

Testimony of John D. Graham, Ph.D., Dean, Indiana University School of Public and Environmental Affairs

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INTRODUCTION

My name is John D. Graham, Ph.D. I am currently Dean of the Indiana University School of Public and Environmental Affairs – SPEA (Bloomington and Indianapolis, Indiana). SPEA is one of the largest public affairs schools in the United States and has graduate programs that are ranked in the top five by US News and World Report and by the National Research Council/National Academy of Sciences. Prior to joining IU in 2008, I served as Dean of the Frederick Pardee RAND Graduate School in Santa Monica California (2006-8), as Administrator of the White House Office of Information and Regulatory Affairs in the U.S. Office of Management and Budget (2001-2006), and as tenured Professor of Policy and Decision Sciences at the Harvard School of Public Health (1985-2001). For twenty-five years, I have taught the analytic tools of risk analysis and benefit-cost analysis in the classroom and published research on the application of these tools to health, safety and environmental issues. In fact, my doctoral dissertation at Carnegie-Mellon University (1983) was a benefit-cost evaluation of automobile airbag technology. While my testimony today draws on my academic expertise, it also draws on my experience at OMB, where I supervised a staff of fifty career policy analysts as they reviewed benefit-cost analyses performed by Cabinet agencies such as the Department of Labor, the Environmental Protection Agency, the Department of Homeland Security and the Department of Transportation. I am honored to have the opportunity to express my opinions on how benefit-cost analysis can be used more effectively to improve the federal rulemaking process. The views I express are strictly me own, and do not necessarily represent the views of SPEA or Indiana University.

TERMINOLOGY

With respect to terminology, the phrases “cost-benefit analysis” (CBA) and “benefit-cost analysis” (BCA) are synonyms and thus can be used interchangeably. I prefer the phrase BCA because it reminds students and policy makers that this analytic tool is aimed at increasing the benefits of regulations as well as reducing unnecessary costs. (B also has the alphabetical advantage over C!) When regulatory options are compared, a BCA tells us which option produces the largest surplus of benefits minus costs (assuming all benefits and costs can be quantified in monetary units). When only some benefits and costs can be quantified (or monetized), the net-benefit surplus (or deficit) is reported but the decision maker is also informed of any important benefits and costs that could not be quantified. After considering both benefits and costs (quantitative and qualitative), OMB instructs agencies to make a determination as to whether the benefits of a rule justify the costs, compared to doing nothing and compared to other viable regulatory options.

The phrase “cost-effectiveness analysis” (CEA) refers to a close analytic cousin of BCA. With CEA, the measure of effectiveness is expressed in physical units (e.g., lives saved or tons of pollution prevented), and the outcome of a CEA is the best option indicated by “bang for the buck” (e.g., the regulatory alternative that saves the most lives given a budget constraint, or the alternative that achieves an environmental goal at minimum cost to society). It is sometimes useful for agency analysts to conduct a CEA in addition (or instead of) a BCA, especially if the benefits of the rule are difficult to quantify in monetary units.

BIPARTISAN SUPPORT FOR REGULATION INFORMED BY BCA

The origins of BCA in federal regulatory policy are a matter of some academic debate but the push for cost-justified regulations goes back at least to the administration of President Jimmy Carter. As a small businessman, President Carter knew that the costs of regulation were a serious national problem and he deployed White House economists in a determined effort to reign in business regulations that were too costly. President Reagan went further and placed OMB in the driver seat during interagency reviews of the BCAs or CEAs prepared by federal agencies. President Clinton reaffirmed the legitimate role of benefit-cost analysis in regulatory decision making while focusing OMB’s efforts on a smaller sample of significant rules and recognizing the primacy of agency policy discretion. President George W. Bush largely reaffirmed the benefit-cost language in the Clinton Executive Order and I interpret President Obama’s position on BCA in regulatory policy to be largely consistent with the positions espoused by previous presidents of both parties. Thus, although there are some advocacy groups and legal academics who oppose the use of BCA in federal regulatory policy, I think it is fair to say that recent Presidents of both parties have expected agencies to prepare benefit-cost analyses and use the insights from those analyses when making regulatory decisions.

I would also like to point out that leading members of Congress from both political parties have been consistent advocates of a stronger role for BCA in federal regulatory policy. For example, Senator Carl Levin (D-Michigan) and Senator Orrin Hatch (R-Utah) have been pioneers of BCA proposals in the Senate. Much can be learned by reviewing the relevant speeches and legislative proposals of these members for the last twenty years.

MYTHS ABOUT BCA

In my testimony today I would like to dispel some popular misconceptions about BCA. Much of my testimony about myths draws on a comprehensive article, “Saving Lives through Administrative Law and Economics,” University of Pennsylvania Law Review, 157(2), December 2008, 395-540 that I have made available to subcommittee staff and would like to have inserted in the record of this hearing.

