

A Brief Comment on “Humanizing Cost-Benefit Analysis”

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On Tuesday, January 18, 2011 President Obama issued a new executive order¹ and two somewhat related memoranda² which embody some of the principles discussed by the Office of Information and Regulatory Affairs (OIRA) Administrator Cass Sunstein in this Journal. Building on three decades worth of practice in the United States with regulatory review, the new order and memoranda maintain significant continuity with past experience, while emphasizing both “humanizing” and rationalizing elements in the practice of regulatory impact analysis.

Background

Much of the Obama order repeats, clarifies, or modestly expands language from President Clinton’s Executive Order 12866,³ which was left in place during the entirety of the second George Bush Administration.⁴ The Clinton executive order was itself an expansion and reform of Executive Order 12,291 issued by President Ronald Reagan in 1981, which established the basic architecture of regulatory review that continues to be in place today.⁵ The Obama order carries forward what has become a firmly entrenched practice, indicating that for the foreseeable future, cost-benefit analysis is “here to stay” as a fixture of the American administrative process.⁶

The great innovation of the 1981 Reagan order, which was based on earlier experiments with regulatory review by the Nixon, Ford, and Carter administrations, was to establish clear regulatory review guidelines and powers for OIRA, which had been recently established in the Office of Management and Budget (OMB) by the Paperwork Reduction Act.⁷ Under the Reagan order, agencies were required to conduct a regulatory impact analysis, which included a description of the potential benefits and costs, of proposed rules, and select options that maximized net benefits.⁸ This analysis was to be reviewed by OIRA, and agencies were to “refrain from publishing” a final rule “until the agency has responded to OIRA’s views.”⁹

While this structure of cost-benefit analysis subject to review by OIRA has been quite controversial, it has also proven to be very robust. Calls to eliminate the practice have become a common refrain from within certain sectors of the public interest community, and larger flare ups in the media or Congress sometimes arise, for example during the confirmation of John Graham as OIRA Administrator under George W. Bush.¹⁰ But notwithstanding its vocal foes, Presidents of both parties have embraced regulatory review as a way to assert power over administrative agencies,¹¹ and cost-benefit analysis has remained the central standard.

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1 Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

2 Memorandum for the Heads of Executive Departments and Agencies on Regulatory Compliance, 76 Fed. Reg. 3825 (Jan. 18, 2011); Memorandum for the Heads of Executive Departments and Agencies on Regulatory Flexibility, Small Business, and Job Creation, 76 Fed. Reg. 3827 (Jan. 18, 2011).

3 58 Fed. Reg. 51,735 (Sept. 30, 1993).

4 Minor modifications were made at the end of President Bush’s term. Executive Order 13,422, 72 Fed. Reg. 2763 (Jan. 18, 2007). These revisions were rescinded on February 4, 2009. Executive Order 13,497, 74 Fed. Reg. 6113 (Jan. 30, 2009).

5 See Murray Weidenbaum, “Regulatory Process Reform from Ford to Clinton”, 20 Regulation (Spring 1997), at p. 20. Weidenbaum

was an early proponent of the use of cost-benefit analysis, and was a member of President Reagan’s Council of Economic Advisors. Richard L. Revesz and Michael A. Livermore, *Retaking Rationality: How Cost-Benefit Analysis Can Better Protect the Environment and Our Health* (2008), pp. 22–25.

6 *Id.*, at p. 11.

7 Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (Feb. 17, 1981).

8 *Id.*

9 *Id.* Sec. 3 (f)(2). This requirement was subject to the caveat that “[n]othing in this subsection shall be construed as displacing the agencies’ responsibilities delegated by law.”

10 See, e.g., “Public Citizen, Safeguards at Risk: John Graham and Corporate America’s Back Door to the Bush White House” (March 2001).

11 Elena Kagan, “Presidential Administration”, 114 *Harv. L. Rev.* (2001), p. 2245.

While the basic structure has remained the same, there have been many important innovations in both the institution of regulatory review and the process of cost-benefit analysis in the past thirty years. Perhaps most striking has been the slow increase of transparency during the process of review: initially cast as a shadowy “black hole”¹² many aspects of regulatory review are now accessible online, including all documents received by OIRA by outside parties, the decision of OIRA regarding particular rules, and the dates when rules are received and OIRA review is finalized. These transparency measures, gradually rolled out after the Reagan Administration, have helped reduce what has always been a primary criticism of OIRA review.

The Obama order fits comfortably in this tradition of slow reform within a largely continuous framework. On the issue of transparency, some elements of the recent order merely clarify or repeat procedures that exist in the Clinton order, for example, a requirement for agencies to reach out to affected parties in order to increase public participation.¹³ More important is a move in an accompanying memorandum that calls on agencies to disclose more information on their enforcement practices,¹⁴ a new and expanded area of transparency that will help the public better monitor how well agencies are ensuring compliance with existing regulation.

