

April 24, 2003

Lorraine Hunt
Office of Information and Regulatory Affairs
OMB, NEOB, Room 10202
725 17th Street, N.W.
Washington, DC 20503

Comments delivered by electronic mail:

OIRA_BC_RTP@omb.eop.gov

OIRA_ECON_GUIDE@omb.eop.gov

Dear Ms. Hunt:

The purpose of this letter is to comment on *OMB's Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations*. The views expressed herein are presented on behalf of the Section of Administrative Law and Regulatory Practice (Section) of the American Bar Association (ABA). The Section is a nonpartisan group of specialists in administrative law and regulation that includes government officials and attorneys, private lawyers, judges, and academics. The Section's members have extensive expertise in the field of cost-benefit analysis and have authored significant scholarly works on the subject.¹

These comments are being sent under the ABA's blanket authority procedure. The comments reflect general ABA policy, but the specific views expressed here have not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and, accordingly, should not be construed as representing the position of the Association. The letter represents only the views of the Section.

The ABA has adopted a number of general policies that are related to OMB's functions in producing a report on the costs and benefits of government regulation and in implementing Executive Order 12866.

¹See, e.g., Cass Sunstein, *The Cost-Benefit State: The Future of Regulatory Protection* (American Bar Association, 2002); Sidney A. Shapiro & Robert L. Glicksman, *Risk Regulation at Risk: Restoring a Pragmatic Approach* (Stanford University Press 2003); Richard W. Parker, *Grading the Government* (forthcoming University of Chicago Law Review, 2003).

- In 1986, the ABA endorsed executive oversight of federal Agency rule making, and, in particular, the implementation of Executive Orders 12,291 and 12,498, the Reagan Administration antecedents to E.O. 12,866.
- In 1990, the ABA also urged the Office of Information and Regulatory Affairs (OIRA) of the Office of Management and Budget to amend its 1986 regulatory review procedures to limit delays and to explain inconsistencies between agency rules and presidential policies.
- In 1992, the ABA urged the President and Congress to exercise restraint in the number of rulemaking impact analyses, and to assess the usefulness of existing and planned analyses.
- In 1993, the ABA recommended that any government entity designated by the president to oversee the rulemaking process should: (1) issue a written explanation whenever it returns a rule with a change; (2) reveal any communications with Congress or non-governmental people pertaining to the rule; and (3) regularly publish a list of all proposed or final rules for which review was concluded.

While the number of separate rulemaking impact analyses required of agencies by statute and executive order remains high, it is gratifying to see that OIRA has taken steps, consistent with these prior recommendations, to greatly improve the transparency of the process of regulatory review. Hoping that its views will remain helpful, and based on the general principles set forth in prior recommendations, the Section has the following comments on the 2003 OMB Draft Report:

The Section appreciates the opportunity to comment on OMB's Draft Report to Congress on the Costs and Benefits of Federal Regulation, which this year includes OMB's Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements. The Draft's clear articulation of the issues offers an excellent basis for public comment and we are confident that, with appropriate amendments, the Guidelines will make a valuable contribution to the goal of effective regulatory accounting and oversight.

After one remark on Chapter I of the Report, our comments will focus on Chapter II and the Draft Guidelines. The latter comments, it will be seen, generally emphasize the need for more careful expert scrutiny, and wider public participation, in the development of key cross-cutting values such as discount rates and the value of a statistical life.

Chapter I – The Costs and Benefits of Federal Regulations

We urge OMB to make its accounting of government costs and benefits more transparent. Tables 4-8 reveal that OMB's and agencies' estimates of the costs and benefits of major rules differ substantially, sometimes by more than an order of magnitude. The tables do not, unfortunately, supply an explanation for the discrepancies. To take just one of many possible examples, OMB estimates that USDA's Rule on Nutrition Labeling of Meat and Poultry Products will cost \$ 25-32 million, while yielding \$205 million in benefits (Table 7). The USDA figures for the same rule are \$218-272 million and \$1.75 billion, respectively (Table 9). The reason for the discrepancy is not apparent, particularly inasmuch as both estimates appear to reflect present values amortized over 20 years and discounted at 7 percent.

