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Why Benefits and Costs Matter

by Alan Randall

We seem to be hearing more and more proposals for systematic benefit-cost analysis (BCA) of regulatory actions, with a clear presumption that those who do not pass the benefit-cost test are, to say the least, suspect. Opposing this suggestion are those who claim, for a variety of reasons, that benefits and costs are not appropriate considerations when deciding policy issues involving human health and safety and, perhaps, environmental quality.

Calls for routine use of BCA are not new: BCA already enjoys a considerable role in public affairs. In 1937, the Flood Control Act famously provided that federal funds could be spent on water resource projects so long as "the benefits to whomsoever they accrue exceed the costs." Ronald Reagan's 1981 Executive Order required BCA for a broad range of regulatory initiatives. Well-entrenched executive agency practice now considers benefits and costs routinely, to evaluate all manner of projects, programs, and policies undertaken by national, state, and local governments. Over this sixty-year period, textbook benefit-cost analysis has evolved from a relatively crude financial feasibility analysis for capital-intensive public works to a rigorous application of the economic-theoretic principles of welfare change measurement based on the compensation test. The test is passed if those who would gain from implementing the proposal could (hypothetically) compensate those who would lose. Actual agency practice has come to incorporate many but not all of the textbook theoretical niceties.

Nevertheless, the current enthusiasm in some circles for an expanded public role for BCA raises some obvious questions: Should a society commit to deciding public issues on the basis of benefits and costs? Should a society regard benefits and costs as relevant information for its public decision processes? And, what good reasons can be given to support affirmative answers to either or both of these questions?

The standard justifications that economists give for systematic consideration of benefits and costs in public policy are not entirely convincing to philosophers or the general public. Nevertheless, good arguments can be found for taking benefits and costs seriously in public policy (but not for according them a decisive role in every case). These justifying arguments, however, have important implications not only for the role that BCA might play in public decisions, but also for the way BCA should be done.

Economists' justifications

When called upon to justify the systematic use of BCA in public decision processes, economists are likely to start talking about the need to impose a market-like efficiency on the activities of government (for example, Arrow et al. 1996). After all, efficiency is simply the avoidance of waste, and who could be seriously in favor of waste! However, this justification is not as convincing to citizens at large as it is to economists.

First, a case has to be made that the efficiency of markets is, in fact, good for society. Perhaps we can do little better than the philosopher Jules Coleman who has argued that the virtues of market institutions (including, but not limited to, their efficiency properties) make them broadly acceptable for taking care of those kinds of human affairs that are not especially contentious, but that political institutions are required to deal with the really contentious issues of public concern. For example, many human concerns can be resolved through arms-length market transactions secured by property rights, but the definition of those rights—a much more contentious matter—is inherently a function of government. In other words, the justification for market institutions applies to those human concerns that remain after some prior assignment of the contentious issues to the political sphere.

Second, having found some virtue in market institutions for handling some appropriate set of human concerns, it is then necessary to argue that society ought to require market-like efficiency in the remaining, more contentious, undertakings that have been assigned to government. Mark Sagoff, also a philosopher, is most vigorous in rejecting this argument. He asserts that it is a simple category mistake to inquire about the efficiency of a governmental undertaking: government is exactly that institution that human societies invoke when they choose, for their own good reasons, not to be efficient. It is easy to play Sagoff's argument for cheap laughs ("Of course! What better institution than government, if the goal is to be inefficient!"),

but his point is not entirely frivolous. Efficiency is a harsh and uneven discipline, and it is by no means clear that society ought to impose that discipline on everything that it does.

Third, economics-style efficiency in fact carries a lot of baggage along with its superficially uncontroversial goal of avoiding waste. It judges actions according to the goodness of their consequences; and it judges goodness to the individual in terms of welfare, and goodness to society by adding up welfare changes across individuals, without reference to distributional concerns. BCA uses numerical values based on preference satisfaction weighted by endowments, a practice that makes the preferences of the well-off count for more, reinforcing the distributional status quo (this is true of all the economist's standard value-measures: buyer's best offer, seller's reservation price, and equilibrium price). And, this baggage is itself a source of controversy.