Humanizing Review

An area where the Obama order expands on past practice in a way that could be considered “humanizing” review is in the area of distributional analysis. Initially, under the Reagan order, regulatory impact analysis only examined economic efficiency through standard cost-benefit analysis, remaining insensitive to how benefits and burdens were distributed. This is a mistake from a social welfare perspective. Because the utility benefits of consumption diminish on the margin, costs borne by the poorest members of society result in greater loss of welfare than the same costs borne by wealthier individuals, and the inverse is true for benefits. Accordingly, absent a costless mechanism for redistributing wealth,¹⁵ rules that pass a pure efficiency test may nevertheless result in welfare losses. This insensitivity to distribution was a core complaint of many in the public interest community against the use of cost-benefit analysis under President Reagan.

The Clinton order addressed this issue by requiring agencies to “select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity).”¹⁶ Inclusion of equity and distributive impacts in the list of benefits to be maximized opened the door for agencies to consider welfare considerations beyond economic efficiency. As a practical matter, however, standard cost-benefit analysis, with its focus on economic efficiency, overshadowed distributional considerations during both the Clinton and second George Bush administrations. For example, despite extensive guidance on best practices for conducting cost-benefit analysis, there has been relatively little development within OIRA or administrative agencies of concrete methodologies for taking distributional issues into account.¹⁷

President Obama, in his order, places some additional emphasis on distribution. Repeating the Clinton order, distributive impacts and equity are included in the list of net benefits to be maximized.¹⁸ In addition, the Obama order states that, “Where appropriate and permitted by law, each agency may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.”¹⁹

The inclusion of factors like human dignity and fairness in regulatory impact analysis is a new development, and it is still very unclear how this will be implemented in practice. It may indicate an important shift in direction in the development of cost-benefit analysis, although it is also quite possible that it will have little effect on agency decision-making, as was

12 Chris Mooney, “Paralysis by Analysis, Jim Tozzi’s Regulation to End All Regulation”, 36 *Wash. Monthly* (May 2004), pp. 23, 24.

13 Compare Obama Order section 2(c), *supra* note 1 with Clinton Order section 6(a)(1), *supra* note 3.

14 Memorandum for the Heads of Executive Departments and Agencies on Regulatory Compliance, *supra* note 2.

15 See generally Steven Shavell, “A Note on Efficiency vs. Distributional Equity in Legal Rulemaking”, 71 *Am. Econ. Rev.* (Papers and Proc.) (1981), p. 414.

16 Clinton order section 1(a), *supra* note 3.

17 See, e.g., Office of Management and Budget, *Circular A-4, Regulatory Analysis: Memorandum to the Heads of Executive Agencies and Establishments* (Sep. 9, 2003); Environmental Protection Agency, *Guidelines for Preparing Economic Analyses* (2010).

18 Clinton order section 1(a), *supra* note 3.

19 Obama order 1(c), *supra* note 1.

dom of choice while allowing government to engage in welfare improving policies.²⁴

Along these lines, the Obama order requires agencies to:

“Identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public. These approaches include warnings, appropriate default rules, and disclosure requirements as well as provision of information to the public in a form that is clear and intelligible.”

This provision can be thought of as humanizing because it shows a commitment on the part of government to respect individual autonomy. Rather than merely being the passive subjects of public policy, the actions of individuals – their choices – make up a core element of the public policy outcome. The goal of these types of public policies is not merely to maximize preferences, but also to help people make choices that most benefit them in the long-run.

Rationalizing Review

One of the most important elements in the new Executive Order is a renewed emphasis on retrospective review. This idea is not new: many presidents have called for one-time or ongoing reviews of existing rules; theoretically, under Executive Order 12866, agencies already should have long ago designed permanent programs for periodic review of significant regulations.²⁵ But retrospective reviews have never been a priority, despite calls from a range of commentators across the political spectrum.²⁶

Retrospective review is important because it provides a mechanism to measure and evaluate the effectiveness of past regulatory decisions. Under the current structure, regulatory impact analysis consists of *ex-ante* estimates about the effects of regulation, but there are few attempts *ex-post* to determine whether those estimates are accurate, and to determine how well rules are achieving regulatory goals, and imposing costs. Without this kind of feedback, it is difficult for policymakers to learn from their mistakes and replicate their successes.

In addition, *ex-post* analysis can improve the quality of *ex-ante* estimation. There are a range of parameters important in cost-benefit analysis that must be estimated: for example, the relationship between air quality and public health outcomes, or the rate of technological change. Retrospective analysis, by

examining the actual effects of regulation, can help improve forward-looking analysis by testing those initial estimates against experience.

In his Executive Order, President Obama renews the call for retrospective analysis, while also making important modifications. Under the Clinton order, backward looking review was focused on “reduc[ing] the regulatory burden” and identifying “unjustified or unnecessary” regulations. This form of review is fundamentally unbalanced and biased, because it acts as a one-way ratchet, ever reducing stringency or eliminating rules on the books. The Obama order reduces this bias by focusing on “outmoded, ineffective, *insufficient*, or excessively burdensome.”²⁷ In this way, areas of both over- and under-regulation are the subject of review, so that retrospective analysis is not biased in an anti-regulatory direction.

