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Joan Claybrook, President

August 15, 2001

Mr. John F. Morrall III
Office of Information and Regulatory Affairs
NEOB, Room 10235
725 17th Street, N.W.
Washington, D.C. 20503

Re: Comments on the 2001 Draft Report to Congress on the Costs and Benefits of Federal Regulations [66 FR 22041, May 2, 2001]

Dear Mr. Morrall:

Public Citizen is a non-profit consumer advocacy organization with 150,000 members nationwide.¹

We are writing in response to your May 2, 2001 notice in the *Federal Register*,² 66 FR 22041, regarding

¹ For 30 years, Public Citizen has had direct, practical involvement with a wide variety of federal health and safety protections. For example, Public Citizen's Litigation Group has represented consumer groups, labor unions, worker groups, and public health organizations in standard-setting proceedings and in litigation involving OSHA, EPA, FDA, USDA, NHTSA and other health and safety agencies. Public Citizen's Health Research Group is the nation's leading advocate for safe drugs and medical devices and has also worked extensively on ways that federal agencies can improve the healthcare delivery system, and protect worker health and safety. Public Citizen's Critical Mass Energy and Environment Program is playing a leading role protecting consumers' rights in the electricity deregulation debate, in testimony on rising gasoline prices and on issues of nuclear safety, and also advocates for strong food safety regulations related to the questionable technology of food irradiation. Public Citizen has also played a critical role in advocating for and participating in the enactment of legislation and the implementation of numerous federal highway and transportation safety standards.

Public Citizen is also a member of Citizens for Sensible Safeguards (CSS), a broad-based coalition of consumer, environmental, civil rights, labor and health care organizations opposed to legislative proposals that would undermine federal safeguards. In October 1998 we submitted joint comments on that year's OMB Draft Report to Congress on the costs and benefits of federal regulations with other members of CSS.

² 66 FR 22041, May 2, 2001.

your *Draft Report to Congress On The Costs And Benefits Of Federal Regulations*. We comment on both OMB's ongoing oversight of agency cost-benefit analyses, and on the procedures used to arrive at the aggregate estimates contained in last year's final *Report to Congress On The Costs and Benefits of Federal Regulations* (hereinafter "2000 Final Report"),³ as was apparently requested in this year's *Draft Report*.

Based on our extensive real world experience, Public Citizen has consistently opposed attempts to impose standardized, uniform cost-benefit analysis mandates on federal health and safety agencies. At best, such requirements waste scarce agency resources and time. At worst, they so distort the regulatory decision-making process as to produce bad real world outcomes causing serious harm to public health, safety and the environment.⁴

Regulatory accounting -- the exercise of aggregating and monetizing the total costs and benefits of disparate public protections and then subtracting one from the other in an attempt to calculate the net benefits of all federal health and safety protections -- has the same fatal flaws. At best, OMB's past three attempts have been a monumental, complex waste of time and resources. Of what earthly use is it to the public or policy makers to know -- for example -- that OMB "...estimates for the existing costs of social regulation as of the first quarter in 1999...shows that health, safety and environmental regulation produces between \$25 billion and \$1,653 billion of net benefits per year?"⁵ Moreover, when all of the assumptions and methodological leaps of faith necessary to arrive at that result - or any such result - are considered, one

³ Report to Congress On the Costs and Benefits of Federal Regulations, June 2000, (Page cites to this document refer to page numbers in the PDF document available on OIRA's website).

⁴ Thus, for example Public Citizen opposed S.746, the Regulatory Improvement Act of 1999, which would have stalled the issuance of regulations until after the completion of a time consuming cost-benefit analysis and a prescriptive risk assessment. This bill would have blocked or weakened urgently-needed environmental and worker safety regulations. It would also have impeded the issuance of strong rules to protect nursing home patients from abuse and neglect, or to ensure access to public accommodations for persons with disabilities. Testimony of David C. Vladeck before the Senate Committee on Governmental Affairs, April 21, 1999.

⁵ 2000 Final Report at 27.

is indeed left holding a very empty bag.

