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Abstract

The Article addresses the criticism of cost benefit analysis (CBA). Although it accepts the monetization of costs will generally oppose regulation, it finds CBA is at least close to an objective standard. It argues the results of CBA are informative, but are not dispositive, and often the procedures used in CBA are imperfect. It concludes financial resources should be devoted to retrospective analyses and/or organization studies in order to achieve rational regulatory decision making.

KEYWORDS: cost benefit analysis (CBA), rational regulatory decision making, Office of Management and Budget (OMB), administrative law

COST-BENEFIT ANALYSIS: WHERE SHOULD WE GO FROM HERE?

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The Viscusi[1] and Scales[2] articles from Fordham University School of Law's symposium entitled *The Contemporary Regulatory State* present an interesting discussion of some of the intricacies of cost/benefit analysis (CBA). They talk about important issues, and I am tempted to weigh in. Resisting that impulse, however, I want to urge those infected with the cost/benefit bug—either pro or con—to devote some of their attention and energy to considering whether the agencies are implementing CBA appropriately and whether CBA is, in fact, producing better regulatory decisions. If the answer to these questions is "only partially," or "no," I believe we should spend our time and resources identifying and addressing (and hopefully eliminating or minimizing) the obstacles to sensible regulatory decision making.

First, my bias: I am pro-CBA. I believe CBA is a sensible and important input to rational decision making. Indeed, I cannot imagine making regulatory choices (or legislative choices for that matter) without a systematic consideration of the intended (and unintended) consequences of a proposed action. And to facilitate comparative evaluations of possible choices, it is helpful not only to quantify but also to monetize both the costs and the benefits of each of the proposals under consideration.

Many of those participating in the Fordham symposium have been working to improve CBA methodology for some time now,[3] which is good because it needed a lot of work. The calculation of the cost side of the

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1. *See* W. Kip Viscusi, *Monetizing the Benefits of Risk and Environmental Regulation*, 33 FORDHAM URB. L.J. ADD INITIAL PAGE (2006).

2. *See* Adam Scales, *How Much is That Doggy in the Window? The Inevitably Unsatisfying Duty to Monetize*, 33 FORDHAM URB. L.J. ADD INITIAL PAGE (2006).

3. Kip Viscusi, Thomas Hopkins, and I were present, if not at the creation, then surely during the formative years. We worked together in the Carter Administration at the Council on Wage and Price Stability in the late 1970s.

equation was relatively straightforward.[4] The benefit side was appreciably more difficult,[5] fueling the oft-repeated criticism that CBA does not present a level playing field.[6] These critics assert (correctly) that, in looking only at the *monetized* costs and benefits, it not infrequently appears that the costs are greater than ("outweigh"[7] or "[do not] justify"[8]) the benefits of a proposal, even though *total* costs may not exceed *total* benefits when *nonmonetized* benefits are considered.[9] In this way, the critics argue, CBA is inherently biased against regulation. Probably true, but there has been a great deal of work in this area, and we are at least *approaching* parity in our ability to monetize costs and benefits.[10]

Let me put to one side another criticism of CBA: the criticism questioning the morality of putting a dollar value on body parts or on a human life.[11] I do not believe that is what is intended or what is being done in monetizing statistical lives or statistical life years saved.

My concern is somewhat different. As I mentioned, we have come a long way since we started down this path many decades ago. Much time has been spent and much ink has been spilled debating and ultimately improving the methodology of CBA. But we still do not know whether the agencies are implementing CBA appropriately and whether the use of CBA

4. I say "relatively straightforward" because some costs are actually difficult to quantify and/or monetize.

5. *See* Scales, *supra* note 2, at ADD PAGE; Viscusi, *supra* note 1, at ADD PAGE.

6. *See* FRANK ACKERMAN & LISA HEINZERLING, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING 35-36 (2004) ("There are, in fact, built-in biases in cost-benefit methods. . . . [W]e will see that the results tilt strongly toward endorsement of business as usual . . . ."); Richard W. Parker, *Grading the Government*, 70 U. CHI. L. REV. 1345, 1391-1400 (2003) (providing examples of rules where agencies were able to monetize all the costs but were unable to monetize the benefits in a complete or rigorous way).

