

Measuring the impact of regulation

The rule of more

Rule-making is being made to look more beneficial under Barack Obama

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IN DECEMBER Barack Obama trumpeted a new standard for mercury emissions from power plants. The rule, he boasted, would prevent thousands of premature deaths, heart attacks and asthma cases. The Environmental Protection Agency (EPA) reckoned these benefits were worth up to \$90 billion a year, far above their \$10 billion-a-year cost. Mr Obama took a swipe at past administrations for not implementing this “common-sense, cost-effective standard”.

A casual listener would have assumed that all these benefits came from reduced mercury. In fact, reduced mercury explained none of the purported future reduction in deaths, heart attacks and asthma, and less than 0.01% of the monetary benefits. Instead, almost all the benefits came from concomitant reductions in a pollutant that was not the principal target of the rule: namely, fine particles.

The minutiae of how regulators calculate benefits may seem arcane, but matters a lot. When businesses complain that Mr Obama has burdened them with costly new rules, his advisers respond that those costs are more than justified by even higher benefits. His Office of Information and Regulatory Affairs (OIRA), which vets the red tape spewing out of the federal apparatus, reckons the “net benefit” of the rules passed in 2009-10 is greater than in the first two years of the administrations of either George Bush junior or Bill Clinton.

But those calculations have been criticised for resting on

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assumptions that yield higher benefits and lower costs. One of these assumptions is the generous use of ancillary benefits, or “co-benefits”, such as reductions in fine particles as a result of a rule targeting mercury.

Mr Obama’s advisers note that co-benefits have long been included in regulatory cost-benefit analysis. The logic is sound. For instance, someone may cycle to work principally to save money on fuel, parking or bus fares, but also to get more exercise. Both sorts of benefit should be counted.

The controversy arises from the overwhelming role that co-benefits play in assessing Mr Obama’s rule-making. Fully two-thirds of the benefits of economically significant final rules reviewed by OIRA in 2010 were thanks to reductions in fine particles brought about by regulations that were actually aimed at something else, according to Susan Dudley of George Washington University, who served in OIRA under George Bush (see chart). That is double the share of co-benefits reported in Mr Bush’s last year in office in 2008.

If reducing fine particles is so beneficial, it would surely be more transparent and efficient to target them directly. As it happens, federal standards for fine-particle concentrations already exist. But the EPA routinely claims additional benefits from reducing those concentrations well below levels the current law considers safe. That is dubious: a lack of data makes it much harder to know the effects of such low concentrations.

Another criticism of the Obama administration’s approach is its heavy reliance on “private benefits”. Economists typically justify regulation when private market participants, such as buyers and sellers of electricity, generate costs—such as pollution—that the rest of society has to bear. But fuel and energy-efficiency regulations are now being justified not by such social benefits, but by private benefits like reduced spending on fuel and electricity.

Private benefits have long been used in cost-benefit analysis but Ms Dudley’s data show that, like co-benefits, their importance has grown dramatically under Mr Obama. Ted Gayer of the Brookings Institution notes that private benefits such as reduced fuel consumption and shorter refuelling times account for 90% of the \$388 billion in lifetime benefits claimed for last year’s new fuel-economy standards for cars and light trucks. They also account for 92% and 70% of the benefits of new energy-efficiency standards for washing machines and refrigerators respectively.

The values placed on such private benefits are highly suspect. If consumers were really better off with more efficient cars or appliances, they would buy them without a prod from government. The fact that they don’t means they put little value on money saved in the future, or simply prefer other features more. Mr Obama’s OIRA notes that a growing body of research argues that consumers don’t always make rational choices; Mr Gayer counters that regulators do not make appropriate use of that research in their calculations.

Under Mr Obama, rule-makers’ assumptions not only enhance the benefits of rules but

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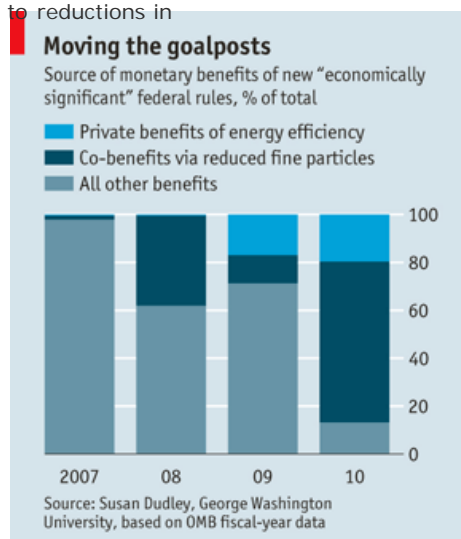
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also reduce the costs. John Graham of Indiana University, who ran OIRA under Mr Bush, cites the new fuel-economy standards as an example. They assume that electric cars have no carbon emissions, although the electricity they use probably came from coal. They also assume less of a “rebound effect”—the tendency of people to drive more when their cars get better mileage—than was the case under Mr Bush.

Mr Bush’s administration was sometimes accused of the opposite bias: understating benefits and overstating costs. At one point his EPA considered assigning a lower value to reducing the risk of death for elderly people since they had fewer years left to live; it eventually backed down. Mr Obama’s EPA has considered raising the value of cutting the risk of death by cancer on the ground that it is a more horrifying way to die than others.

More consistent cost-benefit analysis would reduce such controversies. Michael Greenstone of the Hamilton Project, a liberal-leaning research group, thinks that could be done through the creation of a non-partisan congressional oversight body using the best evidence available to vet regulations, much as the Congressional Budget Office vets fiscal policy. It would also re-evaluate old regulations to see if the original analysis behind them was still valid. Rule-making would still require judgment, but it would be less subject to the whims of the people in power.

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