WORLD

The Stunning Triumph of Cost-Benefit Analysis

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Sept. 13 (Bloomberg) -- It is not exactly news that we live in an era of polarized politics. But Republicans and Democrats have come to agree on one issue: the essential need for cost-benefit analysis in the regulatory process.

In fact, cost-benefit analysis has become part of the informal constitution of the U.S. regulatory state. This is an extraordinary development.

To understand the point, a little history is in order.

When Ronald Reagan became president in 1981, he was greatly concerned about excessive regulation. He was also aware that the federal bureaucracy was large, decentralized and sprawling. He was the boss, but he had limited tools by which to oversee federal rulemaking.

As one of his very early actions, Reagan issued an executive order with two essential components. First, he told executive agencies that to the extent permitted by law, they must not issue a regulation unless the potential benefits to society "exceed the potential costs to society." Second, he directed the Office of Management and Budget to oversee a process to ensure compliance with the cost-benefit requirement (among others) and to promote consistency with the president's goals. The Office of Information and Regulatory Affairs, within OMB, soon assumed that responsibility.

At the time, both the cost-benefit requirement and the OIRA process were exceptionally controversial, especially among Democrats and groups on the left. Some activists argued that the result would be to undermine important public protections, designed to safeguard health, safety and the environment.

REAGAN APPROACH

Defenders of cost-benefit analysis responded that such protections would be spurred, not undermined, if they promised to deliver big benefits at an acceptable cost -- and that if the costs were high and the benefits low, the protections might not be such a good idea. The enthusiasts insisted that we can't know whether to support public protections unless we have a sense of both costs and benefits. But many public-interest advocates remained unconvinced, contending that we should not put crucial safeguards into a kind of arithmetic straitjacket.

Not surprisingly, President George H.W. Bush endorsed the Reagan approach. But when President Bill Clinton came into office, there was a real question whether that approach would be maintained, and a number of Clinton's supporters hoped he would repudiate cost-benefit analysis. He didn't. Although Clinton took steps to make the regulatory process more transparent, he embraced the need for careful analysis of costs and benefits.

For eight years, President George W. Bush operated under the framework established by Reagan and Clinton, and many advocacy groups became increasingly agitated about cost-benefit analysis. Some critics claimed that business had disproportionate influence over the process, exaggerating costs so as to block necessary safeguards. Others said that important protections had become vulnerable to "paralysis by analysis," because the need to assemble information about costs and benefits, and to establish that benefits justify costs, can be difficult and time-consuming.

When President Barack Obama was elected, critics of the whole approach hoped he would jettison it. But he had no interest in doing so. I was head of OIRA from September 2009 until August 2012, and from the beginning, the Obama administration was committed to careful consideration of both costs and benefits. And in an executive order issued in January 2011, the administration doubled down on cost-benefit analysis. First, Obama made an unprecedented commitment to quantification of both costs and benefits. Second, he ordered executive agencies to review all significant rules on the books, largely with the goal of eliminating or streamlining excessive requirements.

OBAMA ORDER

Under the order, it has proved possible to move forward with rules protecting public health, safety and the environment. In late August, for example, the Environmental Protection Agency and the Transportation Department finalized ambitious rules to increase the fuel economy of cars. The benefits of the rules greatly exceed the costs -- the annual net benefits (benefits minus costs) are in the billions of dollars.

At the same time, the requirement of cost-benefit analysis has deterred agencies from proceeding with rules that promise to impose big economic burdens without corresponding gains. With its embrace of cost-benefit analysis, the Obama administration has approved rules with net benefits well in excess of $100 billion.

It is true that even if we accept cost-benefit analysis, serious questions remain. Some of those issues are scientific. If we cut emissions of certain air pollutants, what, exactly, are the public-health benefits? Other questions are economic. Suppose that a rule would save 30 lives a year. How do we turn that figure into monetary equivalents? These and other issues have a philosophical dimension. How should we deal with values that are hard or impossible to quantify, such as human dignity? And should our valuations change if a rule would mostly benefit members of future generations?

It is also true that regulators often face considerable uncertainty, and they have to give ranges for both costs and benefits, rather than specifying a single number. There are also continuing questions about scope, including the role of cost-benefit analysis in the context of homeland security or financial regulation, where the benefits may be especially hard to quantify.

What is remarkable is that all of these issues are being addressed under a framework that is now broadly shared. Endorsed for more than three decades and by five presidents, cost-benefit analysis is here to stay.

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