So, we must dig deeper for good reasons to take benefits and costs seriously in public policy. It is useful to start by observing that—despite some legitimate concerns about endowment-weighted values—benefits and costs, when measured rigorously according to the compensation-test criterion, provide a fairly good account of contribution to preference satisfaction. Then, we can ask why society should take seriously, in its policy decision processes, an account of contribution to preference satisfaction.

Moral theories

The theory that right action is whatever satisfies preferences is most readily understood as a particular version of the more general moral theory that goodness is a matter of value (Vallentyne): what matters about an action is its consequences, and consequences are valued according to their contribution to preference satisfaction. However, this justification of an efficiency test is unlikely to be entirely convincing to all who take the view that goodness is a matter of value. Many would argue that considerations of value cannot be confined to consequences alone and, furthermore, that there are all manner of consequences not readily reduced to welfare but nevertheless worthy of consideration when evaluating the goodness of an action to an individual or to society. Examples might include consequences for the survival of species, habitats, and rural communities. (Yes, I know there are economists who readily evaluate such concerns in welfare terms, but the point is that it is perfectly coherent to resist, for good reasons, doing so.)

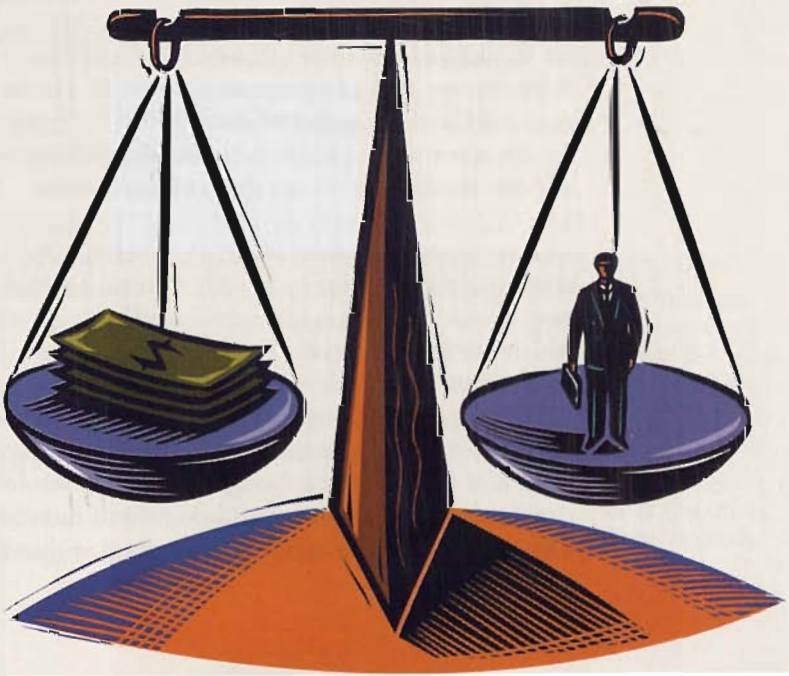
The value theory of goodness is but one of the two major branches of Western moral philosophy. The alternative view asserts that goodness is not confined to considerations of value, so there may be good reasons to rule out by constraint some possible actions (Kagan). Some adherents of this view would rule out actions that transgress moral duty, an approach founded in the writings of Immanuel Kant; others would restrain actions that threaten to violate individual rights. Economists are familiar with the rights-based perspective, which undergirds the contractarian justification of voluntary exchange. However, economists often find Kantian ethics bewildering, with its insistence that moral and prudential reasoning are quite distinct, and that universal moral imperatives can be found from which to deduce rules for action in practical situations. For example, the argument of Kantian origin—that natural entities may have intrinsic value, and humans may have moral duties toward such entities—is quite foreign to many economists but is not to many educated laypersons.