7. Exec. Order No. 12,291, 46 Fed. Reg. 13,193 § 2(b) (Feb. 17, 1981) ("Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society.").

8. Exec. Order No. 12,866, 58 Fed. Reg. 51,735, 52,736 (Sept. 30, 1993) ("Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.").

9. Such nonmonetized costs and benefits must be considered. *See id.* at 51,735 ("Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless *essential* to consider.") (emphasis added).

10. There is one glaring exception, namely, homeland security—especially how to quantify and monetize the reduction in the risk of a terrorist attack. *See* John Graham et al., *Managing the Regulatory State: The Experience of the Bush Administration*, 33 FORDHAM URB. L.J. ADD INITIAL PAGE & JUMP CITE (2006).

11. *See* ACKERMAN & HEINZERLING, *supra* note 6, at 61-62.

produces better regulatory decisions.

Consider two facts. First, an analysis is only as good as the data being analyzed. So how good are the data? Take cost data. The agencies are supposed to be highly knowledgeable and experienced in the matters within their jurisdiction—that was the original attraction of setting up administrative agencies.[12] But as we moved from agencies' regulating a specific sector—like railroads or food and drugs—to agencies' regulating cross-cutting issues like workplace safety or the environment—the rule-writers cannot be expected to be as familiar with the actual operations of the varied factories, construction sites, or farmlands that might be affected by the regulations. Accordingly, in many situations, the cost data either originate from, or must be validated by, the regulated entities. For the most part, regulated entities are resistant, if not downright hostile, to the proposals and thus have an incentive to overstate the expected costs. If you do not want to do something, you inflate the amount of time, inconvenience, and cost you estimate it would take. Moreover, the regulated entities' cost estimates are all *ex ante*—offered while the regulation is under consideration. But once the agencies issue the regulation and the affected entities have to conform to it, then American ingenuity kicks in, and—lo and behold—the affected parties find cheaper (less burdensome, less time consuming) ways of inserting the requisite procedure in the existing process, installing the added protection, training (or retraining) the workforce, or whatever the regulation requires. Consequently, the costs in the CBA are almost always overstated. This is not just my own idiosyncratic view; empirical evidence and learned opinions corroborate it.[13]

To be sure, the benefit estimates may be equally suspect. These are

12. *See* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2261 (2001) ("The need for expertise emerged as the dominant justification for this enhanced bureaucratic power.").

13. William K. Reilly, *The EPA's Cost Underruns*, WASH. POST, Oct. 14, 2003, at A23 ("[A] review of some of the major regulatory initiatives overseen by the EPA since its creation in 1970 reveals a pattern of consistent, often substantial overestimates of their economic costs."); *see also* OFFICE OF MGMT. & BUDGET, VALIDATING REGULATORY ANALYSIS: 2005 REPORT TO CONGRESS ON THE COSTS AND BENEFITS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 41-52 (2005), *available at* http://www.whitehouse.gov/omb/inforeg/2005_cb/final_2005_cb_report.pdf; Dallas Burtraw et al., *Costs and Benefits of Reducing Air Pollutants Related to Acid Rain*, 16 CONTEMP. ECON. POL'Y 379, 397 (1998) ("[C]ompliance costs have fallen significantly compared to prior expectations, though compliance costs do not include all social costs of the program."); Thomas O. McGarity & Ruth Ruttenberg, *Counting the Costs of Health, Safety, and Environmental Regulation*, 80 TEX. L. REV. 1997, 2041-44 (2002) (collecting studies).

often put forward by the interest groups who advocate for the proposed regulation or by agency staff who, in effect, "sponsor" the regulation (and thus have an incentive to make the proposal look good). Some empirical work shows that the *ex ante* benefit estimates also may be overstated, though not by as much as the cost estimates.[14] On the other hand, anecdotal evidence suggests that the benefits may be understated—either deliberately, so as not to provoke allegations of undue enthusiasm for regulation or "cooking the books," or simply because of the difficulty in estimating future benefits. One of my favorite "real life" stories is that, apparently, the releasing of the gray wolves in Yellowstone produced benefits in the form of restoring the ecology and bringing back other plants and animals, which were not even considered when the rule was issued.[15]

We can speculate about the reliability of CBA estimates, or we can look it up—meaning that we can undertake serious systematic empirical research of the *ex post* costs and benefits of major regulations from various agencies. Are our *ex ante* CBA estimates generally in the ballpark or way off the mark? If the latter, can we figure out why? Are there systemic problems in the data or in the methodology that we can adjust for, so that we can go forward using CBA with less debate and greater confidence in the results? Very little time and effort has gone toward this type of retrospective analysis, as compared to the time and effort spent arguing about the value of statistical lives or the appropriateness of senior discounts, for example. To use language that is in vogue today, wouldn't we all be better off if we focused on the results rather than on the inputs?