A principal function of quantitative cost-benefit analysis is to improve the transparency of analysis while improving public understanding of the costs and benefits of regulation. Both goals are thwarted, however, when radically divergent numbers are offered without explanation of the reasons for the difference.

One straightforward solution is for each entry for each major rule to be hyperlinked to an electronic worksheet which (a) outlines the major assumptions behind the agency and/or OMB numbers, (b) sets forth the raw cost and benefit numbers on which the agency and OMB agree, and then (c) details the agency and OMB calculations, respectively, that lead to the divergent final estimates. Embedded in that worksheet should be an additional hyperlink to the underlying agency RIA in electronic format.²

Chapter II – Developing Better Regulation

1. The Draft calls on agencies to monetize benefits whenever possible, using a variety of valuation techniques, of which the two most important are wage premia for hazardous jobs (“labor-market studies”) and contingent valuation surveys (“CV studies”). Although controversy still surrounds the now-common practice of monetizing the benefits of reducing risk to human life, health, and ecosystems, we recognize that some valuation is implicit in any regulatory decision to accept a finite risk on grounds that avoiding it would be too costly. We also recognize the virtue in making such valuations explicit in the analysis.

It is important, however, that the guidelines for quantifying and valuing benefits themselves be developed through an open and inclusive administrative process and grounded in sound science. As explained in more detail below, the Draft Guidelines raise concerns on both counts.

2. OMB’s proposal to require quantification and monetization of costs and benefits “whenever possible” seems quite sensible. The requirement for sensitivity analysis likewise is a sensible recommendation solidly based on widely-recognized principles of cost-benefit analysis. (Draft @ 5523) We also see merit in the proposed requirement that “For major rules involving threshold costs of \$ 1 billion, you should present a formal quantitative analysis of relevant uncertainties.” (Id.)

OMB then adds, however: “In your analysis, you should try to provide some estimate of the probability distribution of risks with and without the regulation, and you must do this for rules that exceed \$1 billion.” (Id.)

We anticipate that a requirement for formal probabilistic analysis will be impossible to meet rigorously in cases where the underlying science is so uncertain as to preclude well-founded

²Of course, this will require offering the OMB report electronically in both Adobe Acrobat Reader format (as it is currently) and in “html,” so as to make the hyperlinks active. There is abundant precedent for dual-format electronic offerings, in the practice of both domestic agencies and international organizations.

estimates of the underlying probability distribution.³ It is well known that such situations arise from time to time in the context of certain health risks and many ecological risks, about which the present state of knowledge is rudimentary at best. If the underlying probabilities are unknown, considerations of regulatory cost cannot make them known. In such situations, the effort to generate probability distributions in the face of fundamental uncertainty through guesses derived from so-called “expert elicitation” or “Delphi” methods (see Draft @ 5524) runs the risk of creating that “false sense of precision” which OMB elsewhere cautions agencies to avoid (see Draft @ 5523). Accordingly, we believe such methods should be used sparingly, and we strongly endorse the recent recommendation of the National Research Council that agencies disclose all cases in which expert elicitation methods have been used, and conduct sensitivity analyses which reveal the costs and benefits of regulation across the full range of assumptions.⁴ We believe that the Draft should be amended to include this recommendation in OMB’s guidance to agencies.

We also would point out that the costs and benefits of a rule often depend in considerable measure on how a rule is applied. This suggests that agencies should also be asked to identify (and, where possible, estimate the impact of) any flexibility mechanisms – e.g. waivers, variances, and delegations of discretion to state agencies -- that are being built into the rule to facilitate adaptation of the rule, as applied, to new information on costs or benefits that may materialize in the future.

