Administrative Law

The Benefits and Costs of Sound Economics: The "Clear Skies" Dilemma

by Jeffrey Ladik

In early 2003, officials from the U.S. Environmental Protection Agency (EPA) embarked on a "listening tour" through various cities in order to learn from senior citizens about the environmental health issues that most concerned them. During several of the meetings between EPA officials and senior citizen groups, the seniors, their advocates, and various environmental groups, expressed great dismay about an analytic method used by the agency to calculate the benefits of certain regulations. In the Bush Administration's proposed "Clear Skies" legislation, limits would be set on specific emissions from power plants which would reduce the amount of fine soot particles in the air, thereby decreasing respiratory-related illnesses. EPA monetized the health benefits of the "Clear Skies" proposal using, in part, analysis that valued the lives of those over 70 years at $2.3 million and the lives of younger people at $3.7 million. In addition to this methodology, EPA also estimated the benefits by using a value of $6.1 million for every statistical life saved regardless of age.[1] Because of the former methodology, seniors were angered by the notion that their lives do not have the same economic worth as younger people. The discontent of this powerful voting block was the impetus for the elimination of the "senior discount."[2] Indeed, the "clear skies" dilemma is an ever-present issue in regulatory policymaking: the willingness of non-economists to conflate social/moral value with economic value.

OMB's Role in the Regulatory Process

Established in 1980 by the Paperwork Reduction Act[3] (PRA), the Office of Information and Regulatory Affairs (OIRA) in OMB oversees agency activity in three areas: regulation, collection of information, and information resources management. OIRA is headed by a Presidential appointed, Senate confirmed, Administrator. Pursuant to Executive Order 12866, OIRA reviews major regulations, i.e. Federal regulations that would have an impact on the economy of $100 million or more, to insure that the benefits of the regulation "justify" the costs.[4]

OMB's published regulatory guidance for agencies explains in plain terms that "the evaluation of both the benefits and costs of alternative options through regulatory analysis helps agency policymakers arrive at sound regulatory decisions and also helps the public, Congress, and the courts understand those decisions."[5] Thus, "regulatory analysis is a tool agencies [should] use to anticipate and evaluate the likely consequences of their actions. It provides a formal way of organizing the evidence on the key effects—good and bad—of the various alternatives that should be considered in developing regulations…By choosing actions that maximize net benefits, agencies direct resources to their most efficient use."[6] To this end, the "distinctive feature of [benefit-cost analysis] BCA is that both benefits and costs are expressed in monetary units, which allows [agency analysts] to evaluate different regulatory options with a variety of attributes using a common measure."[7]

Following the political controversy surrounding EPA's use of an age-adjustment factor in estimating the benefits of the "Clear Skies" initiative, OIRA's Administrator issued a memorandum advising EPA to discontinue use of this factor in the economic value of a statistical life (VSL). The VSL would thus be the same for people of all ages. The memorandum further stated that "OMB is concerned that a simple VSLY [value of a statistical life year] approach could underestimate benefits significantly when applied to rules that primarily or significantly benefit senior citizens. Consequently, OMB recommend[ed] that agency analysts, when performing benefit-cost analysis, present results using both the VSL and VSLY methods."[8]

Valuing Statistical Life and Life Years

In order to conduct high-quality benefit-cost analysis, the value of a statistical life (VSL) and a statistical life year (VSLY) have to be quantified.[9] In terms of maximizing benefits for the smallest cost imposed, which method promotes the greatest net benefits? OIRA advises using both VSL (without an age-adjustment factor) and VSLY approaches. Alternatively, Professor Sunstein of the University of Chicago advocates using the VSLY method, and wisely states that rhetoric suggesting age discrimination are misconceived criticisms. He argues that "if regulatory policy is based on VSLY, every person will, in a sense, be both benefited and burdened, and in exactly the same way. Indeed, every person will be both a beneficiary and a victim of the relevant discrimination. People—the same people—will be benefited when they are younger and burdened when they are older. It is hard to see how that form of discrimination is illicit."[10] In addition, "if the beneficiaries of a regulation are mostly elderly people, then the regulation will seem far less attractive with the use of VSLY than with VSL. But if the beneficiaries are mostly children, then a regulation will seem far more attractive with VSLY than with VSL."[11] This insight might explain, in part, why OIRA has urged agencies to use both VSL and VSLY methods when performing benefit-cost analysis.[12]

To this end, OMB's guidance for agencies instructs that '"opportunity cost'" is the appropriate concept for valuing both benefits and costs. The principle of "willingness-to-pay" (WTP) captures the notion of opportunity cost by measuring what individuals are willing to forgo to enjoy a particular benefit. In general, economists tend to view WTP as the most appropriate measure of opportunity cost, but an individual's "willingness-to-accept" (WTA) compensation for not receiving the improvement can also provide a valid measure of opportunity cost…WTP is generally considered to be more readily measurable and to provide a more conservative measure of benefits.[13] Thus, in "monetizing health benefits, a willingness-to-pay measure is the conceptually appropriate measure."[14]

The Importance of Sound Regulatory Impact Analyses

Economics is the efficient allocation of scarce resources that have alternate uses. Clearly, resources are finite and regulatory decisionmaking must take tradeoffs into account. Although established principles of economic analysis should drive policymaking, too often rhetoric trumps science. When transparency and accountability are not built into the framework, the addition of regulation after regulation burdens the national economy and results in higher prices for consumers.

