

**Remarks of John Morrall at the Conference on
Advancing Social Policy-Making through Benefit-Cost Analysis:
*Challenges and Opportunities***

**June 24, 2008
The Liaison Capital Hill
Washington DC**

**Panel 2: Lessons from Government Experience with Benefit-Cost
Analysis: USA and the EU**

Perspective of a Long-time Government Employee

I am honored to be invited to this Conference on Advancing Social Policy-Making through Benefit-Cost Analysis. I have spent my entire working life in government trying to do just that. I am also honored to be here with so many scholars whose contributions to Benefit-Cost Analysis I have studied and whose future contributions I look forward to reading. But before I start, I need to disclose that what you are about to hear are my own views and not necessarily the views of OMB, the Administration or any future Administration.

This panel has been charged with answering two questions.

- 1) To what extent does BCA improve decision-making? The short answer is that it depends on the quality of the BCA and whether it is used by policy makers.
- 2) How can we increase its (presumably positive) impact with respect to the analysis of federal social programs? The short answer is to increase the incentives to use it faced by policy makers.

In attempting to answer these two questions in greater detail, I propose to use my comparative advantage. I clearly don't have an absolute advantage with my esteemed colleagues on this panel. My comparative advantage is based on my performing and reviewing benefit cost analysis of social regulations at the Executive Office of the President since 1975 and before that for three years as a Brookings Fellow assigned to DOL and HUD to review their social programs. In addition over the last 20 years, I have been asked to as a USG expert to assist at least 20 foreign governments and institutions to develop BCA programs or as also known: Regulatory Impact Analysis programs.

My perspective is as a long termer, an internationalist and as a center-of-government bureaucrat with a broad, public interest perspective. Where I stand is where I sit.

Unfortunately where most other government staff stand is also where they sit and they sit in other agencies often with compelling missions and always competing for limited common resources.

Of course, the phenomenon of the bureaucratic and political lens is well known at least for project evaluation. It is discussed in chapter I of Boardman, Greenberg, Vining, and Weimer's popular text book, *Cost-Benefit Analysis*, in terms of the analyst, guardian, and spender perspectives and is a major part of the discussion in the Wikipedia CBA entry, which has an international flavor.

But when it comes to BCA of regulations, it can be argued that the proactive bias is even stronger. Regulations don't have to go through the public borrowing or spending hurdles. There is no regulatory budget. It uses OPM, other people's money

In fact when it comes to social regulation, the public perception appears to be the opposite; that is, that BCA is inherently biased against government intervention. Richard Zerbe points out in the "Legal Foundation of Cost-Benefit Analysis", CBA is increasingly being criticized in the legal literature both as anti-regulatory and fundamentally flawed.

As an early object of this criticism in a 100 page 500 footnoted 1998 article in the *Yale Law Review*, I feel I know about what I speak. The critique was rather personal and vehement. My sin was that I had compiled and published a table in 1986 of implicit costs per life saved estimates for regulatory interventions that federal agencies had proposed, enacted or rejected over the previous 20 years. I found that there was a very wide range of estimates, implying that better regulation could generate significant savings, a higher level of public benefits, or both. A second sin of my table was that it was cited by many influential scholars who were recommending BCA, including Cass Sunstein, Justice Stephen Breyer, Kenneth Arrow, Richard Zeckhauser and Kip Viscusi.

The legal critics have gone on to list other "Unicorns of Deregulation" as they call us. They include, Bob Crandall and Bob Litan of Brookings, Bob Hahn of AEI, John Graham of RAND and soon Indiana, and Kip Viscusi of Vanderbilt. I am certainly proud to be in their company but concerned that the criticisms are personal and not based on the merit and logic of their scholarly work.

I dwell on this line because the public perception of BCA is being influenced by these legal advocates, which tend to be emotional in their appeal. Although the critics are mostly environmental law professors, I fear they are influencing the acceptance of BCA in general.

