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Restoring Progressive Values to Cost-Benefit Analysis

The current approach to cost-benefit analysis is ill-fitted to the profound and unprecedented set of crises the incoming Biden-Harris administration will inherit. The practice has become ossified in a rigid hyper-formalism grounded in neoliberal orthodoxy.

In this incarnation it lacks the flexibility to adequately account for the vast data gaps and fat-tailed uncertainties[1] that plague our scientific understandings on so many fronts—a newly emerging global pandemic, a legacy of widespread contamination of water, soil and air with a vast array of industrial toxins, and an accelerating global climate crisis.

It is similarly ill-equipped to deal with inherently unquantifiable values like dignity, equity and fairness that have taken center stage in the wake of this summer's Black Lives Matter protests. Compounding these shortcomings, its focus on economic efficiency, defined in terms of *aggregate* social welfare, is fundamentally incompatible with the attention to existing disparities in wealth and power that this political moment demands.

This memo proposes a set of strategies for reorienting the practice of cost-benefit analysis to return it to Executive Order 12866's original grounding in progressive values and to situate the Biden-Harris administration to nimbly meet the challenges of the 21st century.

<u>The Problem</u>:

Although Executive Order 12866 attempted a course correction from the Reagan years—emphasizing the importance of unquantifiable variables, the imperative to consider distributional impacts and equity, and "the primacy" of federal agencies and their statutory mandates in regulatory decision-making—in the intervening decades agency practice has gradually drifted from that progressive vision. This is likely attributable to a White House Office of Information and Regulatory Affairs (OIRA) staff dominated by the economics profession, the "cognitive lure" of numbers and their inherent tendency to "crowd out" qualitative descriptions, and guidance documents from both OIRA and the agencies emphasizing monetization, high discount rates, and the numeric calculation of net benefits.

Accordingly, the version of cost-benefit analysis held up as the norm and the expectation in OIRA review assumes a world where comprehensive data on regulatory impacts are available to agencies, allowing them to monetize all significant costs and benefits and pinpoint the alternative that maximizes net benefit.[2] Unfortunately, that is not the real world. For most of the biggest and most contentious federal rulemakings, the data necessary to meaningfully quantify benefits are simply unavailable.[3] And, for some benefits that resist monetization, these data will never exist. [See accompanying memo on "Data Gaps Plague Cost-Benefit Analysis."]

Nonetheless, despite these yawning data gaps, agencies feel enormous pressure to monetize both sides of the equation and hesitate to submit rules unless they can make their case on the numbers alone.[4] This hyper-attention to dollars and cents crowds out unquantifiable impacts, distributional impacts, and equity even when those intangible values are a primary purpose of an agency's statutory directive. These problems are exacerbated by the practice of applying high

discount rates (3 and 7 percent) that have the effect of drastically shrinking the benefits that will accrue to future generations, sometimes down to almost nothing.[5] As a result, the cost-benefit requirement effectively ends up imposing on agencies a burden of proof that is in many instances insurmountable, putting a chilling effect on the implementation of regulatory safeguards.

This hyper-formalized version of cost-benefit analysis grounded in a rigid adherence to free market fundamentalism has come to dominate agency practice in a way that has led agencies astray from their statutory missions.

Members of Congress were well aware of these pervasive data gaps when they passed many of the statutes from which the biggest and most contentious regulatory programs originate. In response, they came up with a lot of creative ways to make sure costs are kept in check and are not disproportionate to benefits without requiring them to be directly weighed against each other, thus avoiding the need to express regulatory benefits – things like saving lives or preventing neurological damage to kids – in monetary terms. In contexts in which significant benefits (or costs) can't be quantified, these tools can often provide a more useful framework for rational decision making. They include:

- Cost-effectiveness analysis
- Feasibility analysis (*i.e.*, do the best we can using available methods and technologies)
- Qualitative "Ben Franklin" cost-benefit analysis (*i.e.*, an apples-to-oranges comparison to ensure costs are not grossly disproportionate to benefits)
- Multi-factor qualitative balancing.
- Scenario analysis

The current hyper-formalistic approach to cost-benefit analysis is often in tension with these statutory requirements.