To counteract this problem, Executive Orders 12291 and 12866 require agencies to prepare a Regulatory Impact Analysis (RIA) for all major Federal regulations.[15] Robert Hahn and Robert Litan, of the AEI-Brookings Joint Center for Regulatory Studies, have suggested that Congress should require that agencies make each regulatory impact analysis available on the Internet before a proposed or final regulation can be issued. Also, each RIA should include an executive summary with a standardized regulatory impact summary table that contains information on costs, benefits, technical information, and whether the regulation is likely to pass a benefit-cost test based on the estimate of quantifiable benefits and costs.[16]

Messrs. Hahn and Litan also note that Executive Orders are difficult to enforce because they are not judicially enforceable, and agencies cannot be sued for noncompliance. However, an explicit congressional requirement to balance benefits and costs would increase the transparency of the regulatory process by forcing agencies to provide high-quality analyses that the courts could review.[17] These reforms ought to be strongly considered by Congress so that important matters such as the VSL/VSLY debate can be based on the merits of the issue, rather than simple political machination.[18]

One possible way to deal substantively with the matter is through the Paperwork Reduction Act and the Data Quality Act. One purpose of the PRA is to "improve the quality and use of Federal information to strengthen decisionmaking, accountability, and openness in Government and society.[19] The Data Quality Act requires that OMB's interagency data quality guidelines "provide policy and procedural guidance to Federal agencies for ensuring and maximizing the quality, objectivity, utility, and integrity of information disseminated by Federal agencies…"[20] Equally important, the Data Quality Act requires that OMB's interagency data quality guidelines require all Federal agencies subject to the PRA to establish administrative processes allowing "affected persons to seek and obtain correction of information maintained and disseminated by the agency that does not comply with" OMB's interagency guidelines.[21] In fact, the data quality guidelines apply to all and any information that Federal agencies make public.[22]

Conclusion: The Political Realities

Establishing procedures, guidance, and mandates for sound benefit-cost analyses (or a regulatory budget) is not the hardest challenge to improving the regulatory system. Rather, the most difficult obstacle to overcome is devising an effective public relations campaign that conveys principles of benefit-cost analysis to the public. Making economic choices should not be seen as a zero-sum game. Nevertheless, regulatory policymaking will always have to contend with the fact that more people are unfamiliar with economics compared to those who are economically oriented. Thus, special interest groups that launch pro-regulation grass root campaigns are able to exert great influence on the public. Unfortunately, the message is predictably not based on sound science or economics, but it finds receptive audiences by evoking emotionally powerful expressions. The impact in policy terms means that costly regulations are imposed on the economy and finite resources are inefficiently allocated.

Footnotes

[1] *See* Robert H. Hahn and Scott Wallsten, Is Granny Worth $2.3 Million or $6.1 Million? available at http://www.aei-brookings.org/policy/page.php?id=138; *see also* http://www.epa.gov/clearskies.

[2] The AARP told OMB that it was "deeply troubled" by the use of "a 37 percent discount to the life value of adults aged 70," *see* Washington Post, "Under Fire, EPA Drops the 'Senior Death Discount,'" available at www.washingtonpost.com/ac2/wp-dyn/ A47678-2003May12; *see also* Statement of Christine Todd Whitman, Administrator, U.S. Environmental Protection Agency, May 7, 2003, available at http://www.epa.gov/aging/listening/2003/balt_ctw.htm.

[3] 44 U.S.C. §§ 3501 *et seq*.

[4] Executive Order 12866, 3 C.F.R. 638 (1993).

[5] *See* Office of Management and Budget, Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations, 68 Fed. Reg. 5498 (February 3, 2003).

[6] *Id*. at 5514.

[7] *Id*. at 5516.

[8] *See* Memorandum of John D. Graham, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget, to the President's Management Council 1-2 (May30, 2003), available at http://www.whitehouse.gov/omb/inforeg/pmc_benefit_cost_memo.pdf.

[9] *See* OMB Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs" (10/29/92) (Revised 01/22/2002) available at http://www.whitehouse.gov/omb/circulars/a094/a094.pdf.

[10] *See* Cass R. Sunstein, Lives, Life-Years, and Willingness to Pay, Working Paper 03-5 at 30 (June 2003) available at http://aei.brookings.org/admin/pdffiles/phprW.pdf.

[11] *Id*. at 2.

[12] *See* Memorandum of John D. Graham, *supra* note, at 2.

[13] *See* OMB 2003, *supra* note, at 5518.

[14] *Id*. at 5520

[15] *See* Executive Order 12291, 3 C.F.R. 128 (1981); Executive Order 12866, 3 C.F.R. 638 (1993).

[16] *See* Testimony of Robert W. Hahn before the House Government Reform Committee, Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, March 2003, 8 available at http://reform.house.gov/UploadedFiles/3-11-03_Testimony_Hahn.pdf.

[17] *See id*. at 10-11.

[18] S*ee eg* Press Statement of Senator Lieberman, Bush Administration Policy Shows No Respect for Seniors, May 20, 2003, available at http://lieberman.senate.gov/~lieberman/press/03/05/2003521436.html.

[19] *See* 44 U.S.C. § 3501(4).

[20] *See* 44 U.S.C. § 3516 note. The Data Quality Act, which is uncodified, amends the PRA.

[21] *See* id.

[22] *See* "Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies" ("data quality guidelines") http://www.whitehouse.gov/omb/fedreg/reproducible.html.