Finally, whether or not formal probability analysis is required, we believe it advisable for agencies to identify any irreversible costs or benefits that may flow from enacting (or failing to enact) the rule. Such an analysis is needed to support a rational judgment as to the level of precaution – in terms of cost-avoidance or risk-avoidance – that should be built into the rulemaking decision.

3. OMB reports suggestions that the value of a statistical life (VSL) be replaced or augmented by the monetary value of a statistical life year (VSLY). We recognize the intuitive appeal of an approach which recognizes that death comes to us all and that the value of preserving a life depends in some way on the remaining life expectancy of the statistical person in question. However, there is not, at present, a clear empirical consensus on what value(s) VSLY should take. Indeed, OMB has not identified a consensus that VSLY is constant over the life of the individual (i.e. that VSL declines linearly with age). The experience of health care rationing in Oregon reveals considerable public resistance to the basic premise of VSLY methodology, that the implicit value of reducing risk to life should depend on the age of the individual. Moreover, many of the illnesses and fatalities – such as various cancers -- that are typically associated with late onset (and hence a reduced regulatory benefit if VSLY techniques are used) may also be associated with extreme individual suffering and prolonged familial anguish. VSLY techniques which consider only age of onset – adjusted, perhaps, to reflect the expected quality of life of the

³See William E. Griffiths, et al, *Statistical Concepts for Economists*, Ch. 2 of Learning and Practicing Econometrics, at 36 (1993) (demonstrating mathematically that calculating the expected value of a variable requires knowledge of the underlying probability density function of that variable).

⁴National Research Council, *Estimating the Public Health Benefits of Proposed Air Pollution Regulations* 147 (2002).

statistical person apart from the target disease – will not take into account the special benefit of avoiding such dreaded diseases. The circumstances described above do not mean that VSLY approaches should never be used. But they do suggest that OMB would be well advised to undertake a careful expert and public vetting of all the issues – both empirical and ethical – as it considers VSLY for general use.

4. OMB proposes: “As a first step, [agencies] should present the annual time stream of benefits and costs expected to result from the rule, clearly identifying when the costs and benefits are expected to occur.” We support this proposal. The propriety of discounting and the choice of the correct rate has been the subject of a long-standing debate both in the scholarly literature and in the Congress. The guidance offered above, if followed, will do much to help ameliorate that controversy, although it will not eliminate it.

Along the same lines, OMB should also consider advising agencies to offer a sensitivity analysis which employs a zero discount rate, as well as the 3 and 7 percent rates mentioned in the Draft. This would allow a straight comparison of total costs and total benefits by those who object to discounting, while preserving the comparison of discounted values for those who approve of the practice. This additional analysis will not cause undue burden for agencies. Indeed, modern computer spreadsheet techniques are such that a zero-discount-rate scenario can probably be added with a few keystrokes.

Finally, in situations where VSLY methodology is used, we believe it appropriate for agencies to disclose both the number of lives saved, and the expected mean age of the persons saved by the regulation in question. The age parameter will have to be estimated in any case in order for VSLY values to be calculated, and disclosing it would greatly improve transparency and public understanding, with minimal additional burden for agencies.

5. OMB proposes: “It will not always be possible to assign monetary values to all of the important benefits and costs and when it is not, the most efficient alternative will not necessarily be the one with the largest net-benefit estimate. In such cases, you should exercise professional judgment in determining how important the non-quantifiable benefits or costs may be in tipping the analysis one way or the other, but you should not use non-quantifiables as “trump” cards, especially in cases where the measured net benefits overwhelmingly favor a particular alternative.” (Draft @ 5514. See also Draft @ 5516)

The fact that monetized net benefits “overwhelmingly” favor a particular alternative is meaningful only if the monetized benefit is a dominant portion of the expected total benefit. That is not always the case. For example, in EPA’s Great Lakes Water Quality Guidance, EPA was asked to estimate the costs and benefits of significantly reducing the discharge of toxic, bioaccumulative substances into the Great Lakes ecosystem. Though EPA qualitatively described an impressively broad range of human health and ecosystem benefits, it was able to develop quantitative and monetizable estimates only for the “reduced incidence of fatal cancer to sports anglers and Native American subsistence fishermen” who eat fish that they themselves have caught in the Great Lakes. This narrow and partial benefit yielded a number that was considerably smaller than the total cost of the rule.