Myth #1: It is not feasible to quantify the benefits of public health, safety or environmental regulations.

Due to thirty years of progress in public health science, environmental science, risk assessment, and health/environmental economics, it is now feasible to produce (at least approximate)

estimates of the benefits of federal health, safety and environmental regulations. The validity of benefit estimates varies depending on the quality of science used by federal agencies. For example, the projected number of lives saved by DOT's mandatory airbag regulation (1977) was estimated based on laboratory crash tests with cadavers, observed rates of safety belt use, injury surveillance data from police reports and hospital records, and engineering judgment. Based on more than 30 years of real-world experience with the airbag regulation, we now know that the safety benefits are smaller than projected by regulatory analysts but benefits are still large enough to justify the extra investment in airbag technology. In contrast, EPA's air pollution regulations have been shown to have higher public health benefits than previously thought due to better understanding of how the rate of premature death rises in a community due to the inhalation of soot and smog. As rates of urban air pollution have declined, the trends in mortality rates from chronic diseases (age adjusted) have been downward. Today, some of the best analytic work on the benefits of federal regulations is performed by analysts at the U.S. Environmental Protection Agency. While the benefits of federal regulations are sometimes overestimated and sometimes underestimated, there is no evidence that use of BCA causes any systematic bias in the estimates of benefits prepared by federal agencies.

Myth #2: It is unethical to consider costs when making regulatory decisions about medicine, public health, safety, and environmental protection.

The notion that "safety" or "protection" from harm is an absolute right, regardless of costs, is not defensible on either philosophical or practical grounds. Philosophically, complete safety (also called "zero risk") is an illusion because well-informed citizens choose, on a daily basis, to assume many risks in life in exchange for a variety of benefits (e.g., we reduce travel time by driving faster on four-lane highways than we do on two-lane roads). When risks are imposed on citizens without their explicit consent (e.g., when a pedestrian inhales pollution emitted by a car), the philosophical analysis is more difficult but the ethical solution is not necessarily a mandate for zero risk. A more compelling resolution is that regulators should protect citizens from imposed risks to whatever extent the affected citizens would prefer, assuming those affected citizens were to experience both the benefits and costs of the regulation. Philosophically, this is a standard of hypothetical informed consent, and it forms the ethical foundation of BCA. To reject the informed preferences of citizens in favor of absolute safety is a form of authoritarianism – an ill-considered rejection of the ideals of personal freedom and consumer sovereignty that are at the heart of democratic capitalism. The practical objections to zero risk are even more compelling. If regulators go so far in the pursuit of complete safety that they make families poorer (e.g., through higher prices for regulated, zero-risk products), there may be more imposed risk from the induced poverty than from the target risk that regulators seek to eliminate. For example, many regulations in the energy sector have the practical effect of raising the prices of gasoline at the pump. For many low-income households, rising gasoline prices have adverse ramifications for all aspects of welfare (including health). Thus, practical considerations favor some form of benefit-cost determination rather than blind pursuit of zero risk.

Myth #3: BCA is a mathematical straight jacket that prevents consideration of important qualitative values such as fairness and special concern for the welfare of children.

The falsehood here is the assumption that a benefit-cost determination may be based only on a numerical comparison, without consideration of qualitative values such as fairness and the special needs of children. It is well-accepted in the field of BCA that, while many benefits and costs can be quantified, some valid considerations are essentially intangible. BCA textbooks call for intangible benefits and costs to be disclosed by analysts and considered by regulators. For example, suppose that a federal regulation will reduce the rate of lead poisoning among children in poor urban communities. Assume further that the quantified benefits and costs of this regulation are roughly equal, without considering the fact that low-income children are the primary beneficiaries. A fairness argument can be made that a tie-breaking, intangible consideration favors the regulation: the notion that the federal government owes a special sense of fairness to low-income children who are less able than middle-class or wealthy adults to protect their own interests. Notice that this legitimate, fairness consideration may not be as compelling if the costs of the regulation are also borne by low-income families. In other words, a benefit-cost determination is not a mathematical straight jacket that prevents analysts and regulators from giving weight to compelling intangible considerations.

Myth #4: BCA of business regulations is biased against regulation because the costs of regulations are exaggerated and the benefits of regulation are understated.

For a variety of reasons, it is sometimes asserted that analysis of business regulations is biased because costs are exaggerated and benefits are under-valued. The literature now includes several dozen regulations where the ex post estimates of benefit and cost are compared to the ex-ante estimates made by agency analysts before regulations were issued. While many of these estimates have been shown to have errors, there is no universal pattern that costs are exaggerated and benefits are underestimated. Indeed, my summary of this literature is that it shows no systematic bias in the quantitative estimates of benefits and costs by federal agencies.

