



## Regulatory Experimentation

### Committee on Rulemaking

#### Proposed Recommendation for Committee | October 24, 2017

1 Congress, the President, and the Administrative Conference have issued various  
2 pronouncements directing or encouraging agencies to build the base of evidence upon which  
3 government policies and programs are based. For example, several executive orders direct  
4 agencies to engage retrospective review of administrative rules.<sup>1</sup> Congress created the  
5 Commission on Evidence-Based Policy Making to issue recommendations encouraging agencies  
6 to incorporate outcomes measurement, institutionalize randomized controlled trials (RCTs), and  
7 integrate rigorous impact analysis into program design and operations.<sup>2</sup> Although created with a  
8 broader mandate than agency rulemaking, the Commission’s recommendations reinforce the  
9 requirements of the executive orders. Finally, in Recommendation 2014-5, ACUS provides  
10 agencies with a framework for cultivating a “culture of retrospective review” of rules within

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<sup>1</sup> See, e.g., Executive Order 12866 § 5, 58 Fed. Reg. 51735, 51739 (Oct. 4, 1993), (“...to...improve the effectiveness of existing regulations... each ... agency will periodically review its existing significant regulations to determine whether any such regulations should be modified or eliminated so as to make the agency’s regulatory program more effective in achieving the regulatory objectives...”); Executive Order 13563 § 6, 58 Fed. Reg. 3821, 3822 (Jan. 21, 2011) (requiring agencies to “consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned”); Executive Order 13771 § 2, 82 Fed. Reg. 9339 (Feb. 3, 2017) (requiring the repeal of two existing regulations for each new regulation proposed, and leaving in place prior requirements for the repeal of rules, including analyzing the costs and benefits of each action proposed for repeal); Executive Order 13777 § 3, 82 Fed. Reg. 12285, 12286 (Mar. 1, 2017) (requiring the establishment of Regulatory Reform Tasks forces that “shall evaluate existing regulations (as defined in section 4 of Executive Order 13771) and make recommendations to the agency head regarding their repeal, replacement, or modification, consistent with applicable law.”)

<sup>2</sup> See *id.* at § 4(a)(3); By-Laws and Operating Procedures of the Committee on Evidence Based Policymaking, *available at* <https://www.cep.gov/content/dam/cep/about/by-laws.pdf>



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11 | regulatory agencies. The ACUS recommendation encourages agencies to use rigorous methods  
12 | to assess the effects of their existing stock of regulations.<sup>3</sup>

13 |         Meaningful retrospective review of rules is very difficult without some kind of variation.  
14 | In laboratory settings, scientists vary conditions by exposing one set of subjects to the treatment  
15 | and then compare that treatment group to the “counterfactual,” that is, by observing an identical  
16 | set of subjects not subject to the treatment. Regulators cannot “observe the counterfactual” in the  
17 | same way when retrospectively reviewing their regulations. However, by observing and  
18 | collecting relevant data from times or places with varied conditions, including regulatory  
19 | obligations, it is possible for regulators to draw more reliable inferences about what regulatory  
20 | options may be more effective and therefore enhance the quality of retrospective review.  
21 | Agencies can introduce – and exploit opportunities for – regulatory variation throughout the  
22 | lifecycle of rulemaking: at the earliest stage when agencies are considering a new rule; as they  
23 | write that rule and consider comments on it; and then once the rule has been put into place.

24 |         As agencies are considering a rule, they can learn about the potential effects of the  
25 | regulations they are considering by analyzing or commissioning empirical studies of existing  
26 | variation or of past regulatory policies. They might, for example, look at variation in existing  
27 | policies at the state level or perhaps in other countries<sup>4</sup>, taking to heart Justice Louis Brandeis’s  
28 | observation that “a state may, if its citizens choose, serve as a laboratory; and try novel social  
29 | and economic experiments without risk to the rest of the country.”<sup>5</sup> They might also engage in  
30 | experimentation as part of information gathering to develop a proposed rule or they can solicit  
31 | empirical data from key stakeholders. For example, in developing certain passive restraints  
32 | regulations in the 1970s, the National Highway Traffic Safety Administration cooperated in pilot

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<sup>3</sup> See Administrative Conference of the United States, Recommendation 2014-5, Retrospective Review of Agency Rules, 79 Fed. Reg. 75114 (Dec. 17, 2014).