Unfortunately, however, such regulatory accounting is more than a waste of time and resources. Regulatory accounting is intended by its proponents to become a basis for making decisions about federal health, safety and environmental protections that will have a real world impact. Its proponents would use aggregations of costs and benefits as the first step toward establishing a regulatory budget – a scenario where federal agencies would have to cap regulatory costs at a certain number or percentage of GDP, and, if costs exceeded that cap, agency rules would have to be eliminated and no new rules could be issued.⁶ That is one reason why the systematic bias toward understating the value of the benefits of public health, safety, and environmental protections contained in OIRA’s previous aggregate estimates is so serious.

In addition, current OMB practices and guidelines to the agencies⁷ do not reflect the high level of controversy surrounding the use of cost-benefit analysis. As two commentators note:

The reputation of cost-benefit analysis (CBA) among America academics has never been as poor as it is today, while its popularity among agencies in the United States government has never been greater. Many law professors, economists, and philosophers believe that CBA does not produce morally relevant information and should not be used in project evaluation. A few commentators argue that the information produced by CBA has some, but limited, relevance. Defenders of CBA form an increasingly beleaguered minority, consisting mostly of applied economists who feel compelled to respond to attacks on the methodological underpinnings of their work. Modern textbooks on CBA are plentiful, and some of them are optimistic about the usefulness of their procedure, but most of them frankly acknowledge its serious flaws and the inadequacy of the standard methods for correcting these flaws.⁸

OIRA has the responsibility to look beyond the publications of this “beleaguered minority” of cost-benefit analysis’ adherents, and make a legitimate effort to address the concerns of cost-benefit analysis’ many

⁶ Testimony of Gary D. Bass Before the Senate Committee on Governmental Affairs, April 22, 1999.

⁷ OMB’s Guidelines to Standardize Measures of Costs and Benefits and the Format of Accounting Statements, March 22, 2000.

⁸ Matthew D. Adler & Erica A. Posner, “Rethinking Cost-Benefit Analysis”, Yale Law Journal, November 1999.

detractors. It is outrageous that OMB still uses a seven-percent discount rate for environmental and public health benefits, and that it uses willingness-to-pay estimates to value benefits in many cases where an economic consensus exists that higher, willingness-to-accept numbers would be more appropriate.

These comments address several methodological assumptions made by the OMB that result in the 2000 Final Report's significant underestimation of the public benefits of federal health, safety and environmental regulation. As components of OMB's *Guidelines to Standardize Measures of Costs and Benefits and the Format of Accounting Statements* to the agencies,⁹ they result in significant bias against protective regulations.

Last year, OMB's response to this criticism included the following:

Two commenters stated that the report under-estimates the benefits of federal health, safety and environmental regulations (5, 22). The report specifically acknowledges that some benefits of health, safety and environmental regulation are difficult to quantify and to monetize. At the same time, is also recognizes that some costs of regulations are also difficult to quantify and monetize. For example, much of the analyses conducted by agencies quantify compliance expenditures incurred, but fail to quantify lost consumer surplus and producer surplus associated with a particular regulatory action. While the compliance expenditures may be reported, the economy-wide costs are frequently not captured. Thus, both the benefits and the costs of health, safety and environmental regulation may be understated.¹⁰

There are two major problems with this response by OMB. First, it evinces a misunderstanding of welfare economics. In cost-benefit analysis theory, the total social welfare costs of a regulation are estimated to be the sum of the changes in consumer and producer surpluses brought about by the regulation.¹¹ Rather than attempt to estimate changes in consumer and producer surpluses, practitioners tend to instead use industry compliance costs to estimate net social welfare costs. If agencies were to add changes in consumer and

⁹ OMB's *Guidelines to Standardize Measures of Costs and Benefits and the Format of Accounting Statements*, March 22, 2000.

¹⁰ 2000 Final Report at 9

¹¹ Caroline Dinwiddy and Francis Teal, "Principles of Cost-Benefit Analysis for Developing Countries," Cambridge University Press, 1996. 6-7

producer surplus to direct industry compliance costs to arrive at a net social cost figure, this double counting would result in very inflated cost estimations.

In addition, the above response indicates that OMB is insufficiently concerned with improving its benefits estimation procedures. Whether or not there are difficulties with estimating the costs of regulation, OMB is obligated to estimate the benefits of regulations as accurately as possible.

