	$ _____	Cost-effectiveness ratio: $ _____

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT (Indicate appropriate boxes1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in _____, Budget Act of _____ or Chapter _____, Statutes of _____

☐ b. will be requested in the _____ Governor's Budget for appropriation in Budget Act of _____
(FISCAL YEAR)

☐ 2. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in _____

☐ b. implements the court mandate set forth by the _____

court in the case of _____ vs. _____

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. _____ at the _____ election;
(DATE)

☐ d. is issued only in response to a specific request from the _____

_____, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the _____ authorized by Section
(FEES, REVENUE, ETC.)

_____ of the _____ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

☐ 3. Savings of approximately $ _____ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.

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ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

☐ 5. No fiscal impact exists because this regulation does not affect any local entity or program.

☐ 6. Other.

B. FISCAL EFFECT ON STATE GOVERNMENT (Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year. It is anticipated that State agencies will:

☐ a. be able to absorb these additional costs within their existing budgets and resources.

☐ b. request an increase in the currently authorized budget level for the _____ fiscal year.

☐ 2. Savings of approximately $ _____ in the current State Fiscal Year.

☐ 3. No fiscal impact exists because this regulation does not affect any State agency or program.

☐ 4. Other.

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS (Indicate appropriate boxes1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year.

☐ 2. Savings of of approximately $ _____ in the current State Fiscal Year.

☐ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.

☐ 4. Other.

FISCAL OFFICER SIGNATURE		DATE
AGENCY SECRETARY [1] APPROVAL/CONCURRENCE		DATE
DEPARTMENT OF FINANCE [2] APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER	DATE

1. *The signature attests that the agency has completed the STD.399 according to the instructions in SAM sections 6601-6616, and understands the impacts of the proposed rulemaking. State boards, offices, or department not under an Agency Secretary must have the form signed by the highest ranking official in the organization.*

2. *Finance approval and signature is required when SAM sections 6601-6616 require completion of Fiscal Impact Statement in the STD.399.*

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Appendix D

Letter from Legislature Requesting Study

California Legislature

STATE CAPITOL
SACRAMENTO, CALIFORNIA

July 12, 2010

Mr. Daniel Hancock
Chairman, Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

Dear Mr. Hancock:

In our respective Houses and Caucuses, we have been deeply involved in legislation to improve the state's regulatory processes and adopt principles of accountability and transparency. Because of our critical responsibilities in overseeing the Executive Branch as it implements policies enacted by the Legislature, we take seriously the need to ensure regulatory processes incorporate the best information on effectiveness, impacts and alternatives, while still ensuring that the goals of the legislation are diligently achieved.

In this spirit, we respectfully request that the Little Hoover Commission conduct a study of some of the critical aspects of the current regulatory process in California and identify improvements in the following areas:

- The Administrative Procedures Act requires agencies to "assess the potential for adverse economic impact" on California businesses and the economy. Are state agencies adequately and usefully preparing those assessments? Are they using solid and consistent economic or analytical principles? Are they soliciting or taking advantage of credible and reliable third-party resources to buttress their analyses?
- Are these assessments, and the other analytical requirements in the APA, vetted with knowledgeable third parties as well as the regulated community?
- How are agencies reviewing and analyzing alternative approaches to a regulatory proposal? Are there consistent policies and protocols used to assess alternatives? Do agencies have a policy to consider market or incentive-oriented regulatory approaches over more intrusive or "command and control" approaches? How are these policies incorporated into the regulatory adoption process?
- Are there best practices used by the federal government or other states that could be applied to improve the responsiveness, cost-effectiveness, transparency and accountability of California's regulatory adoption process?

As the Legislature struggles with the related challenges of balancing the state budget and spurring job growth in California, we are concerned that the current regulatory system may be hindering those objectives. We believe that Californians demand a regulatory system that not

only improves their health, safety and environmental protection, but also ensures that employers will consider making California home to their businesses and employ our citizens. This is a key element to improving our investment climate and thereby providing the basis for long-term fiscal improvement.

We appreciate your consideration of this request, which we believe is consistent with your critical mission to promote efficiency and economy in California government.

Sincerely,

FELIPE FUENTES
Assemblymember, 39th Dist.

ROBERT DUTTON
Senator, 31st Dist.

Appendix E

Economic Analysis Approaches at Selected California Agencies

Agency	Economic Analysis Process
Agricultural Labor Relations Board	Does not create rules that require economic analysis
Air Resources Board	Has a formal economics program; described in Background and Solutions chapters of report
Boating and Waterways, Department of	Rarely proposes regulations; no formal economic analysis process
Building Standards Commission (BSC)	Staff (e.g., Associate Construction Analysts) conducts economic analyses when necessary; BSC primarily acts as an administrative oversight body for agencies that are proposing building-related regulations
Cal/EPA	Economic Analysis Program (EAP); described in Background chapter of report
Cal/Occupational Safety & Health	Technical staff conducts analyses on an as-needed basis
Caltrans	Staff conducts analyses via an informal process; propose only a small number of regulations that require an assessment; hire consultants if a major analysis is required
Coastal Commission	Rarely needs to perform analyses; no formal process
Coastal Conservancy	Does not create rules that require economic analysis
Conservation, Department of	Does not create rules that require economic analysis
Conservation Corps	Does not create rules that require economic analysis
Consumer Affairs, Department of	Budget office analysts conduct needed reviews; if economic analysis from a particular board or bureau needs substantial improvement, budget office performs revisions
Corporations, Department of	Proposes roughly five or fewer regulations per year, which rarely produce a significant economic impact; staff completes the Form 399
Delta Stewardship Council	Does not create rules that require economic analysis
Energy Commission	Formal standards; described in Background and Solutions chapters of report
Fair Employment and Housing, Department of	Proposes a small number of regulations; staff completes Form 399
Fair Employment and Housing Commission	Rarely proposes regulations; no formal economic analysis process
Financial Institutions, Department of	Informal analysis process; considering developing a formal economic analysis unit, but concerns exist regarding ability to hire economists
Fish and Game, Department of	Consultants have performed significant economic analyses
Food and Agriculture, Department of	Individual divisions perform analyses on an as-needed basis by using informal (e.g., internet research) and formal (e.g., stakeholder workshop) processes
Health and Human Services Agency	Some departments (e.g., Department of Social Services) assign program specialists to conduct analyses on an as-needed basis
Housing & Community Development, Dept of	Codes Division performs analyses through an informal process; other divisions rarely need to perform analyses

Insurance, Department of	Proposes roughly 20 regulations each year, but only recently started completing the economic impact section of the Form 399; staff completes the form to the best of its ability
Parks and Recreation Commission	Does not create rules that require economic analysis
Public Utilities Commission	Staff in individual divisions conducts economic analyses on an as-needed basis (e.g., determining the impacts on ratepayers of a rate change), but the agency generally is outside the scope of the Administrative Procedure Act
Real Estate, Department of	Proposes a small number of regulations each year; program analysts/managers complete the Form 399
State Lands Commission	Does not create rules that require economic analysis
State Water Resources Control Board	Performs analyses on an as-needed basis; a research program specialist assigned to economic tasks is listed on Office of Planning, Research & Performance organization chart
Toxic Substances Control, Department of	Consultants have performed economic analyses for significant proposed rules; can use air board's economic expertise
Water Resources, Department of	Formal economics unit with guidance documents, but generally not considered a regulatory entity

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