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The Empty Call for Benefit-Cost Analysis in Financial Regulation

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Abstract

The call for benefit-cost analysis (BCA) in financial regulation misunderstands the origins and utility of BCA as a guide to administrative rule making. Benefit-cost analysis imagines an omniscient social planner who can calculate costs and benefits from a natural system that generates prices (costs and benefits) that do not change (or change much) no matter what the central planner does. For example, the toxicity of chemicals, the health hazards of emissions, the statistical value of life—these do not change in response to health-and-safety regulation. For the financial sector, however, the system that generates costs and benefits is constructed by financial regulation itself and the subsequent processes of adaptation and regulatory arbitrage. An important new rule will change the system beyond our calculative powers. Instead of weighing costs and benefits, financial regulation necessarily is based on a series of trade-offs of normatively derived values, which may entail principles of pragmatic design.