I. THE SEVEN-PERCENT DISCOUNT RATE

In responding to comments on the 1998 Draft Report to Congress on the Costs and Benefits of Federal Regulation that the practice of discounting averted deaths and other health, safety, and environmental benefits had resulted in an erroneously low valuation of these benefits, the 1998 final report offered only the following conclusory response: “Discounting is a generally agreed practice in the economics profession and required by the Best Practices document and an OMB circular.”¹² Last year, OMB responded to complaints regarding its discount rate similarly:

The report reflects the fact that the economics profession has reached a general consensus that discounting procedures are necessary to make meaningful comparisons of benefits and costs that occur in different time periods. *The Guideline to Standardize Measures of Costs and Benefits and the Format of Accounting Statements* (reproduced in the Appendix) reflect this fact. The discount rate of 7 percent is specified in *The Guideline to Standardize Measures of Costs and Benefits and the Format of Accounting Statements*, the “Best Practices” document, and the OMB Circular A-94 as the appropriate discount rate to approximate the opportunity cost of capital for incremental private investment.¹³

¹² OMB Report to Congress on the Costs and Benefits of Federal Regulations, 1998, at 96.

¹³ 2000 Final Report at 11.

This argument is unconvincing, since OMB is free to change the discount rate specified in its own circular. Moreover, discounting is *not* a “generally agreed practice” among economists, and, to the extent that there is a consensus among those who do practice it, it does not support the seven-percent rate.

Many economists have persuasively argued that human lives and other intangible goods should not be discounted at all.¹⁴ After all, “harms to future generations deserve no less protection than harms to the current generation.”¹⁵ The 2000 Final report assumes that benefits only accrue at the time the injury would have occurred, not at the time the harm is avoided. But, as Lisa Heinzerling points out, that is not at all obvious. She noted that discounting these benefits embraces “a bizarre metaphysics which holds that an illness is not prevented, nor a death averted, at the moment when it is avoided, but at the moment when the physical hardships otherwise would have become patent.”¹⁶ For these reasons, the dubious practice of discounting human lives and other goods, such as health and environmental goods, that have intangible components should be abandoned.

Moreover, although experts disagree over whether all goods may properly be discounted, to the extent that an academic consensus with respect to discounting can be said to exist, the consensus is to use the so-called “Social Rate of Time Preference” (SRTP),¹⁷ which is estimated to be a real rate of

¹⁴ Lisa Heinzerling, *Environmental Law and the Present Future*, 87 GEORGETOWN L. J. 2025 (1999); Thomas McGarity, *A Cost Benefit State*, 50 ADMIN. LAW REV. 7, 71-72 (1998) (citing Douglas E. Maclean, *Comparing Values in Environmental Policies: Moral Issues and Moral Arguments*, VALUING HEALTH RISKS, COSTS, AND BENEFITS FOR ENVIRONMENTAL DECISION MAKING 83,95 (P. Hammond & R. Coppock eds., 1990)).

¹⁵ Edward R. Morrison, *Comment: Judicial Review of Discount Rates*, 65 U. CHI. L. REV. 1333, 1339. For an excellent discussion of this topic see Heinzerling, *supra* note 5.

¹⁶ Heinzerling, *supra* note 5, at 2028.

¹⁷ In a leading textbook on benefit-cost analysis, Richard O. Zerbe stated:

It has come to be understood, from Bradford (1975), Musgrave (1969), and others, that an approach to determining the public project discount rate involves setting out the consumption that results over time from the investment and then discounting the consumption at the social rate of time preference (SRTP)[.] The SRTP is by definition the rate at which society is willing to trade off present for future consumption. The SRTP represents the marginal rate of time preference adjusted for external effects or ethical considerations.

approximately three percent.¹⁸ There is thus no sound economic basis for the continued use of the higher seven-percent rate.

Use of the seven-percent discount rate significantly undervalues all benefits that are expected to accrue in the future, and thus seriously distorts evaluation of the benefits of public protection. In his testimony before the Senate Committee on Governmental Affairs on regulatory accounting legislation, Professor Sidney Shapiro explained this point:

Consider, for example, OSHA's lockout/tagout regulation in an earlier OMB analysis. OMB has estimated the regulation costs \$70.9 billion for each premature death it prevents. OSHA, which did not discount future benefits, estimated the cost for each premature death avoided as between \$190,000 and \$1.2 million.¹⁹

In application, a seven-percent discount rate also means that saving a single life this year will be considered more valuable to society than saving ten lives thirty-five years from now. This simply does not reflect our actual preferences as a nation that cares about its children.

