Accounting Methods for Calculating Costs under Executive Order 13771

Executive Order 13771 required agencies to eliminate two regulations for each new regulation and to impose no net regulatory costs in Fiscal Year 2017. In the *Regulatory Reform Status Report: Two-for-One and Regulatory Cost Caps,* the Office of Information and Regulatory Affairs (OIRA) summarizes agency progress under EO 13771. In order to ensure consistent and comparable accounting of costs and cost savings, OIRA has worked with agencies to apply the same analytical assumptions to all regulatory actions.

Because EO 13771 requires a regulatory cost cap, agencies need an accounting method that allows for a comparison of the costs of regulatory actions to the cost savings of deregulatory actions. A challenge arises, however, because the analyses accompanying regulations often estimate impacts over different time periods, which makes it difficult to compare costs and cost savings across regulatory actions.

To allow for cost comparisons under EO 13771, agencies have applied the same time horizon to all regulatory actions and assumed that the impacts of regulations continue in perpetuity. A perpetual time horizon reflects a general presumption, for the purposes of this accounting, that regulatory and deregulatory actions are permanent. Agencies will use a perpetual time horizon unless they offer a specific and credible reason why a particular regulation's analysis requires a unique time horizon.

This accounting standardization is necessary to calculate net regulatory costs. To illustrate why, consider the differences in the following regulatory and deregulatory actions: (1) a new regulation effective indefinitely, imposing $200 million per year in costs; and (2) a new reporting requirement delayed for one year, resulting in cost savings of $200 million for only that one year. Without a uniform time horizon, these costs and savings appear to offset each other in the first year, although they have different impacts in later years. By contrast, under the uniform time horizon methodology of EO 13771, the new regulation would impose $200 million per year in costs (with a present value of $2.9 billion), and the reporting delay (with a present value of $200 million) would save the equivalent of only $14 million per year ($200 million "amortized"[1] at seven percent[2] in perpetuity). This amortization accurately reflects that a one-time $200 million savings should not offset a regulation that costs $200 million each year.

Finally, for the purposes of EO 13771, the agencies will often present estimates of impacts using both annualized and present values, which are standard economic concepts that represent different formats of the same information. Present value is akin to the full value of a loan, while the annualized value is akin to the equal periodic payments occurring once per year, as illustrated in the example above.

[1] "Amortization" is the process of converting a one-time value to equal annual amounts that, taken together, are worth the same as the one-time value. In the case of a perpetual time horizon, a useful way to think of it is that $200 million in a savings account that pays a seven percent interest rate will generate $14 million in interest in perpetuity.

[2] For purposes of EO 13771 accounting, we use a seven percent discount rate for simplicity and clarity. OMB Circular A-4 requires the use of both three and seven percent for cost-benefit analysis under EO 12866. The choice of discount rate, however, matters less when comparing costs and cost savings across actions than it does in the cost-benefit analysis of a particular rule, where benefits never accrue substantially before costs. By contrast, there is no such predictability regarding the timing of the costs of one action and the cost savings of another action. Either may precede the other. Therefore the choice of discount rate does not tip the scales in favor of costs or cost savings.