Is Cost-Benefit Analysis a Panacea for Administrative Law?

by Cass R. Sunstein

Both administrative law and cost-benefit analysis are nowadays popular subjects among all three branches of the federal government. During the past 10 years, the courts have often required administrative agencies to justify their decisions by showing that the "benefits" outweigh the "costs." Congress has expressly required cost-benefit analysis, forcing agencies to show that the benefits of regulation are greater than the costs. Our last four presidents have shown similar enthusiasm for cost-benefit principles. Most recently, President Reagan has signed an executive order stating that agencies may not issue expensive rules unless "the potential benefits to society... outweigh the potential costs to society."

It is not hard to understand this enthusiasm for cost-benefit analysis as a tool for improving the performance of administrative agencies. Recent studies, many of them coming from or based on the work of lawyers and economists from the University of Chicago, have tended to show that regulation often reduces rather than improves economic welfare. Indeed, agencies sometimes impose costly regulatory requirements that do little to help the supposed beneficiaries. (Certain occupational safety and health requirements are frequently given as examples.) Cost-benefit analysis, designed to ensure that regulation helps rather than hurts, promises to provide a remedy for these problems.

I want to explore here some of the most important questions raised by the use of cost-benefit analysis for remedying defective performance by administrative agencies. The first problem is one of definition. What does cost-benefit analysis mean? It is sometimes suggested that cost-benefit analysis is simply a rough tool for weighing the advantages and disadvantages of regulation. In this view, President Reagan's executive order amounts to little more than an echo of a conventional principle of administrative law—that an agency's decision must not be "arbitrary or capricious." Cost-benefit analysis thus becomes a means of making sure that agency decisions are reasonable and that they do not impose costs that are disproportionate to their benefits.

The virtue of this definition is its flexibility. Who would object to a principle that prevents administrators from taking action having costs that are disproportionately high? But the virtue of this approach is also its vice, for it renders cost-benefit analysis almost wholly indeterminate. The critical questions become ones of valuation—how much does one value a certain gain in health or life? How important is it to reduce the incidence of racial discrimination? What price should be paid to justify the benefits that would be gained by mandatory seat belts? All of these questions cannot be answered simply. Numerical values must be used in cost-benefit analysis, and therein lies the problem. There must be some more specific notion of how costs and benefits are to be valued. As a result, cost-benefit analysis—if it is merely a principle of proportionality—states a truism that is apt to be of little or perhaps no help to regulators.

This critique of cost-benefit analysis—the critique from indeterminacy—depends not at all on an argument that it is in some sense immoral or unethical to put a price tag on such things as life or health. That argument has undoubted appeal, but in a world of scarce resources, there is some limit to the amount that one would pay, for example, to diminish the incidence of cancer due to carcinogens in the workplace. Perhaps regulatory decisions should not be made to depend on an effort to maximize social wealth—a question I take up below. But no matter what approach one takes to regulation, it will be necessary to decide that some prices are simply too high to be worth paying.

Thus far I have suggested that if cost-benefit analysis means a rough weighing of the advantages and disadvantages of regulation, it is simply too vague to be of much use for actual decisions. But in setting forth the notion of cost-benefit analysis, economists have something in mind other than a rough, ad hoc assessment of advantages and disadvantages. In their view,
costs and benefits are measured far more rigorously—by seeing how much people are willing to pay for the item in question. To speak in rough and general terms: The benefits of pollution regulation, for example, would be measured by the willingness of those subject to pollution to pay for the regulation. Aggregate willingness to pay would in turn be compared with the costs of regulation, which would include the amount those subject to regulation would have to expend, and also the administrative costs of the regulatory scheme. The same would be said of regulation of race and sex discrimination, of safety in the workplace, and so forth. There are of course formidable difficulties in finding out how much people are willing to pay for these things, but that is a practical and not a theoretical problem.