To recap, the theory that goodness is a matter of preference satisfaction underpins the economists' justification of BCA, but it is merely one particular and controversial version of one of the two main branches of Western moral philosophy.

Moral pluralism

A broad acceptance seems to be emerging among Western philosophers that the contest among the competing ethical theories, in their various formulations, is likely to remain inconclusive (Williams). While each has powerful appeal, each is incomplete in some important way, each remains vulnerable to some serious avenue(s) of criticism, and it seems unlikely that any one will defeat the others decisively.

Among those who seek ethical grounding for policy prescriptions, two kinds of pluralism have emerged. The more traditional kind seeks to cultivate an intellectual environment in which people who hold resolutely to different foundational ethics can nevertheless find agreement on particular



real-world policy solutions. Agreement might be reached, for example, that real resources should be expended to protect natural environments, among people who would give quite different reasons as to why that should be so. The task of the thoughtful moral agent in the policy arena is, it follows, to find heuristics—rules for action—that can command broad agreement.

The second kind of pluralism imagines thoughtful people calling upon different ethical traditions to answer different kinds of questions in their own lives. To this way of thinking, if the search for the single true, complete, and internally consistent ethical theory is bound to be fruitless, exclusive allegiance to any particular moral theory is hardly a virtue. It becomes coherent to argue that some questions in life are best resolved by reference to moral imperatives, some as matters of respect for rights, and for the remainder it is reasonable to go about maximizing value, perhaps even focusing on consequences and evaluating them in terms of preference satisfaction.

Taking seriously both kinds of pluralism encourages us to think of the policy process as a search for heuristics we can agree upon, and to accept that these heuristics are likely to incorporate insights from various moral theories. The question that motivates this enquiry becomes, Would a society of thoughtful moral agents agree to take seriously an account of benefits and costs, within some more complete set of heuristics?

Public roles for benefit and cost information

Benefits and costs cannot count for everything. Donald Hubin asks us to consider benefit-cost moral theory: the theory that right action is whatever maximizes the excess of benefits over costs, as economists understand the terms benefit and costs. It is hard to imagine a single supporter of such a moral theory, among philosophers or the public at large. Instead, we would find unanimity that such a moral theory is inadequate, and an enormous diversity of reasons as to exactly why. Even as we concede that the search for the one true moral theory is bound to fail, benefit-cost moral theory is not a plausible contender.

Benefits and costs must count for something. Preference satisfaction matters morally. It turns out that one cannot imagine a plausible moral theory in which the level of satisfaction of individual preferences counts for nothing at all (Hubin, Randall). Examining a broad array of contending moral theories, preference satisfaction counts for something, in each of them. (Even a thoughtful Kantian would concur that there exists a broad domain of human concerns where happiness may be pursued without violating moral strictures, and, within that domain, more preference satisfaction is better than less).

So the issue is not whether benefits and costs are morally considerable; clearly they are. The interesting questions are about what sorts of considerations might trump preference satisfaction, and in what ways. What else, beyond preference satisfaction, might one want to consider, and in what manner might one want to take account of those things? One approach treats benefit and cost information as simply one kind of decision-relevant information.

Benefit-cost analysis to inform decisions, rather than to decide issues. Since preference satisfaction is a consideration under any plausible moral theory, an account of benefits and costs might be used routinely as a component of some more comprehensive set of evidence, accounts, and moral claims to inform the decision process. The notion that benefits and costs cannot always be decisive in public policy, but should nevertheless play some role, is congenial to many economists (for example, Arrow et al., p. 221). However, it leaves unanswered the question of exactly what role. Are there particular situations and circumstances in which an account of preference satisfaction should be ignored entirely, and others in which it should be decisive? How should an account of preference satisfaction be weighted relative to other kinds of information? Can the answers to these questions be principled, or must they always be circumstantial?

These unanswered questions are most worrisome if one imagines a technocratic policy process: if we are to entrust decisions to the technocracy, we would surely want to give it more guidance about how to decide. However, if we have a pluralistic policy process in mind, the concern is not so great: these unanswered questions would be resolved in pluralistic discourse.