Myth #5: BCA is so complicated and time consuming that it slows the regulatory process to a halt.

There is a theory in the legal literature that the federal regulatory process has become so “ossified” by procedural and judicial requirements that the pace of federal rulemaking is now at a snail’s pace. A related concern is that the addition of BCA requirements will exacerbate the ossification, and slow down the issuance of necessary regulations. Based on the available empirical literature and my five years of experience at OMB, I can assure you that federal agencies have no difficulty issuing numerous regulations, including highly expensive ones, when there is a political desire to do so. Consider, for example, the rapid flow of homeland security rules after the tragic events of 9/11. Anyone who has been following the Obama administration is aware that numerous new regulations are being proposed and finalized, despite the BCA requirement and other procedural requirements on agencies. And since most important regulations are already litigated by a wide range of stakeholders, and federal judges are already considering the findings of BCA, it is hard to see how a well-crafted statutory requirement for BCA could lead to more ossification or judicial delays.

Now that I have addressed some of the myths about BCA in federal regulation, I turn to some constructive suggestions for legislation in this arena.

SUGGESTIONS FOR STATUTORY REFORM

First, I recommend that Congress pass a simple statutory requirement that regulators conduct and use BCA (and related tools) when issuing significant federal rules. Reasonable people can disagree over how the benefit-cost mandate should be framed but I think it is sensible to start from the principles in the Clinton-Gore executive order (1993). I believe it may also be useful to review the legislative language that Senators Carl Levin and Fred Thompson crafted almost fifteen years ago, including some of the refinements made in consultation with the Clinton-Gore administration. I am very pleased that President Obama has recently reaffirmed presidential commitment to BCA as a valuable tool in rulemaking.

Basically, there needs to be a statutory requirement that regulators perform BCA, a requirement that a preferred regulatory option have benefits that justify costs, and some safeguards to ensure that the BCA is performed with a high degree of quality. For example, the agency should be required to analyze at least one option that is less expensive and one option that is more expensive than the agency's preferred option. In other words, analyses that simply compare one regulatory option to "doing nothing" should not be considered adequate. Since presidents and agencies do not always adhere to the provisions in presidential executive orders, it is imperative that judicial review of the new statutory requirements be authorized. The benefits-justify-costs test should be applicable to each significant regulation, unless the agency's authorizing statute has explicitly prohibited consideration of BCA.

Second, I recommend that Congress require OMB to issue guidance on the proper conduct of BCA, and that this guidance be updated periodically (e.g., at least every ten years or as soon as there is significant change in the state of the art of BCA). OMB currently uses a guidance document called Circular A-4 that was issued in 2003 after public comment, interagency deliberation, and expert peer review. I recommend that Congress require a similar process in the future, placing OMB in the lead in consultation with the White House Council of Economic Advisors and other agencies. In order to better ensure that the data and models used by agencies are valid and appropriate, the new statutory mandate should reference the information-quality and peer-review guidelines that have been issued by OMB, and provide stakeholders an opportunity for judicial review in cases where these well-developed guidelines are not followed by agencies.

Third, I recommend that Congress expand the scope of the statutory mandate to include significant guidance documents as well as legislative rules, at least in cases where the agency's action to issue a guidance document has the same practical effect on regulated parties as a regulation. Senator Collins (R-Maine) has already proposed a bill in the Senate to apply BCA to guidance documents, and I urge the subcommittee to take a careful look at her guidance-related provisions.

Finally, Congress should consider adding a distributional arm of the "benefits-justify-costs" test that ensures that the welfare of low-income Americans is considered before a significant rule is

issued. Thus, even if a regulation passes the benefit-cost test for society as a whole, it may not be advisable if low-income Americans are likely to incur more costs than benefits. For example, energy-related regulations that increase the price of gasoline at the pump have a disproportionately harmful effect on low-income families, especially those families living in small towns and rural areas where alternatives to automobile travel are not available. The benefit side of the ledger also needs to be considered, since some regulations offer significant benefits to low-income families while others do not. As a matter of fairness, regulators owe it to the most economically disadvantaged families in society to explore whether a proposed rule will make these families better off or worse off. My 2008 article in the *Pennsylvania Law Review* provides a more complete discussion of the philosophical and practical aspects of this recommendation.

In summary, it has been accepted by U.S. presidents for at least 30 years that BCA should play an important role in federal rulemaking. While OMB and federal agencies have made significant progress in this direction, it is well known that OMB and federal agencies do not implement this policy with consistency and a high degree of quality. Congress should build on the logic of the recent presidential orders by passing a simple statutory requirement that is backed by the force of judicial review. If OMB and federal agencies know that federal courts are authorized to review the role of BCA in federal regulation, they will take their BCA-related responsibilities much more seriously than they do today.