This is not to say that, pending such retrospective research, we should throw out all the numbers we have generated or foreswear the use of CBA until its utility has been verified with certainty. But it does militate in favor of viewing the analytical results as informative rather than dispositive. I further urge that we resist the impulse to sum up the annual *ex ante* cost numbers and add them to the annual costs numbers (so derived) year after year and pretend that we have anything like a real estimate of the "total regulatory burden" in the United States. The *ex ante* cost numbers become highly suspect two or three years into the future, but the accuracy of cost projections ten to twenty years into the future is pure fantasy. Again, I am not alone on this point: the Office of Management and Budget (OMB) has

14. *See* OFFICE OF MGMT. & BUDGET, *supra* note 13, at 45 tbl. 3-1 and 49 n.25.

15. Guy Gogliotta, *New Predator in Yellowstone Reshapes Park's Entire Ecosystem*, WASH. POST, Jan. 26, 2004, at A8 ("Wolves stalk the elk, so elk leave the rivers, where they are vulnerable. The willows, cottonwoods and aspens grow, casting shade that cools the water to temperatures favored by trout. Migratory birds return to roost in the new foliage.").

also eschewed the use of such calculations over an extended period,[16] and it is time that we put this practice to rest.[17]

The second fact is that CBA (at least a thoughtful, careful, comprehensive CBA) takes time and resources, and the more significant the proposal, the more time and resources it consumes.[18] What are the implications of this for what happens at the agencies? I believe that many agencies cut corners. Remember that, for the most part, a rule is not a single amoeba, but rather consists of many interacting pieces. As a result, there are multiple opportunities for CBA to help fashion the most cost effective/efficient rules. Yet, more often than not, the programmatic experts who draft the rules and the economists or policy analysts who do the CBA are not working hand in glove in an iterative process as the rule is developed. To the contrary, the all too frequent pattern is for the programmatic experts to "design" the rule, putting the different pieces together, and then when the bulk of the work is done, and shortly before the work is sent to the agency's senior officials or to OMB for review, the work gets passed to the agency's policy office or to the chief economist for them to do their work. The CBA analysis then becomes simply a paper exercise that justifies the result reached rather than serving—as it should—in informing the decision-making.

Why is this happening? There may be as many different answers as there are different agencies. But one explanation is that if the programmatic and analytic staffs were fully integrated and there were truly

16. *See* OFFICE OF MGMT. & BUDGET, STIMULATING SMARTER REGULATION: 2002 REPORT TO CONGRESS ON THE COSTS AND BENEFITS OF REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 40 (2002) ("In our future annual reports, we plan to improve the estimates by focusing on the last ten years of Federal regulations. . . . We do not believe that the estimates of the costs and benefits of regulations issued over ten years ago are reliable or very useful for informing current policy decisions.").

17. There are other serious methodological flaws in the calculations of total costs by Thomas Hopkins, who is the primary author of the huge numbers always cited by opponents of regulation. For a thorough and thoughtful critique of the Hopkins methodology, see CURTIS W. COPELAND, CRS REPORT FOR CONGRESS, FEDERAL REGULATIONS: EFFORTS TO ESTIMATE TOTAL COSTS AND BENEFITS OF RULES 4-9 (2004), *available at* http://www.library.dau.mil/CRS_RL32339.pdf.