So what can be done? There are very few advocates of BCA. I think we are mostly in this room or perhaps just on this panel. And most of them are two handed economist who are not advocates by nature and thus at a great disadvantage when dealing with legal advocates for popular support.

Although there are legal scholars who have long defended BCA such as Sunstein and Judge Breyer. A more recent defense is admittedly begrudging. For example, Revesz and Livermore's new book: *Retaking Rationality: How Cost-Benefit Analysis Can Better Protect the Environment and Our Health*, takes the approach that BCA is here to stay so if you can't beat them join them. They recommend developing BCAs that will show more benefits for less costs.

They appear not to have carefully read most of the hundreds of BCAs that the agencies have done in support of regulation over the last 15 years. And they appear not to be familiar with OMB Circular A-4, which advises agencies how to do BCA and deals straight on with the so-called fallacies of BCA.

Orrin Pickly in his a June 13th review of their book in *Science* magazine lists five of these "fallacies" of the way BCA is done in practice:

1. All unintended consequences are bad.
2. Older people are less valuable.
3. People cannot adapt.
4. Industry cannot adapt.
5. People value only what they use.

All of these issues are properly dealt with by Circular A-4 and agencies are well aware of them. In fact A-4 is a state of the art set of guidelines that has not gotten the US recognition it deserves although it has been used by Canada and the EC in their recently issued BCA guidance.

A-4 was peer reviewed and went through notice and comment and interagency review. John Graham and his staff with the help of CEA (Randall Kroszner and John List) spent many hours reviewing the comments and revising the document. The document itself was an update of the 1996 OMB/CEA "Best Practices" document directed by Joe Stiglitz., chair of the CEA back then. For example:

1. All unintended consequences are bad.
A-4 has a section on "Ancillary Benefits" (p. 26)
2. Older people are less valuable.
A-4 explicitly recommends using a higher value for seniors VSLY because they face higher overall risks and enjoy higher savings
3. People cannot adapt.
He is talking about how the disabled adapt yet this implies that reducing morbidity should not be as highly valued. A-4 recommends that for fairness and simplicity when using QALYs for a disabled population the population mean should be used so as not to undervalue the disabled.
4. Industry cannot adapt.
A-4 has a section on taking into account technical change and the learning curve. In fact it is some statutes that prohibit taking into account technical change not BCA.

5. People value only what they use.
A-4 states that not taking into account non use value significantly understates benefits (p. 22) In fact there is a whole section on Stated Preference Methods.

Economist should not let the legal profession dictate how BCA should be performed. We have to do a better job showing how BCA or perhaps Cost-Effectiveness Analysis has improved social decision-making by providing systematic and objective information. No No case has not been made to reinvent mainstream BCA as taught in most public policy schools. Almost always a case can be made to improve a specific BCA.

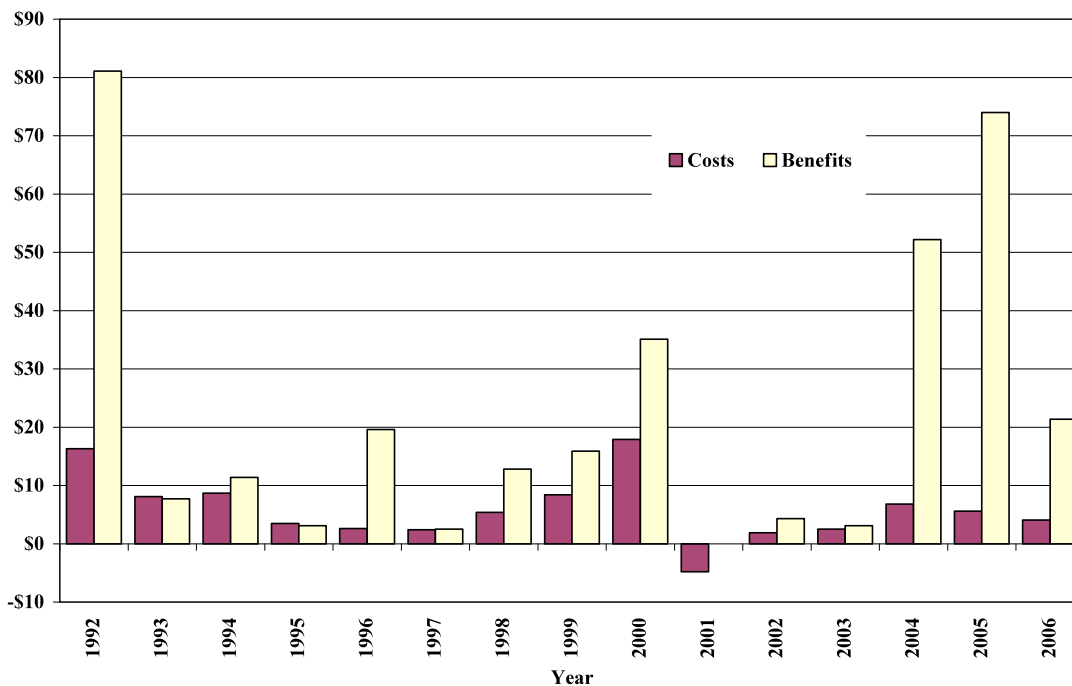
As mentioned, many of the critiques of BCA appear to have a simplistic view of how BCA is actually performed by the agencies and what the results of those BCAs indicate.

