

Chapter 3

Statement of Need for Policy Action

A clear *statement of need for policy action* is an essential component in economic analyses of environmental policy prepared for economically significant rules.¹ This chapter discusses the key elements that comprise this statement:

- **Problem Definition:** Section 3.1 provides components to include in a definition of the environmental problem to be addressed;
- **Reasons for Market or Institutional Failure:** Section 3.2 identifies factors relevant to an analysis of the reasons existing legal and other institutions have failed to correct the problem; and
- **Need for Federal Action:** Section 3.3 describes items to consider in preparing a justification of the need for federal intervention instead of other alternatives.

The statement of need for policy action should also describe any statutory or judicial requirements that mandate the promulgation of particular policies or the evaluation of specific effects pertaining to the action. In some instances, statutes prohibit the use of certain types of analysis in policy making. In these cases, the guidance presented in *Guidelines* should be applied in a manner consistent with such mandates.

3.1 Problem Definition

The problem definition discussion should briefly review the nature of the environmental problem to be addressed. The following considerations are often relevant:

- The primary pollutants causing the problem and their concentration;
- The media through which exposures or damages take place;
- Private and public sector sources responsible for creating the problem;
- Human exposures involved and the health effects due to those exposures;

- Non-human resources affected and the resulting outcome;
- Expected evolution of the environmental problem over the time horizon of the analysis;
- Current control and mitigation techniques;
- The amount or proportion (or both) of the environmental problem likely to be corrected by federal action.

3.2 Reasons for Market or Institutional Failure

After defining the problem, the statement of need should examine the reasons why the market and other public and private sector institutions have failed to correct it. This identification is an important component of policy development because the underlying failure itself often suggests the most appropriate remedy for the problem.

¹ EO 12866 states that “Federal agencies should promulgate only such regulations as are required by law, *are necessary to interpret the law, or are made necessary by compelling need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people...*” (emphasis added). EO 13422 extended the requirements in EO 12866 to guidance documents, but has since been revoked.

OMB's *Circular A-4* discusses three categories of market failure, including externalities, market power, and inadequate or asymmetric information.² *Circular A-4* also points out that there may be other social purposes for regulation beyond correcting market failures, such as improving government function, removing distributional unfairness, or promoting privacy and personal freedom. Externalities are the most likely cause of the failure of private and public sector institutions to completely correct environmental damages. However, information asymmetries and pre-existing government-induced distortions can also be responsible for these problems.

Externalities occur when the market does not compensate for the effect of one party's activities on another party's well-being. Externalities can occur for many reasons, for example, high transaction costs can make it difficult for injured parties to ensure that polluters internalize the cost of damage through bargaining, legal, or other means. Externalities can also result when activities that pose environmental risks are difficult to link to the resulting damages, such as those that occur over long periods of time or those that are transferred from one location to another.

Consistent with EO 12866, the statement of need should assess the significance of the problem. Economic analyses should explore, for example, why transaction costs are high or what information asymmetries exist. Similar analyses are appropriate for situations where other factors are responsible for the failure of the market or public and private sector institutions to adequately address an environmental problem.

3.3 Need for Federal Action

The final component of the statement of need for policy action is an analysis of why a federal remedy is preferable to actions by private and other public sector entities, such as the judicial system or state and local governments.³ Federal involvement is often required for environmental problems that cross jurisdictional boundaries (for instance, international environmental problems). In some cases, federal involvement is mandated by statute or EO as described in Chapter 2. This analysis should justify the basis for federal involvement by comparing it to the performance of a variety of realistic alternatives that rely on other institutional arrangements. This component of the statement of need for policy action should verify that the proposed action is within the jurisdiction of the relevant statutory authorities, and that the results of the policy will be preferable to no action. Finally, the statement of need should identify any aspects of the regulations being proposed that are necessitated by statutory requirements rather than being discretionary, as this may have an influence on the development of the economic analysis and presentation of the results.

2 For further discussion of market failure, see Perman et al. (2003), Hanley et al. (2001), and Nicholson (1995).

3 See EO 13132 on "Federalism" for introductory statements regarding principles of federalism, and a section describing the special requirements for preemption.