II. WILLINGNESS TO ACCEPT IS THE APPROPRIATE MEASURE OF THE VALUE OF MOST ENVIRONMENTAL GOODS

According to the 2000 Final Report, “[t]he benefits of environmental protection are represented by the value that society places on improved health, recreational opportunities, quality of life, visibility, preservation of ecosystems, biodiversity, and other attributes of protecting or enhancing our environment.”²⁰ We agree. However, the 2000 Final Report next asserts, without explanation, that “[t]his

RICHARD O. ZERBE, *BENEFIT-COST ANALYSIS IN THEORY AND PRACTICE* 281 (1994).

¹⁸ See, e.g., Morrison, *supra* note 7, at 1341; ZERBE, *BENEFIT-COST ANALYSIS*, *supra* note 9, at 287.

¹⁹ Testimony of Sidney A. Shapiro Before the Senate Committee on Governmental Affairs, April 22, 1999.

²⁰ 2000 Final Report at 8.

value is best measured by society's willingness to pay (WTP) for these attributes."²¹ In this section, we argue that society's willingness-to-accept (WTA) environmental harms is generally the best measure of the value of environmental protection. We argue that by using the WTP measure the 2000 Final Report grossly underestimated the value of environmental goods. Although these comments concentrate on how use of WTP rather than WTA undervalues environmental goods, the same analysis is equally applicable to valuing the benefits of other public health and safety protections.

Responding to this argument by Public Citizen last year, the 2000 Final Report acknowledged that WTA can be greater than WTP, and WTA is the appropriate measure when the public – not the polluter or potential polluter – owns the good in question. However, OMB argued that WTA is very difficult to estimate.²² While this may be true, it is an unacceptable reason to use lower WTP numbers, which, we note, are also very difficult to estimate for health, safety, and environmental goods. Since WTA is the appropriate measure for environmental and other public goods, OMB and the agencies are obligated to estimate its value as well as they can.

A. For Environmental Goods, WTA is generally many times greater than WTP

For goods traded in markets, WTP equals WTA. However, as McGarity explained, for goods not traded in markets, such as health, safety, and environmental goods,

²¹ *Id.* at 8

²² 2000 Final Report at 9

As we stated in the "Best Practices" guidance we issued in 1996, either WTP or WTA can provide an appropriate measure of benefits, depending on the allocation of property rights. We also indicated then that the common preference for WTP over WTA measures was based on the empirical difficulties in estimating the latter. In theory, the two can diverge if income effects are large, if there are no substitutes for the amenity in question, or if there is a substantial degree of "loss aversion." Empirical support for these theories is not robust, and empirical difficulties in disentangling these effects from other factors have yet to be resolved.

the two measures are not necessarily the same. For example, the amount that a person might demand to allow someone to expose him to one-in-one-thousand risk of death (under the willingness-to-sell²³ measure) probably exceeds the amount that he is prepared to pay someone to reduce an existing risk by an equivalent amount (under the willingness-to-pay criterion). The latter measure depends upon the resources available to the person; the former measure is limitless.²⁴

Indeed, this intuition has been borne out by empirical studies. Zerbe found that “[r]esearchers have demonstrated repeatedly that WTA questionnaires generate values from 3 to 19 times greater than those elicited by WTP questionnaires, as reported by one source. For environmental goods, the ratio of WTA to WTP may be as much as 142 to 1, according to another source.”²⁵

These results are unsurprising, since the poorer the substitutes for the good, the greater the divergence between WTP and WTA,²⁶ and many, if not most, environmental goods have no close substitutes.”²⁷

B. WTA is the Appropriate Measure of Value for Most Environmental Goods.

Part A, above, established that WTA is generally many times greater than WTP for environmental goods. We now explain why the OMB and the relevant agencies should use the higher WTA rate.

Id.

²³ As used by McGarity, the expression “willingness-to-sell” has the same meaning as “willingness-to-accept.” McGarity, *supra* note 5, at 68.

²⁴ *Id.* at 67-68.

