

Comments on Proposed New Executive Order on Federal Regulatory Review
(74 Fed. Reg. 8819)

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I have four brief comments on the proposed Executive Order: (1) on the role of cost-benefit analysis; (2) pertaining to the discount rate used in cost-benefit analysis; (3) concerning the valuation of human lives in cost-benefit analyses; (4) relating to OMB's review of agency cost-benefit analyses.

- 1) The role of cost-benefit analysis in federal agency decision making should be generally guided by Kenneth Arrow et al., "Is There a Role for Benefit-Cost Analysis in Environmental, Health, and Safety Regulation?," 272 *Science* 221 (April 12, 1996). The most important point of that article, in my view, is that major regulatory decisions should be *informed* but not necessarily determined by cost-benefit analyses.
- 2) Under past and current Executive Orders, the OMB *mandates* a 7 percent social discount rate for all federal agency cost-benefit analyses, but *permits* the use of alternative rates, such as 3 percent. I do not believe any economist outside of conservative think tanks, regulated industries, or the OMB itself believes that 7 percent is an appropriate base rate to use for discounting the future costs and benefits of environmental, health and safety regulations. There are several reasons why such regulations are different from normal market investing, where a 7 percent discount rate (or even higher) might make sense. For one, government "investments" in public and environmental health and safety have returns over much longer periods than market investments. We simply don't know the market rate of return for investments over 50+ year periods because investors typically are seeking returns on investments over 5-, 10-, or at most 20-year periods. Second, government expenditures on environmental protection and public health are often designed to reduce risks that are externalized from private market investments that can provide higher returns specifically because they externalize costs.

OMB should require different base discount rates for different kinds of federal agency activities. Where an agency, such as the Bureau of Reclamation, is planning an investment designed primarily to generate economic returns (not necessarily to the government itself), a market-based discount rate is appropriate. But where a government agency is acting to internalize or at least offset social costs generated by private economic activities, it should use a discount rate based on a risk-free rate of return, and should seriously consider hyperbolic discounting, with rates that decline over periods of time. In this it would find guidance in UK Treasury's "Green Book," which provides the following schedule of discount rates:

Table 2. UK Treasury's Schedule of Declining Long-Term Discount Rates	
<i>Period of years</i>	<i>Discount rate (%)</i>
0-30	3.5
31-75	3
76-125	2.5
126-200	2
201-300	1.5
300+	1

Source: Her Majesty's Treasury,
Greenbook: Appraisal and Evaluation in
Central Government, Annex 6, Table 6.1

Similarly, OMB can find guidance on the appropriate discount rate for long-term environmental policies, such as climate change policy, in a survey Harvard economist Martin Weitzman's conducted of more than 2,000 of his fellow economists about their "professionally considered gut feelings" about the appropriate rate for discounting future costs and benefits from a climate change policy. Weitzman aggregated their responses in the table below.

Table 1. Aggregation of Economists' Recommended Discount Rates for Climate Change Policy	
<i>Time from present</i>	<i>Discount Rate (%)</i>
1-5 years	4
6-25 years	3
26-75 years	2
76-300 years	1
More than 300 years	0

Source: Martin Weitzman, *Gamma Discounting*, 9 AMER. ECON. REV. 260, 261 (2000).

- 3) On the valuation of statistical lives in cost-benefit analyses, OMB should avoid applying different values depending on the age of affected populations. There is no basis in economic theory for assuming that the life of an older person is worth less than the life of a younger person. As Dean Richard Revesz of the NYU Law School has explained, the basic economic theory of scarcity suggests that someone with fewer good years

remaining is likely to value those years more highly than someone with more good years remaining.

- 4) OMB has a fairly well-deserved reputation as an anti-regulatory agency, in part because it has used cost-benefit analysis to retard regulatory processes, including in some cases substituting its own numbers for those of the agencies. Meanwhile, in other cases, where agencies have clearly fudged the numbers, as with the EPA's infamous cost-benefit analysis to promote the Bush Administration's "Clear Skies" program (which was exposed by the Congressional Research Service), the OMB did nothing. If the OMB wants to be viewed as a neutral arbiter, rather than an anti-regulatory agency, it needs to (a) avoid substituting its judgment for the proper discretion of agencies preparing cost-benefit analyses, and (b) consider when it might promote *more*, rather than less, regulation, e.g., through the use of regulatory prompt letters.