

## Economics focus

**The regulators' best friend?**

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**Europeans embrace the logic of cost-benefit analysis just as some Americans grow suspicious of it**

ACCORDING to one of the European Commission's pettifogging regulations, cucumbers sold in the single market cannot be too curvy. According to another proposal, packets of coffee and chicory must conform to weights specified in Brussels.



The first regulation is largely apocryphal, a myth propagated by Euro-sceptic newspapers in Britain and debunked by the commission's team of counter-spinners. But the second regulation is quite real. It was one of several examples of regulatory overkill lambasted by Günter Verheugen, a vice-president of the commission, in a speech last month. Mr Verheugen wants to withdraw such needless regulations, simplify others and subject new proposals to "solid cost-benefit analyses".

Cost-benefit analysis—which typically quantifies the attractions and drawbacks of a regulation, converts them into dollars or euros, then tots them up—sounds both dull and innocuous. But its findings can be revealing. For example, Robert Hahn, a scholar at the American Enterprise Institute in Washington, DC, calculates that over 40% of American regulations impose costs that outweigh the benefits they confer\*. What might a similar review of the European Union's regulatory rule-book reveal? How many of the 90,000 pages of the *acquis communautaire* might be safely torn out, to the net benefit of the union?

The findings of Mr Hahn and other cost-benefit analysts in America have not passed unchallenged, however. A number of critics doubt the worth of the techniques and distrust the motives of the practitioners. They say that America's current administration is guilty of "regulatory underkill" and that cost-benefit analysis is its weapon of choice.

Whether or not this is fair to President George Bush's administration, is it fair to cost-benefit analysis? Is the method fatally flawed and intrinsically anti-regulatory? The Centre for Progressive Regulation (CPR), a think-tank that shelters many sceptics, thinks so. It objects to two features in particular: the "translation of lives, health, and the natural environment into monetary terms" and "the discounting of harms to human health and the environment that are expected to occur in the future"†.

Those who question cost-benefit analysis doubt that a price tag can ever be put on life. How could one seriously count the cost of death and injury caused by road accidents, for example? But, as Robert Frank, an economist now at Cornell University, has pointed out, even the fiercest critics do not get their brakes checked every morning. They have more pressing uses of their time. Road safety, then, does have an opportunity cost, and an economist will want to know what it is. Thus, when the CPR accuses economists of "pricing the priceless", most economists would plead guilty as charged. They devote considerable effort, and not a little ingenuity, to discovering the implicit price of many things that are not traded directly in arm's-length markets.

As the critics allege, cost-benefit analysis works like a kind of universal solvent. It breaks qualities down into quantities, differences of kind into differences of degree, gold into base metal. A safe childhood, a breathtaking view, a clean pair of lungs—all are reduced to fungible “dollar-equivalents”. In doing so, the method forces into the open trade-offs that many would rather not face too squarely. Should taxpayers' money be devoted to keeping grandmother alive for an extra month in an intensive-care unit? Or would it be better spent reducing the risk of asthma faced by deprived children in the polluted inner city? Such comparisons may seem crass. But they are democratic.

## The less sweet hereafter

Accused of pricing the priceless, economists are charged with under-pricing the future as well. Most practitioners of cost-benefit analysis assume that gains in the hereafter are worth less today than gains in the here-and-now. They discount future benefits, including lives saved, in much the same way that they discount future profits or costs.

But are lives saved 12 months' hence really worth less than lives saved this year? To say so, the critics argue, is to make a false analogy between financial resources, which can be borrowed from, or invested for, the future, and human life, which cannot. By discounting future lives, economists also further an anti-regulatory agenda, the critics allege. After all, the costs of most health and safety regulations arrive upfront. The benefits can take time to emerge.

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Discounting future lives is indeed awkward, and some economists have fretted about it for decades. But it is not necessarily anti-regulatory. If regulators discounted costs, but not lives saved, they would defer action indefinitely, Mr Hahn points out. The benefits would be the same if they waited a year (or a decade, for that matter) but the costs would always be less.

Cost-benefit analysis does not always argue for less regulation. It weeds out regulations that do not pay their way, but it can also identify measures not on the statute books, that should be. For example, defibrillators installed in workplaces might be a cost-effective way to save victims of heart attacks. The White House's Office of Management and Budget has sent about a dozen letters to the agencies it oversees prompting them to investigate such potentially beneficial regulations.

Fundamentally, it is not “anti-government” to weigh the costs of public action. On the contrary, the “regulatory excess” Mr Verheugen sees in the EU has doubtless damaged the prestige of Brussels. Some regulatory circumspection, nudged by cost-benefit sheepdogs, might even rehabilitate it. If the EU had not mandated the weights of chicory packets, perhaps people would not so readily believe that it regulates the curvature of cucumbers.

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\* “In Defence of the Economic Analysis of Regulation”. American Enterprise Institute

† “Cost-Benefit Analysis”. Available at <http://www.progressiveregulation.org/>