Likewise, OMB's draft report on the benefits of roadless area conservation (relying on a USDA regulatory impact assessment) mentions \$219,000 per year savings on maintenance costs as the numerical benefit of the rule, while relegating all other recreational, aesthetic, and spiritual benefits – along with the options value of preserving wilderness – to the phrase “a variety of other non-quantifiable benefits.”⁵

Such examples could be multiplied many times over. As they illustrate, numerical imbalance does not prove much about the wisdom of the regulation if it turns out that the agency is, in fact, able to quantify only a minuscule portion of the total benefit.

This is not to say that agencies should be able to disregard numerical cost-benefit comparisons by making a vague reference to non-monetized variables. The point is simply that OMB's implied litmus test of ‘trumping’ is flawed. We recommend deleting the last clause in the quoted passage and adding the following sentence (or something to the same effect) in its place. “In situations where measured net benefits seem to overwhelmingly favor a particular alternative which is not chosen, the agency should offer a clear explanation of why it considers unquantified and/or non-monetized factors of sufficient importance as to justify its choice.”

6. OMB notes: “The estimates of VSL in the literature vary considerably but this is not surprising because VSL is not expected to be a universal constant. Economic theory predicts that VSLs may vary in different lifesaving contexts depending on factors such as the magnitude of the probabilities and the health preferences of the target population.” (Draft @ 5521)

VSLs derived from revealed-preference studies vary over a range that extends from \$200,000 to about \$18 million (i.e. almost two orders of magnitude).⁶ We are aware of no study that systematically accounts for the variability of current studies in terms of the factors mentioned in the passage above. Most observers believe that the extreme variability of VSL in the occupational setting arises in large part from differences in the assumptions and design of various studies.⁷

We believe the value assigned to reduction of risk to life and health in regulatory assessment is an important issue that merits a more careful, systematic, and open review than it has hitherto received at the agency level. We urge OMB to convene an inter-disciplinary expert working group with a mandate to synthesize the existing literature and develop a standard model which best accounts for the factors thought to influence wages and best isolates the impact of risk on wages. An acceptable model should be able to generate statistically significant and stable estimates for occupational VSL across a range of population samples, not just for the sample that produced the original estimate.

⁵OMB, Draft Report to Congress on the Costs and Benefits of Federal Regulations, 67 Fed.Reg. 15014, 15025 (March 28, 2002).

⁶W. Kip Viscusi, *Fatal Tradeoffs: Public and Private Responsibilities for Risk* 52-54, tbl. 4-1 (1992) (summarizing labor-market studies of the value of life); USEPA, *Guidelines for Preparing Economic Analyses* (Sept. 2000) (same).

⁷See, e.g., *Fatal Tradeoffs*, supra at 34-59.

7. OMB properly recognizes that developing an occupational VSL is only the starting point in developing VSLs appropriate to the regulatory setting. As OMB observes: “the use of occupational-risk premiums [without adjustment] can be a source of bias because the risks, when recognized, may be voluntarily rather than involuntarily assumed, and the sample of individuals upon which premium estimates are based may be skewed toward more risk-tolerant people.” (Draft @ 5519). Moreover, many of the illnesses and fatalities that regulations seek to reduce – such as various cancers – are particularly dreaded for their association with extreme individual suffering and prolonged familial anguish. Scholars have recognized the validity and importance of accounting for this “dread” factor in the valuation of risk reducing regulations. Yet OMB offers no guidance on how to adjust for these differences – voluntariness, risk preference heterogeneity or dread – and does not advise agencies to develop sound methodologies for doing so.