In this light, what is one to say about efforts by the courts and the executive branch to make the decisions of administrative agencies depend on application of cost-benefit analysis? One obvious problem is that few believe that, as a general rule, Congress passes regulatory statutes in order to promote economic efficiency. Indeed, Professor George Stigler’s Nobel Prize was awarded in large part because of Stigler’s efforts to demonstrate that regulation is often designed not to maximize wealth, but to redistribute it. Laws forbidding racial discrimination and protecting wilderness areas are not, in this view, best understood as efforts to increase the size of the pie; they are instead designed to transfer resources and opportunities from certain segments of the public to another.

Some have criticized this “interest group theory” of the legislative process and suggested that regulation is not about the allocation and transfer of resources at all. In their view, legislation is an effort to decide upon and implement certain widely held public values. But the proponents and the critics of the interest group approach are agreed on one fundamental thing: that as a general rule, regulatory statutes do not, in purpose or in effect, promote efficiency.

In these circumstances, judicial and executive branch efforts to make regulatory decisions on the basis of cost-benefit analysis, economically defined, raise serious questions of separation of powers. The executive is supposed to execute the laws, not to make them. If the executive decides to implement a statute only when implementation is “efficient” under the standards of economic efficiency, he will (often) be violating the intent of Congress. If those who passed a regulatory statute did so in order to do something other than promote efficiency, the executive has no authority to decide that regulatory decisions will be made by applying economic principles of cost-benefit analysis. So too with the courts, which are charged with interpreting and applying, not rewriting, the law.

To say all this is to suggest that courts and administrators are often prohibited from making regulatory decisions on the basis of cost-benefit analysis, economically defined. (It is not, of course, to say that decisions may not be based on a rough balancing of advantages and disadvantages; and it is not to deny that some statutes can be understood as efficiency-promoting.) But what of Congress? Shouldn’t Congress design statutes so as to promote efficiency? Some bills now pending in Congress would amend all regulatory statutes to ensure that regulatory action could be taken only when the benefits outweigh the costs. Those bills would drastically alter a number of existing regulatory provisions, including, for example, those that regulate cancer-causing and other substances and hazardous conditions in the workplace. Should those bills be enacted?

This is a large and difficult question, and I can only outline some of the relevant considerations here. First, cost-benefit analysis, economically defined, takes the status quo—including the existing distribution of income—for granted. Willingness to pay is inevitably a function of ability to pay. But regulation often should not assume that the existing distribution is perfect; indeed, regulation is often a referendum on the current distribution.

Second, cost-benefit analysis, taken by itself, does not easily square with an approach that is deeply engrained in American law—one that understands the law as a means of protecting entitlements rather than of maximizing utility or wealth. The law of tort—and the law of racial discrimination—may be understood as concerned not with maximizing aggregate economic welfare, but with protecting a set of individual rights. Cost-benefit analysis may, to be sure, proceed after the initial set of entitlements has been established; but it does not help very much in setting that initial structure, from which willingness to pay must be measured.

Finally, regulation, and government activity in general, are often best regarded not as an attempt to serve the existing set of preferences but as an effort to reexamine them, and to decide upon those values that ought to govern the community as a whole. Economic cost-benefit analysis is generally hostile to this approach. It takes current preferences as its starting point;
costs and benefits are calculated by seeing how much people, given whatever preferences they may have, are willing to pay for regulation. But regulatory activity, I submit, often operates as an effort to scrutinize our preferences, to see whether what we now want—like pollution or discrimination—is what we should continue to want. Indeed, this process of scrutiny may be what self-government is all about.

It will be useful to conclude with a summary of my objections to cost-benefit analysis as a tool for regulatory decisions. To the extent that it is defined as a rough counting of advantages and disadvantages, it is too indeterminate to be of much help. To the extent that it is defined in economic terms, cost-benefit analysis often cannot, as a matter of separation of powers, be made the basis of decision by the courts or the president; and cost-benefit analysis, economically defined, is usually not an attractive basis for decision by the legislature.

All this is not to say that it is undesirable to identify the costs and benefits, or the advantages and disadvantages, before proceeding. Nor is it to deny that costs and benefits should sometimes be taken into account as a relevant consideration in the regulatory process. But the current enthusiasm for cost-benefit analysis should be tempered with the understanding that it is far from a panacea for the current problems of administrative regulation.

Cass Sunstein is Assistant Professor of Law.