²⁵ Zerbe, *Is Cost-Benefit Analysis Legal? Three Rules*, *supra* note 13, at 441 (citing Daniel S. Levy and David Friedman, *The Revenge of the Redwoods? Reconsidering Property Rights and the Economic Allocation of Natural Resources*, 61 U. CHI. L. REV.493, and Don L. Coursey and Russell D. Roberts, *Aggregation and the Contingent Valuation Method for Evaluating Environmental Amenities*, Working Paper, Olin School of Business Washington University, St. Louis, MO. (1992)).

²⁶ *Id.* at 442 (citing Michael W. Hanneman, *Willingness to Pay and Willingness to Accept: How Much Can They Differ?*, 81 Am. Econ. Rev. 635 (1991)).

²⁷ *See id.*

As McGarity points out,

[a] fundamental assumption underlying most health and environmental legislation is that each individual is entitled to some minimal level of security from risks posed by others, and that commonly held resources are likewise protected. Potentially affected individuals or their governmental representatives must be persuaded to accept additional risks; *they cannot be imposed with impunity up to the point at which the potentially affected individuals are willing to pay to prevent the risk producing conduct.*²⁸

In other words, the use of the WTP measure assumes that the polluter has extortion rights, and can demand of society, for example, “how much are you willing to pay to avoid further air pollution?” when the question should actually be, “how much would you have to be offered before you would allow more air pollution?”²⁹ The use of the WTP measure erroneously ignores the public’s ownership interest in the natural environment.³⁰

This point was developed by Zerbe:

The logic of using the WTA to measure loss rests on a normative decision to recognize ownership. The WTA recognizes the initial or reference position as one that incorporates already having the good. The WTP incorporates an initial position in which one does not have the good and asks what the good is worth from this position.³¹

Thus, OMB should recognize the public’s ownership of public goods and use the WTA measure for most environmental goods. In the absence of data to the contrary, OMB must assume that WTA will be 3 to 142 times greater than WTP for environmental good.

²⁸ McGarity, *supra* note 5, at 68 (internal citation omitted) (emphasis added).

²⁹ *See id.* at n.321 (quoting Douglas R. Williams, *Valuing Natural Environments Compensation, Market Norms, and the Idea of Public Goods*, 27 CONN. L. REV. 365, 455 (1995)).

³⁰ Zerbe explains that:

The standard benefit-cost approach in which losses are valued according to the WTA and gains according to the WTP is consistent with the empirically derived asymmetrical value function of Tversky and Kahneman [1981]. This function reflects a state in which individuals value losses more highly than they value gains. Individuals appear to place a significantly higher value on the units of a good they already have and might lose or have to give up than they place on getting additional units of the same good.

Zerbe, *Is Cost-Benefit Analysis Legal? Three Rules*, *supra* note 13, at 443.

III. THE DISTRIBUTIONAL EFFECTS OF REGULATION

A frequent criticism of cost-benefit analysis is its fundamentally utilitarian nature.³² It rests upon a philosophy to which many, if not most, Americans do not ascribe. However, even considered as a strictly utilitarian exercise, the 2000 Final Report is incomplete because it fails to account for an important good: distributional changes effected by regulation.

In this section, we explain that the 2000 Final Report substantially undervalues the benefits of federal health, safety, and environmental regulation by failing to include the distributional effects of these regulations in its calculation of costs and benefits.³³ Distributional benefits are goods that should not be arbitrarily excluded from cost-benefit analysis. However, rather than attempt to determine the true societal costs and benefits of federal regulation, including distributive effects, the 2000 Final Report rested on an incomplete utilitarian accounting in which giving a dollar to Bill Gates was considered as valuable to society as giving a dollar to the poorest member of society. The result is a significant underestimation of benefits.

Wilfred Pareto famously postulated that “[a]n economic change is desirable if in the new situation at least one individual is better off and no individual is worse off.”³⁴ Such an economic change is referred to as a Pareto improvement. In the 1930’s, economists Kaldor and Hicks proposed that if a policy has the effect of making one set of people better off and another set worse off, a *potential* Pareto improvement can be said to have occurred so long as the winners could theoretically compensate the losers. The 2000

³¹ *Id.* at 440 (internal citation omitted).