OMB also makes no mention of appropriate adjustments to reflect differences in income levels, though it is undisputed that workers in wage-risk studies generally have below average incomes, that real incomes tend to grow over time, and that willingness to pay to avoid risk (and/or willingness to accept risk in exchange for compensation) tend to rise with real income levels.⁸ Calling for an income adjustment does *not* mean that social regulators should value rich people’s life more highly than poor people’s in practice. The social value of a life does not depend on the income of the person. The point is simply that the decision to use a single life value for all people in society in no way justifies drawing that value exclusively from the low-income segment of society, or from a lower-income time period, with no adjustment to reflect the higher incomes of others, or income growth.

In short, the values that labor-market studies elicit are derived from different contexts, and are different values, than those which regulators must consider in assigning monetary numbers to the benefit of avoiding many regulatory risks. We urge OMB to inaugurate a process for developing and implementing appropriate adjustments to VSL to reflect the clear and well-documented differences between the values that labor-market studies elicit, on the one hand, and the values that are relevant to social regulation, on the other. In some cases, the empirical literature may suggest an appropriate numerical adjustment, and an expert working-group could determine an appropriate adjustment. In other cases, a heuristic policy judgment is likely to be required. We believe that such judgments should be based upon an open and inclusive process of public participation.

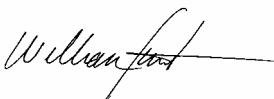
8. We believe the deliberative process recommended above should also address the propriety of using contingent valuation methods (CVM) to establish VSLs in the regulatory setting. CVM is widely regarded as a methodologically suspect estimation procedure in that it derives values solely from responses of casual survey-takers to hypothetical questions. We recognize that the 1992 NOAA Panel on Contingent Valuation provisionally endorsed CVM, subject to strict guidelines, for purposes of deriving non-use values of ecosystems, in light of the fact that such values cannot be derived by another means. Neither expressly nor impliedly, however, did the Panel endorse the use of CVM for life valuation for which alternative, revealed-preference estimation methods are available.

⁸See, e.g., W. Kip Viscusi, The Value of Risks to Life and Health, 31 J. Econ. Lit. 1912, 1930 (1993) .

9. While the APA does not require notice and comment for OMB to establish uniform values, such as the VSL and discount rate, used in agencies' regulatory analyses pursuant to E.O. 12866, agencies' choice of such values in actual rulemaking has been subject to judicial review and has been set aside for failure to adequately explain why the agency chose a particular value or why it simply relied on OMB's value. Moreover, for reasons outlined above, good policy also requires both more rigorous expert scrutiny and greater public involvement in the derivation of these extremely important, cross-cutting values than they have currently received. We therefore urge the OMB to undertake – or advise agencies to undertake -- a careful and rigorous expert and public process for reviewing, establishing, and periodically updating (perhaps once a decade) the benchmark VSL(s), VSLY(s) and discount rates to be used in agency regulatory assessments. Values adopted in this manner are more likely both to garner public support and to withstand judicial review.

10. We suggest that any written OMB recommendations for changes in proposed rules that are communicated to agencies prior to issuance of the Notice of Proposed Rulemaking (NPRM)) and adopted by the agency be described and explained in the NPRM. This will give the public an opportunity to understand and comment on agencies' and OMB's implementation of the Guidelines as applied to individual rulemaking proceedings. OMB recommendations regarding changes in the final draft after issuance of the NPRM ideally would be disclosed upon receipt, in the same manner as comments received from other sources. We note that E.O. 12,866 already requires OIRA to disclose written communications with agencies relative to the merits of rulemaking upon publication of the final rule. We believe that post-comment-period OMB recommendations for changes in draft final rules – whether communicated orally or in writing -- should be disclosed upon publication of the final rule, if those recommendations are accepted by the agency.

Very truly yours,

A handwritten signature in black ink, appearing to read "William Funk", with a long horizontal flourish extending to the right.

William Funk
Chair-Elect