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Jessica Hertz
Office of Management and Budget
Washington, DC

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Dear Ms. Hertz:

This letter is in response to your email message to me of February 5, 2009, which asked me to give my views about a possible new Executive Order that would replace Executive Order 12,866.

Executive Order 12,866 put into place the current system of regulatory review. This system centralizes regulatory review in OIRA. Agencies must submit regulatory plans to OIRA in the spring of each year, and whenever they propose to issue major rules, they must submit a regulatory impact statement to OIRA that includes, among other things, a cost-benefit analysis. OIRA may return regulatory actions to agencies that do not comply with the provisions of the Executive Order. Disputes between OIRA and agencies are resolved by the President.

The regulatory review process has received much criticism. Some commentators believe that it blocks or delays needed regulation; others believe that OIRA has not enforced the rules strictly enough. Many regulations, for example, continue to be issued even though they do not comply with cost-benefit analyses. See, e.g., Robert W. Hahn, [An Analysis of the 2008 Government Report on the Costs and Benefits of Federal Regulations](#), Reg-Markets Center, AEI Center for Regulatory and Market Studies (Regulatory Analysis 08-04, 2008) (and citations therein).

Below I list ten topics that deserve study and make recommendations. Throughout, I assume that these recommendations are consistent with existing law. However, some bodies of regulatory law give the President less discretion than others do. To the extent my recommendations would require a change in the law, the President should consider seeking relevant legal changes from Congress. I will focus on cost-benefit analysis, which is my area of expertise.

1. Retain cost-benefit analysis.

Cost-benefit analysis has two virtues. First, it helps ensure that the executive branch devotes its scarce resources to correcting the worst problems at least cost. Second, it promotes transparency. A cost-benefit analysis reveals the assumptions of regulators, which enables the public, regulated parties, and courts to challenge and criticize regulations that are poorly designed.

In recent years, critics of cost-benefit analysis have argued that it should be discarded because it has methodological problems. Some of these criticisms have merit; however, they are best addressed with incremental modifications to cost-benefit analysis and procedural safeguards (as discussed below). Until a superior decision-procedure is developed, cost-benefit analysis should be retained.

2. Require point estimates in all cases.

Under Executive Order 12,866, agencies are not strictly required to estimate costs and benefits, and many agencies have taken advantage of this loophole. Agencies sometimes simply refuse to estimate costs or benefits on the ground that the estimate is infeasible; at other times, they provide ranges. As a result, the cost-benefit analysis is impossible to evaluate. This loophole should be closed. Agencies should be required to estimate all of the relevant costs and benefits of the proposed regulation. They should also give confidence intervals where appropriate.

3. Establish a central database of valuations in OIRA.

Different regulations often have similar effects—for example, reducing the incidence of a particular disease or injury. Where they do, agencies should use the same valuations. This is not the current practice. To remedy this problem, OIRA should establish a central, publicly accessible database of valuations. OIRA should establish a valuations office that keeps track of valuations and solicits outside peer-reviewed studies to refine and update existing valuations and develop new ones. The list of standard valuations should include the discount factor, the benefit from an incremental reduction in the risk of death, the benefit from avoiding various injuries and illnesses, and so forth. When performing cost-benefit analyses, agencies would be required to use these OIRA-approved valuations.

4. Resolve the discounting issue.

When regulations produce benefits and costs that will occur in the future, they should be discounted to present value. However, the exact discount rate is subject to significant scholarly dispute. The Executive Order should require OIRA to resolve the discount rate controversy by convening a panel of economists, ethicists, and government officials with experience in regulation. Agencies should be required to use the discount rate established by OIRA.

5. Flag distributively unfair regulations.

Most cost-justified regulations have little effect on the overall distribution of wealth because their effects are widely dispersed, or the benefits and costs are felt by the same people. However, when cost-justified regulations impose significant costs on a relatively small group of people, rather than the public at large, agencies should report the distributive impact of the regulation. Such a regulation might be appropriately blocked or modified, at the discretion of the President alone, who may seek a Congressional appropriation for the purpose of compensating those harmed by the regulation.

6. Take advantage of the behavioral sciences.

Many regulations have benefits that are hard to monetize using the standard techniques of economics. Recent advances in cognitive psychology offer some hope for improving valuation techniques. OIRA should keep abreast of these developments and take advantage of them, where appropriate, in determining valuations that will be used by the agencies. Traditional willingness-to-pay measures should presumptively be used. However, when OIRA determines that those measures do not approximate actual effects on human well-being, OIRA alone (not the agencies) should have the authority to issue substitute measures on the basis of a peer-reviewed study that uses alternative approaches.

7. Improve agency compliance.

Sometimes, agencies simply disregard OIRA's instructions. OIRA needs more enforcement power. For example, it could be given the power to block regulations that do not comply with the Executive Order, to the extent permissible by law.

8. Permit interested parties to submit alternative regulations.

Agencies should permit interested parties to submit proposed regulations along with cost-benefit analyses, which should be reported to OIRA. The agency's proposed regulation should be approved by OIRA only if its cost-benefit ratio is superior to those of the alternative regulations.

9. Apply cost-effectiveness analysis to transfer regulations.

Transfer regulations distribute money or other benefits to individuals rather than solving market failures or producing other public goods. Examples include regulations that govern food stamp distribution systems, national disaster responses, and agricultural subsidies. Such regulations are not appropriately subject to cost-benefit analysis because, by design, they do not generate benefits greater than costs; they merely shift money from

the Treasury to beneficiaries. Nonetheless, these regulations should be subject to cost-effectiveness analysis. Cost-effectiveness analysis is used to evaluate regulations according to the extent that they achieve a predefined goal at least cost. All transfer regulations should be accompanied by a cost-effectiveness analysis that shows that the regulation achieves its goals more cheaply than alternative regulations that have been proposed by interested parties.

10. Peer review.

Agencies' cost-benefit analyses should be subject to peer review. As noted above, the valuations established by OIRA should also be subject to peer review.

I hope that these recommendations may be useful. Please let me know if I can be of further assistance.

Sincerely,

Eric A. Posner