³² “It is by no means agreed that ‘welfare’ is simply a function of individual utilities.” CAROLINE DINWIDDY AND FRANCIS TEAL, *PRINCIPLES OF COST-BENEFIT ANALYSIS FOR DEVELOPING COUNTRIES* 22 (1996).

³³ *See* Richard O. Zerbe, *Is Cost-Benefit Analysis Legal? Three Rules*, 17 *J. OF POLICY ANALYSIS AND MANAGEMENT* 419 (1998).

Final Report appears to adopt the Kaldor-Hicks principle that such potential Pareto improvements are social “benefits” regardless of who wins and who loses.³⁵ That is, if the sum of the individual utilities before the change is less than the sum of individual utilities after the change, the change will be said to have had a net benefit.³⁶ Everyone’s utilities are given equal weight in the calculus.³⁷

For at least thirty years, some cost-benefit analysts have recommended that distributive effects be taken into account through the use of “distributive multipliers” that give greater weight to benefits that accrue to disadvantaged groups.³⁸ The multipliers are derived from estimates of the relative values of the benefits to groups with various levels of need.³⁹ This approach would be an improvement over the 2000 Final Report’s methodology, because it accounts for the fact that we value benefits given to some groups more than benefits given to other groups.

However, the best practice in this area, as stated by economist R.O. Zerbe in his excellent article “Is Cost-Benefit Analysis Legal? Three Rules,”⁴⁰ is to recognize that changes in distribution are in fact goods that can be included in the cost-benefit analysis. As Zerbe pointed out, “[a] change in income distribution has a value, positive or negative, that can be determined by the willingness to pay (WTP) or willingness to accept (WTA), and in this respect is like any other good[.]”⁴¹ Under this

³⁴ DINWIDDY AND TEAL, *supra* note 12, at 60.

³⁵ *See id.* at 66-68.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.* at 68-72

³⁹ DINWIDDY AND TEAL, *supra* note 12, at 68-72.

⁴⁰ Zerbe, *supra* note 13.

⁴¹ *Id.* at 426.

approach, when costs and benefits accrue more to one segment of society than another, distribution effect can be incorporated directly into the cost-benefit equation.⁴²

Even though, as the 2000 Final Report notes, achieving equitable distribution is often a reason for regulation,⁴³ its methodology completely excludes distribution effects from the analysis.

The following example illustrates the problem. Assume that a regulation restricting the location of a foul-smelling waste treatment facility would result in \$110 million in foregone industry profits and other costs, but would prevent a neighborhood of mostly low-income families from experiencing \$100 million in property value reductions. Using the 2000 Final Report's methodology, one finds that the regulation has a net cost to society of \$10 million. We argue that this result is an error, since such a regulation would actually benefit society by preventing an inequitable and undesirable result. Put another way, the net social welfare of a world with that regulation would be greater than the net social welfare of a world without it.

By not including the distributional effect in its calculations, the 2000 Final Report assumes that its value is zero. For example, the EPA's lead phase-down was substantially targeted at inner city children who were consuming dirt that was contaminated by lead from car exhaust. These children were disproportionately poor. By ignoring the distributional effect for this rule, the OMB substantially underestimated the value of this benefit.

IV. CONCLUSION

As stated at the outset, Public Citizen does not believe that this statutorily-mandated regulatory accounting exercise provides useful information for policy makers or the public. Reliance on the

⁴² *Id.*

methodological assumptions noted in these comments that systematically and significantly undervalue the benefits of public health, safety and environmental regulation makes such efforts misleading as well, and undercuts the public purpose of health, safety, and environmental protection standards.

To the extent that these methodologies are current policy, the application of these assumptions to critical government decisions affecting the lives and quality of life of taxpayers robs the public of its future in very real ways. With cost calculations supplied by self-interested industries that are exaggerated and often uncritically accepted by decision makers without the resources to dissect them, the OMB's methodological assumptions are even more damaging to effective public policy making. We urge the OMB to make the adjustments we recommend to be fair to the interests of the citizens whose lives are in your hands.

Sincerely,

Frank Clemente
Director
Public Citizen's Congress Watch

Melissa Luttrell
Legislative Counsel for Regulatory Affairs
Public Citizen's Congress Watch

⁴³ 2000 Final Report at 16.