<sup>4</sup> See Administrative Conference of the United States, Recommendation 2011-6, International Regulatory Cooperation, 77 Fed. Reg. 2257 (Dec. 8, 2011).

<sup>5</sup> See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932)



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33 projects with automakers and owners of vehicle fleets to experiment with different technological  
34 options.<sup>6</sup>

35 As an agency is writing a rule, it can write it in such a way that lends itself to variation  
36 and learning. Namely, the agency can employ a variety of “quasi experimental” approaches and  
37 commit to using statistical techniques to draw the necessary causal inferences. For example,  
38 agencies could draft the rule to allow for greater variation at the state level by setting some  
39 federal minimum standard and allowing states to exceed that standard, therefore allowing for  
40 state-by-state comparisons. Agencies can also take advantage of threshold effects that arise  
41 naturally in rules they adopt. Comparing observations of outcomes for those firms just above  
42 and just below the threshold, the agency can generate an estimate of the so-called average  
43 treatment effect of the regulation. Finally, agencies could choose to simply apply the regulation  
44 to all firms within its scope and compare observations before and after the regulation went into  
45 effect.<sup>7</sup> Indeed, in any rulemaking, there is variation in the sense that there was the world before  
46 the rule went into effect and the world in which the rule is in effect (or, in the case of a rule that  
47 sunsets, to be described below, the world before the rule went into effect, the world in which the  
48 rule was in effect, and the world after the rule has lapsed.) Learning from this kind of variation  
49 simply requires an agency thinking ahead about how to do retrospective review, using  
50 appropriate statistical and design techniques to control for potential confounders and to  
51 determine the direction of causality.

52 An agency might choose to adopt a temporary rule that sunsets after a certain period.  
53 During the period within which such a temporary rule is in place, an agency may more  
54 intensively study or seek feedback on the effects of the rule. Temporary rules are most

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<sup>6</sup> See, e.g., Testimony of Cary Coglianese before the U.S. Senate Committee on the Judiciary, 10-12 (Nov. 7, 2013)

<sup>7</sup> There are a variety of statistical methods that can help agencies account for confounders and to distinguish between causal and correlational relationships. For more extensive discussion of these methods, see Joe Aldy, Learning from Experience: An Assessment of the Retrospective Reviews of Agency Rules and the Evidence for Improving the Design and Implementation of Regulatory Policy 17-22 (November 17, 2014), available at <https://www.acus.gov/sites/default/files/documents/Aldy%2520Retro%2520Review%2520Draft%252011-17-2014.pdf>; Cary Coglianese, Measuring Regulatory Performance: Evaluating the Impact of Regulation and Regulatory Policy, Organisation for Economic Co-Operation and Development Expert Paper No. 140-44 (August 2012).



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55 appropriate on occasions where uncertainty associated with the rule is high, so that the agency  
56 has the chance to learn how the rule operates. On the other hand, it might be inappropriate for an  
57 agency to adopt a temporary rule if the rule required a very high fixed cost to comply; this is  
58 because firms have likely invested heavily in anticipation of the regulation being put in place and  
59 therefore could incur high sunk costs unnecessarily. Before the rule sunsets, the agency could  
60 engage in notice and comment rulemaking in the event it chooses to adopt the rule on a  
61 permanent basis, or it could scrap the rule, depending on what it has learned.

62 If the agency decides to write the rule as a temporary rule, it has several options for  
63 writing it in ways that permit variation and learning. For example, the agency could write the  
64 rule to create the quasi-experimental methods described above. It might also write it in such a  
65 way as to create a randomized control trial (RCT). In a regulatory RCT, the agency randomly  
66 selects some firms within its regulatory scope to be subject to the regulation, and leaves others  
67 not subject to the regulation, thus creating variation across entities.<sup>8</sup> Although writing a rule as  
68 an RCT allows an agency to achieve variation, the potential challenges related to such an  
69 approach may include fairness concerns or potential market-distorting effects implicated by  
70 randomly subjecting some firms to regulation. Agencies must weigh these potential concerns of  
71 an RCT against any possible analytical benefits.