Since 1997, OMB has produced an annual *Report to Congress on the Costs and Benefits of Federal Regulations*. The Regulatory Right-to-Know Act requires OMB to report on costs and benefits in the aggregate, agency by agency and by program and major rule.

The record shows that from 1992 to 2007 according to the over 100 BCAs that have been done for major rules and reviewed by OIRA under EO 12866 issued in 1993 (EO 12291 before 1993), the Federal Government has produced conservatively about \$350 billion in annualized net benefits. (Costs were about 120B and benefits four times larger at about 480 in 2007 dollars using midpoints of ranges.)

The handout shows the year-by-year costs and benefits. Note the pattern of large benefits during election years.

Costs and Benefits
billions of 2001 dollars



Using a subset of this data from 1996 to 2006 for 91 regulations for which we have both cost and benefit data shows that the lower range of the benefit estimates always exceed the upper range of the costs estimates.

Table 1-1: Estimates of the Total Annual Benefits and Costs of Major Federal Rules, October 1, 1996 to September 30, 2006 (millions of 2001 dollars)

Agency	Number of Rules	Benefits	Costs
Department of Agriculture	6	3,454-3,692	2,106-2,215
Department of Education	1	633-786	349-589
Department of Energy	6	5,194-5,260	2,958
Department of Health and Human Services	17	20,746-32,946	3,781-4,071
Department of Housing and Urban Development	1	190	150
Department of Justice	1	275	108-118
Department of Labor	5	1,173-4,302	611-620
Department of Transportation	15	3,913-6,147	3,879-7,377
Environmental Protection Agency	39	62,917-430,004	25,235-28,055
Total	91	98,492-483,603	39,176-46,152

Source: OMB's 2007 Report to Congress on the Costs and Benefits of Federal Regulations

Retaking Rationality suggests that we look back at the assumptions behind past BCAs. But the claim that BCA has an anti-regulatory bias should be checked by systematically looking at *ex post* validation studies of *ex ante* BCA estimates not by relying on selected court cases and anecdotal evidence. In OMB's 2005 report, *Validating Regulatory Analysis*, we reviewed the 47 cases we could find where pre-regulation estimates were made by government agencies and follow-up studies were published by academics or government agencies during the 1975 to 1996 period. Our results indicate that U.S. federal agencies tend to overestimate both benefits and cost, but they have a significantly greater tendency to overestimate benefits than costs. Since our convenience sample was small further research is needed to determine if systematic errors are foreseeable and correctable.

In conclusion, the way to improve the positive impact of the use of benefit-cost analysis can have on the well-being of society is not by reinvention. We do need to continue to improve, most likely incrementally, BCAs quality and utility by systematically examining its record and results.

Thank you.