<u>The Solution</u>:

President Biden should sign an executive order that aligns the practice of cost-benefit analysis with his progressive vision. This includes reaffirming the primacy of federal agencies and their statutory mandates in regulatory decision-making by directing agencies to use the context-specific methods specified in their authorizing statutes for considering costs and benefits, rather than applying the now-prevalent hyper-formalistic version of cost-benefit analysis as a one-size-fits-all tool. Additionally, this new executive order should implement a set of specific practices aimed at elevating unquantified benefits and costs to the same level of attention and consideration accorded to quantified effects. Finally, it should bring front and center the consideration of cumulative burdens on frontline communities and distributional impacts (including the impact of discount rates on intergenerational equity).

Potential opposition:

Some within the Democratic Party may feel invested in the practice of cost-benefit analysis as it has evolved over the decades (pre-Trump). They may resist these recommendations, arguing that rational regulation requires the economists' approach to weighing of costs and benefits. Ironically, the hyper-formalistic version of cost-benefit currently in use regularly produces results that can only be described as irrational and entirely at odds with common sense. [See accompanying memo on "Restoring Rationality to Regulatory Analysis."] Indeed, even some of those who have traditionally been cost-benefit's staunchest defenders have come more recently to recognize that it may be ill-fitted to some of the 21st century's defining challenges.[6] Some of those who defend the status quo may fail to appreciate how widespread and pervasive the data gaps really are. Some may argue that the Supreme Court's 2015 opinion in *Michigan v. EPA* now requires the economists' formalistic cost-benefit analysis, but that would be a misreading of that case. In fact, *Michigan* supports the notion that agencies should have discretion to choose from a menu of tools for the consideration of costs and benefits like those listed above.

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[1] *See* Martin L. Weitzman, *Fat-Tailed Uncertainty in the Economics of Catastrophic Climate Change*, 5 REV. OF ENVTL. ECON. & POL'Y 275 (2011).

[2] *See* Office of Mgmt. & Budget, *Circular A-4: To the Heads of Executive Agencies and Establishments: Regulatory Analysis* 10 (2003) ("[a] distinctive feature of . . .Benefit-Cost Analysis is that both benefits and costs are expressed in monetary units, which allows you to evaluate different regulatory options with a variety of attributes using a common measure.").

[3] *See* Amy Sinden, *The Problem of Unquantified Benefits*, 49 ENVTL. L. 73 (2019) (study of 45 cost-benefit analyses prepared by EPA in connection with major final rules issues between 2002 and 2015; in 80 percent of cost-benefit analyses, EPA was, due to data limitations, entirely unable to monetize whole categories of benefits the agency described as either actually or potentially "important," "significant," or "substantial"); John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications* 124 YALE L. J.. 882, 997-98 (2015) (presenting a series of case studies "suggest[ing] that the capacity of anyone . . . to conduct quantified CBA[] with any real precision or confidence does not exist for important representative types of financial regulation.").

[4] Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 HARV. L. REV. 1838, 1865-66 (2013) ("In the Obama Administration, it has been very rare for a rule to have monetized costs in excess of monetized benefits."); Cass R. Sunstein, *The Real World of Cost-Benefit Analysis: Thirty-Six Questions (and Almost as Many Answers)*, 114 COLUM. L. REV. 167, 180-81 (2014) (noting that where a regulation's monetized benefits are less than monetized costs, "the agency is unlikely to attempt to go forward with this regulation," and if it does, it "will not be easy to establish" that the benefits justify the costs); Lisa Heinzerling, *Inside EPA: A Former Insider's Reflections on the Relationship between the Obama EPA and the Obama White House*, 31 PACE ENVTL. L. REV. 325, 352 (2014)("OIRA's fine cost-benefit sieve leads EPA personnel to be deeply wary of developing rules that have very high costs in relation to their quantified and monetized benefits.").