72 After the rule is in place, agencies can achieve variation by considering waivers,  
73 exemptions, and otherwise suspending enforcement of the rule for some firms. For example, if a  
74 regulated party can demonstrate that an alternative approach to compliance will achieve the same  
75 goal, the agency might grant a waiver or exemption.<sup>9</sup> Over time, this may provide the agency

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<sup>8</sup> See Zack Gubler, Regulatory Experimentation 21, *available at* <https://www.acus.gov/report/regulatory-experimentation-draft-report> (Sep. 19, 2017)

<sup>9</sup> See Recommendation 1 of current ACUS draft recommendation on waivers and exemptions, *available at* <https://www.acus.gov/recommendation/waivers-and-exemptions-recommendation-revised>



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76 with information that justifies amending an existing rule, and it may help identify rules that will  
77 benefit from retrospective review.<sup>10</sup>

78 In addition to waivers and exemptions, an agency can deregulate a segment of the market  
79 on a random basis to create a regulatory experiment. Such deregulatory experiments might not  
80 be considered waivers or exemptions, since class-based waivers and exemptions are based on  
81 some criteria (i.e. are not random), but nonetheless they are a way for an agency to learn from  
82 variation once a rule has been adopted. For example, in 2004, the Securities and Exchange  
83 Commission (SEC) began a regulatory experiment with respect to its “Uptick Rule.”<sup>11</sup> The rule  
84 prohibited short sales at successively lower prices so that if the market was increasing, the  
85 Uptick Rule would allow for unrestricted short selling, but in a declining market, the rule would  
86 eventually put a halt on short sales beyond a threshold. As part of its experiment, the SEC  
87 randomly selected a group of companies consisting of approximately one-third of the Russell  
88 3000 index. Those companies were the “treatment” group; for those companies, the SEC  
89 suspended enforcement of the Uptick Rule. The SEC did not suspend enforcement of the rule  
90 for the remaining companies: these constituted the “control” group. The SEC’s analysis of the  
91 data suggested that the rule did not substantially increase market efficiency. Consequently, the  
92 rule was eliminated. Agencies may find they can use waivers, exemptions, and conditional  
93 rescinding of rules as a part of their overall efforts to seek causal inferences about the effects of  
94 their rules and to revise or rescind rules as such inferences may warrant.

### 95 **RECOMMENDATION**

#### 96 **Learning from Variation**

- 97 1. To improve the quality of their rules, agencies should seek opportunities to learn from  
98 regulatory variation. Agencies can learn from variation they intentionally introduce, with  
99 due regard for legal, practical, and fairness limitations, and from variation that otherwise

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<sup>10</sup> See Administrative Conference of the United States, Recommendation 2014-5, Retrospective Review of Agency Rules, 79 Fed. Reg. 75114 (Dec. 17, 2014).

<sup>11</sup> See SEC Release No. 50104 (July 28, 2004), available at <https://www.sec.gov/rules/other/34-50104.htm>



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100 may exist. They can learn from such variation at one or more stages of the rulemaking  
101 lifecycle, from pre-rule analysis to retrospective review.

102 2. Where appropriate, agencies should consider creating variation, such as by establishing a  
103 randomized control trial or using a quasi-experimental design. Agencies can also  
104 generate variation through creating pilot programs, temporary regulations, or policies that  
105 permit state-by-state variation. When agencies deliberately create variation in such ways  
106 to facilitate learning more about the effectiveness of different policy options, they should  
107 accompany such experimentalism with efforts needed to collect data and conduct reliable  
108 analysis of the variation in regulatory policies or practices.

109 3. Congress should consider ensuring that agencies have adequate resources to conduct  
110 analyses of such experiments and, as needed, explicit statutory authorization to create  
111 them.

### 112 **Structuring Sunset Provisions**

113 4. If an agency chooses to establish and learn from a temporary rule, the sunset period  
114 provided in such a rule should afford the agency enough time for evaluation and enough  
115 time to engage in notice and comment rulemaking in the event it chooses to adopt the rule  
116 on a permanent basis.

### 117 **Data Collection and the Paperwork Reduction Act**

118 5. When gathering data, agencies should be mindful of the potential applicability of the  
119 Paperwork Reduction Act, and agencies and OMB should use flexibilities within the Act  
120 and OMB's implementing regulations (e.g., a streamlined comment period for collections  
121 associated with proposed rules) where permissible and appropriate.