Cass Sunstein <csunstei@midway.uchicago.edu>
02/01/2003 11:29:11 AM

Record Type:Record

To: Lorraine D. Hunt OIRA ECON GUIDE/OMB/EOP@EOP
cc:
Subject: John_Graham@omb.eop.gov

University of Chicago Law School
1111 E. 60th Street
Chicago, Illinois 60637

Cass R. Sunstein
Karl N. Llewellyn Distinguished Service Professor of Jurisprudence, Law School and Department of Political Science
Telephone 773-702-9498
FAX 773-702-0730
e-mail: csunstei@uchicago.edu

Memorandum

To: Office of Information and Regulatory Affairs
From: Cass R. Sunstein
Date: February 1, 2003
Subject: Draft Guidelines

Here are some brief, preliminary comments on the draft guidelines. In general, they seem to me superb and to hold out considerable promise for improving both the substance and the process of regulation.

1. On market failures and other purposes: a) The discussion of information is a bit crude. The discussion should more clearly separate 1) an absence of sufficient information (para. 1) from 2) a problem in information-processing (para. 3). People might process information poorly because of rules-of-thumb (heuristics) *or* because of identifiable biases, such as optimistic bias. Contrary to para. 3, the problem of poor processing is not limited to "low probability high consequence events," as recent Nobel Prize winner Daniel Kahneman (among many others) has demonstrated. The third paragraph would be improved if redone along the following lines: "Even when information is available, people might process it poorly. They might rely on rules-of-thumb that produce errors; if an incident is cognitively "available," for example, they might overstate the probability that it will occur. People might also process information in a biased manner, for example by being too optimistic. Poor information-processing often occurs in cases of low-probability, high-consequences situations. Sometimes people focus on a bad outcome, without taking sufficient account of the fact that that outcome is exceedingly unlikely to occur. Markets may overreact or underreact accordingly. Regulators should be aware of cognitive limitations and should not adopt policies based on a misunderstanding of the underlying reality. But the mere possibility of poor information processing is not enough to justify regulation. Any such problems should be carefully documented in the particular case."

b) After the Coase theorem, it is more accurate to think of A1 as involving transactions costs, not externalities. The idea of externalities is a rough first way of getting at the fact that people are often unable to bargain their way to an efficient solution. Coase's theorem was an attack (and a successful one) on Pigou's effort to describe pollution and other problems as involving externalities. It might be that the section should be called Externalities or Transactions Costs and that a sentence should be added to the following effect: "If bargaining were costless, people could handle the problem of externalities on their own. In fact it is often more productive to see the problem of externalities as arising in situation in which transactions costs prevent people from reaching an efficient solution through bargaining." A more sophisticated treatment would say that the real problem here is one of transactions costs.

c) The "other social purposes" section reads as if it were written by an economist who hasn't thought a lot about "other social purposes"! The section might be thickened. Something along the following lines might be added: "Some regulations are designed to distribute resources to groups that are deemed especially deserving. (Note, however , that any effort at redistribution should be both effective and cost-effective, and that regulation is sometimes an unsuccessful way of redistributing resources to those who are needy.) Some regulations are designed to forbid discrimination on grounds that are deemed to be unacceptable. Some regulations are designed to promote democratic aspirations, such as the aspiration to greater privacy."

2. On alternative approaches: II(I) is excellent, but several qualifications should be added about information processing. One possibility: "There is a risk that informational measures will be ineffective if people will not properly process information. In the domain of social risks, some informational campaigns create excessive fear; others induce too little in the way of behavioral response. It is important to devise informational measures with careful attention to how people process what they read or hear."

3. Section IIID, suggesting attention to distributional effects, is a large advance. I would suggest only a little more concreteness, as in: "Sometimes regulation imposes especially high costs on those least able to afford those costs. Sometimes the benefits of regulation accrue to the most disadvantaged members of society. In either case, this should be disclosed."

4. Section IV(B)(2) contains errors. It is not true that WTP and WTA are comparable "when the change being evaluated is small," as many studies have demonstrated. (The most prominent such study is by Kahneman, Knetsch, and Thaler in the Journal of Political Economy.) Nor is it true that the two are comparable "when there are reasonably close substitutes available." The last sentence ("Adoption of . . .") is also untrue. WTA has the same implication. The correct sentence is the "more readily measurable" one. It should probably be acknowledged that WTP and WTA often diverge, sometimes very substantially. But if WTP is to be preferred (as I tend to think it should be), this might be stated explicitly, with the suggestion that WTA raises some serious measurement problems and there are reasons to question whether it really reflects valuation.

5. The discussion of contingent valuation is excellent, but it might be stressed, somewhat more, that substantial questions have been raised about the reliability of even "best" practice contingent valuation. Perhaps more could be said to check the validity of the answers, eg to ensure that they are not entirely out of line with market behavior and government expenditures. (If contingent valuation produces numbers that look like a large fraction of GDP, there is probably a problem.)

6. I might have missed it, but there appears to be no concrete guidance about appropriate numbers for agencies to use in valuing regulatory benefits, such as mortality and morbidity gains. Agencies use sharply divergent numbers for valuation, which leads to apparent arbitrariness, and which also risks both excessive and insufficient controls. It would be appropriate for OIRA guidelines to specify either (a) presumptive values for a life-year and for a statistical life or (b) a range of appropriate values for both of these. The specified range might be for 2003, with a notation that it should be updated for inflation. As the guidelines recognize, context matters: If an agency would like to depart from the presumptive value, or from the specified range, it might be asked to explain the reasons for the departure. A more minimal step would be simply to list the ranges that existing studies suggest are appropriate. If for some reason any step of this kind seems inappropriate, the guidelines might say that OIRA will work with agencies to ensure reasonable monetary values for mortality and morbidity effects, and also to ensure a degree of coherence across agencies.

7. Because agencies have long shown a mixed record of compliance with OIRA guidelines, it would be valuable for the President or the Vice President to accompany the final guidelines with a statement of some sort, indicating a commitment to improved regulation. One value of these guidelines is that they have a strong nonpartisan "feel" and should appeal to people from across the political spectrum.

I hope that these brief comments are helpful.