18. There had been a suggestion in past administration guidance that the thoroughness of the study should be commensurate with the importance and complexity of the issue, taking into account the need for expedition (as in a potential serious crisis is looming that will be irreversible versus this is something we have lived with for decades and very few have sustained serious injury or illness) as well as the likely sensitivity of the net benefits of the proposal. Some have blithely said this means an agency should do a CBA of doing a CBA. But how do you know at the outset what the parameters are likely to be—especially if the problem is one beset by great uncertainty, both as to the nature or scope of the problem and the nature or effectiveness of the proposed solution?

an iterative process, rulemaking would inevitably take more time, often much more time. And rulemaking already takes a lot of time—some would say too much time,[19] particularly where there is an imminent danger that might produce irreversible adverse effects.

More importantly, to do CBA right takes resources—such as staff time and/or consulting contracts—and agencies do not have the resources to spend on this type of venture. In the last decade we have placed (some would say piled) many requirements on the agencies that they must fulfill during the rule development: from notifying and consulting with certain constituencies,[20] to performing analytical exercises pertaining to the subject matter being considered,[21] to analytical exercises going to matters beyond their jurisdiction but nonetheless implicated by their proposals.[22] These are not trivial tasks, and they require resources to be done right. Yet, the agencies do not have the necessary resources. They were not flush even during the Clinton years when there were surpluses as far as the eye could see. Today, unless the agencies can claim some relationship to defense or homeland security, they are clearly strapped for resources: their budgets are being cut even as their fixed expenses increase. In a public forum, I once asked John Graham, then-Administrator of the Office of Information and Regulatory Affairs at OMB, why President Bush's budget did not include an allowance for the analysis that the Administration says is so critical to rational regulatory decision making. He responded that the agencies do not ask for it. This is not surprising—one would rather spend money on new initiatives than on providing support for a pending proposal. Still, I

19. *See, e.g.*, Thomas O. McGarity, *The Courts and the Ossification of Rulemaking: A Response to Professor Seidenfeld*, 75 TEX. L. REV. 525, 528 (1997) ("By the mid-1990s, it has become so difficult for agencies to promulgate major rules that some regulating programs have ground to a halt and others have succeeded only because agencies have resorted to alternative policymaking vehicles."); *see also* M. Elizabeth Magill, *Agency Choice of Policymaking Form*, 71 U. CHI. L. REV. 1383, 1390 (2004) ("[T]oday, promulgating an important legislative rule is a labor-intensive enterprise.").

20. *See* Unfunded Mandates Reform Act of 1995, 2 U.S.C.A. § 1534 (2006) (requiring agencies to permit elected state, local, and tribal governments "to provide meaningful and timely input"); Regulatory Flexibility Act, 5 U.S.C.A. §§ 609(b)(1)-(4) (detailing procedures for convening a panel of federal employees for the purpose of receiving and responding to advice and recommendations from representatives of affected small businesses).

21. *See, e.g.*, Unfunded Mandates Reform Act of 1995, 2 U.S.C.A § 1535 ("[B]efore promulgating any rule for which a written statement is required under section 1532 of this title, the agency shall identify and consider a reasonable number of regulatory alternatives and from those alternatives select the least costly, most cost-effective or least burdensome alternative that achieves the objectives of the rule."); Exec. Order No. 12,866, 58 Fed. Reg. 51,735, 51,740 § 6(a)(3)(c) (Sept. 30, 1993).

22. *See, e,g.*, National Environmental Policy Act of 1969, 42 U.S.C.A. § 4332 (2006); Exec. Order No. 12,988, 61 Fed. Reg. 4729 (Feb. 5, 1996).

followed up by asking why *OMB* does not include an allowance for such analysis, given that OMB does not hesitate to make other additions to the agencies' requests in the President's budget to promote Administration priorities. I did not receive an answer. But, based on my experience, even if the President's budget included money for analysis, it would probably not survive in Congress, which would rather have a new project for the home folks than appropriate money to make government work better.

Given the realities of the regulatory landscape, at least as I see it, I seriously question whether all the work being done to refine and polish CBA methodology emphasizes the wrong syllable. It would be better, in my opinion, to devote some resources to retrospective analyses and/or organization studies. Because the agencies do not have the resources, I would urge those who underwrite many of the ongoing projects in this field—industry (which believes CBA works—at least for them), the academy, and foundations, among others—to step up to do this work and identify what, if any, obstacles exist to the agencies doing what we are asking them to do: rational regulatory decision making.