Another area of the Obama order that focuses on rationalizing the process of review is a renewed emphasis on agency coordination. The Clinton order, which has been left in place, creates a structure for agency coordination through a regulatory planning mechanism.²⁸ The most important component of this mechanism is the creation and publication of a “unified regulatory agenda.”²⁹ This agenda, which includes basic information on “all regulations under development”³⁰ helps facilitate coordination by ensuring that agencies are aware of what is planned elsewhere within the federal bureaucracy.

The Obama order renews the call for “coordination, simplification, and harmonization.”³¹ While no additional review structures are put in place, this language may indicate a renewed emphasis on coordination by OIRA. Sunstein mentions a particularly important process to facilitate agency harmonization in measuring the value of greenhouse gas reductions through an interagency taskforce on the social cost of carbon. This process involved an extensive review of a wide range of scientific and economic literature by a number of agencies and White House offices

24 *Id.* at p. 14.

25 Clinton order section 5, *supra* note 3.

26 See, e.g., Michael Greenstone, “Toward a Culture of Persistent Regulatory Experimentation and Evaluation” in David Moss and John Cisternino (eds), *New Perspectives on Regulation* (2009).

27 Obama order section 6 (a), *supra* note 1 (emphasis added).

28 Clinton order section 4, *supra* note 3.

29 *Id.* section 4(b).

30 *Id.*

31 Obama order section 3, *supra* note 1.

whose decisions affect greenhouse gas emissions.³² The interagency taskforce released a unified range of estimates for the social cost of carbon, which has been used for several regulations, and which will likely form the basis for valuing greenhouse gas reductions for future regulations that have potential climate impacts.

But in other areas, coordination could be improved. For example, in keeping with the Obama administration's emphasis on flexible regulatory alternatives, there have been several efforts to move forward with environmental and efficiency labels in the past two years. In particular, rules have been proposed on labels for automobile fuel-efficiency, the energy efficiency of household appliance, general "eco" characteristics of consumer products, and tire pressure (which implicates auto fuel efficiency). In some of these cases, there have been inconsistent treatments of key questions, such as whether the environmental effects from the entire fuel-cycle are explained as part of the label.³³ Given the growing importance of labels as a regulatory tool, there may be room for increased agency coordination on these questions.

There are some areas where the Obama order falls short. For example, the regulatory flexibility memorandum requires agencies to explicitly justify in writing all decisions not to create special small business exemptions. This memorandum is part of a tradition of both executive and congressional efforts to reduce regulatory burdens on small business.³⁴ The general justification for small business exemptions is that there are certain fixed costs associated with regulatory compliance. As a consequence, small businesses face higher average compliance costs per worker or unit of production. Some regulations, then, that may be efficient when applied to large firms may generate net social losses when applied to small businesses.

While this is a factor that should be analyzed by agencies when setting rules, it is not clear that the degree of special attention devoted to small businesses is justified. There are a large number of important consequences that may arise from the distribution of regulatory costs and benefits: not only whether small businesses are affected, but also based on regional differences, the effect of regulation on layoffs, and distribution of costs according to income. Rather than requiring a specific procedure for small business, a better approach would be to create a more robust system for identifying the entire range of distributional effects, into which small business effects could be incorporated.

The new Executive Order also leaves some important problems in regulatory review unaddressed. Currently, there is no robust mechanism for OIRA to review cases where agencies fail to act to address important social risks. Under George W. Bush and OIRA Administrator John Graham, the institution of "prompt letters," in which OIRA calls agency attention to areas of under-regulation, was developed. But these prompt letters were relatively infrequent, especially compared to the volume of agency actions that are reviewed, and the Obama administration has not continued the practice.

While the retrospective review mechanism may help identify areas of agency inaction, there remains a need for OIRA to balance its checking function with some mechanism for cost-benefit analysis to be used to spur agencies forward. One potential tool could be through an annual review of petitions for rulemakings that have been denied by agencies, or which are currently pending. Review of these petitions would give OIRA an opportunity to use information that has been generated by the private sector and civil society to evaluate whether agencies are appropriately addressing high-priority issues.

Conclusion

On the whole, the order is another small, positive step toward a balanced, effective regulatory review structure. What remains to be seen is how precisely the order will be implemented by this and future administrations, and what role the public and stakeholders want to play in shaping that implementation.

32 Dep't of Energy, Small Electric Motors Final Rule Technical Support Document Appendix 15A: Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12866 (2010)(presenting the results of the Interagency Working Group on Social Cost of Carbon).

33 Letter from Richard L. Revesz and Michael A. Livermore to Office of Information and Regulatory Affairs Administrator Cass Sunstein (Dec. 16, 2010), available on the Internet at <http://policyintegrity.org/documents/12.16_10_OIRA_Interagency_Label_Letter_.pdf>.

34 See, e.g., Small Business Regulatory Enforcement Fairness Act, Pub. L. 104-121 (1996) (amending Regulatory Flexibility Act).