A benefit-cost decision rule subject to constraints. An alternative way of coming to terms with the idea that preference satisfaction counts for something in any plausible moral theory, but cannot count for everything, is to endorse a benefit-cost decision rule for those issues where no overriding moral concerns are threatened. Benefits and costs could then be decisive within some broad domain, while that domain is itself bounded by constraints reflecting rights that ought to be respected and moral imperatives that ought to be obeyed. This would implement the commonsense notion that preference satisfaction is perfectly fine so long as it doesn't threaten any concerns that are more important.

To free individuals for the pursuit of happiness, constraints securing some well-defined set of human rights seem essential. If the beneficence of reasonably free markets is to be enjoyed, a set of

secure property rights is also necessary. People acting together to govern themselves need also to establish a framework of laws, statutes, regulations, and policies, to legitimize and also to limit the role of activist government. The constitution was designed with exactly these concerns in mind.

To take this idea beyond the well-known protections for life, liberty, and property, consider a set of policy issues familiar to environmental economists: the protection of habitats, species, and particular ecosystems. A society could adopt the practice of deciding these kinds of issues on the basis of preference satisfaction, but subject to some kind of conservation constraint. A safe minimum standard (SMS) of conservation has been suggested by a variety of authors: harvest, habitat destruction, etc., must be restricted in order to leave a sufficient stock of the renewable resource to ensure its survival. The SMS constraint makes most sense when cast transparently as a discrete interruption of business-as-usual, imposed to act upon firm—and often nonutilitarian—intuitions that to permit destruction of a unique renewable resource would be foolish and (perhaps) morally wrong.

The general form of such constraints might be "don't do anything disgusting." The basic idea is that a pluralistic society would agree to be bound by a general-form constraint to eschew actions that violate obvious limits on decent public policy. This kind of constraint is in principle broad enough to take seriously the objections to unrestrained pursuit of preference satisfaction that might be made from a wide range of coherent philosophical perspectives. Examples of such constraints might include "don't violate the rights that other people and perhaps other entities might reasonably be believed to hold"; "be obedient to the duties that arise from universal moral principles, or could reasonably be derived therefrom"; and "don't sacrifice important intrinsic values in the service of mere instrumental ends." In each of these cases, the domain within which pursuit of preference satisfaction is permitted would be bounded by nonutilitarian constraints, and these constraints themselves would be determined in pluralistic processes.

Implications for doing benefit-cost analysis

While the above argument endorses a significant but restricted public role for BCA as an account of preference satisfaction based on welfare-theoretic principles, not all accounts presented to public decision makers and labeled as BCAs are rigorously compensation-test based. Some still bear clear evidence of BCA's roots in financial feasibility analysis. In some cases, the rules for doing BCA have themselves become the subject of policy, so that deviations from the principles of welfare change measurement are institutionalized. Examples include the mandated use of discount rates that deviate from the real social opportunity cost of capital, and willingness-to-pay (WTP) measures of costs (for example, WTP to avoid losing access to a preferred resource) rather than the theoretically correct "compensation demanded" measure.

If BC analysts wish to claim, based on arguments such as are provided in this essay, that the public has a duty to take BCA seriously, then the analysts themselves have a duty to implement the compensation-test valuation framework rigorously and carefully. The result would be BCAs that depart from customary practice—to the extent that customary practice retains some remnants of BCA's roots in financial feasibility analysis—in several ways. Less attention would be paid to market prices and demands, while more attention would be paid to public preferences for public goods and the nonmarket values those preferences imply, and to willingness-to-sell as the appropriate measure of costs. We found, much earlier in this essay, that a claimed need to impose a market-like efficiency on the activities of government provides an implausible justification for taking benefits and costs seriously. Now, we find that a sounder justification for BCA entails an obligation on the part of the analyst to pay more-than-customary attention to preferences and less-than-customary attention to market outcomes. ■

■ For more information

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