[5] *See* RICHARD L. REVESZ & MICHAEL A. LIVERMORE, RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH 107-117 (2008).

[6] Jonathan Masur & Eric Posner, *Climate Regulation and the Limits of Cost-Benefits Analysis*, CAL. L. REV. 1557 (2011) ("[T]he formulaic approach to weighing costs and benefits that is embodied in the standard methods used by regulatory agencies is not appropriate for [the] problem [of climate change].") ; Michael A. Livermore, *Can Cost-Benefit Analysis of Environmental Policy Go Global?* 19 NYU ENVTL. L. J. 146, 172 (2011)(cost-benefit analysis "of only limited value" in the context of regulations protecting natural resources); Susan Rose-Ackerman, *Putting*

Cost-Benefit Analysis in Its Place: Rethinking Regulatory Review, 65 U. MIAMI L. REV. 335 (2011) (arguing that "a number of pressing current problems do not fit well into the cost-benefit analysis paradigm, [including in particular those with potentially long-term catastrophic and irreversible effects, such as] climate change, nuclear accident risks, and the preservation of biodiversity"); CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION 68-69 (2002) (suggesting that cost-benefit analysis may be inappropriate for regulations aimed at protecting endangered species, "ensur[ing] against irreversible damage, or otherwise . . . prevent[ing] the violation of rights").

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APPENDIX

Specific provisions of a Biden executive order on reforming cost-benefit analysis could include:

- Reiterating the Supreme Court's admonition in *Michigan v. EPA* that there is no one-size-fits-all method for the consideration of costs and benefits and that it is "up to the agency to decide how to account for costs [and benefits]" by choosing among the wide array of tools available.
    - This choice should be tailored to the particular context in which the rulemaking arises, including :
        - Attention to the feasibility of quantifying and monetizing relevant costs and benefits; and
        - The agency's statutory mandates.
    - OIRA should be required to defer to the agency's choice of decision-making tool.

- Requiring the agencies to articulate the particular methods their organic statutes direct them to use in accounting for regulatory costs and benefits.

- Reaffirming that any attempt to characterize or quantify regulatory benefits should include co-benefits.

- Ending the practice of across-the-board use of 3- and 7-percent discount rates. Instead, agencies should reevaluate the use of discount rates in order to:
    - Develop new approaches to discounting that are tailored to particular statutory contexts; and
    - Give priority to the value of intergenerational equity.

- Prohibiting calculation of net benefit unless all significant categories of benefit and cost can be effectively and non-controversially monetized, with only two specific exceptions:
    - Where net benefits are calculated in the context of a breakeven analysis; or
    - Where an incomplete benefits estimate exceeds a reasonably complete cost estimate and the net benefits estimate is clearly designated as a lower bound.

- Forbidding monetization of benefits (or costs) for which prices are not set in existing markets.

- Directing the agencies and OIRA to employ the principle of "proportionality" to decide what decision-making tool to adopt and the level of time and resources to devote to quantification, ensuring that the rigor of the analysis is commensurate with the magnitude of the rule's impacts.
    - This principle is currently used in the European Union.

- Requiring any chart presenting a rule's total quantified costs and benefits to:

- Use a "+B" or a "+C" to indicate where significant benefits or costs could not be quantified;
- List in narrative terms all significant categories of non-quantifiable benefits or costs; and
- For any monetized estimates of non-market goods, to include an alternative valuation in natural units (lives saved, illnesses averted, acres of wetlands preserved, etc.).

- Requiring an analysis of distributional impacts and of relevant equity and justice considerations.
  - This analysis should account for who bears the costs and who reaps the benefits of the rule
  - It should also pay particular attention to cumulative burdens suffered by historically marginalized groups and frontline communities as well as other similar distributional concerns.