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To Whom It May Concern:

I am submitting this comment in response to the February 26, 2009 request for comment by the Office of Management and Budget(OMB) on recommendations to the President on ways to improve the process and principles governing regulation under a new Executive Order on Federal Regulatory Review. I am providing these comments on the basis of more than 25 years of experience in the Office of Information and Regulatory Affairs (OIRA) as Chief of the Natural Resources Branch from 1987 to December 2008 and as a staff economist from 1981 to 1987. Each year of my tenure as Chief of the Natural Resources Branch, I was responsible for the review under Executive Order 12866 (and its predecessor Executive Order 12291) of major rules to improve the environment and protect natural resources that imposed present value costs of billions of dollars.

As this Administration implements its agenda for change, many of its most important actions will be implemented through regulations. The design and scope of these regulations and the effective delivery (or not) of benefits and the imposition of costs is especially important in today's economic climate. In any case, the effects of such rules will be with us for years into the future. As a result, an effective centralized review and a careful and deliberate consideration of the effects of regulatory actions will be even more important than in past years.

Introduction

There are compelling reasons for a coordinated, centralized oversight of Agency rulemaking as provided by Executive Order 12866. As outlined in the President's Memorandum of January 30, 2009, "The purposes of such review have been to ensure consistency with Presidential priorities, to coordinate regulatory policy, and to offer a dispassionate and analytical "second opinion" on agency actions."

In my view, the oversight process established under Executive Order 12866 (and the process established under earlier Executive Orders) has served the nation and past Administrations well. There are two key elements to the current Executive Order oversight process: (1) an administrative process of coordinated, centralized review of significant regulatory actions, and (2) a set of requirements for regulatory analysis of major rules to inform decisionmakers within the Administration, Congress, and the public on the consequences of significant regulatory actions.[1] The President's Memorandum directed the Director of OMB to offer suggestions with respect to eight aspects of Federal regulatory review.

The comments below address two of these areas: (1) the relationship between OIRA and the agencies and (2) the role of benefit/cost analysis. Since the current process has worked well, I believe changes to the current process should bear a substantial burden of proof. That being said, in the discussion below on the relationship between OIRA and other agencies, I offer two suggestions that I believe will substantially improve Federal regulatory oversight. On the role of benefit/cost analysis in the regulatory oversight process, I argue that the oversight process should continue to rely on benefit/cost analysis because it provides an uniquely valuable framework for evaluating and discussing alternative regulatory approaches and options and the effects of taking alternative regulatory actions. In addition, I discuss three specific requirements of current OMB guidance in Circular A-4 that have attracted substantial attention and offer my views on these specific issues.

The Relationship between OIRA and Other Federal Agencies

There are some aspects of the current administrative process for oversight that deserve careful consideration and I believe there are changes that could be made to improve the process.

First, the Executive Order review comes at the end of agency development of proposed and final rules. It is much more difficult to change the course of a draft rule once the regulatory agency has "locked-in" on a specific approach. In addition, this end stage review process has been susceptible to practices that undermine the purposes of the Executive Order. Many major rules have been submitted for Executive Order review under very tight deadlines—sometimes as little as a few days—either because of a statutory or court-related deadline or an administratively determined deadline coupled with internal delays within the agency in developing the rulemaking package. The resulting truncated review largely fails to meet the basic purposes of the Executive Order. In addition, agency regulatory analyses are often prepared after the agency has made key decisions on the draft rule. In some cases, agencies have submitted draft regulatory analyses for Executive Order review weeks after submitting their draft rule and preamble language. When agencies prepare a regulatory analysis after the policy decisions have

[1] These requirements are set out in both Executive Order 12866 and in OMB's current guidance in Circular A-4 on the requirements for a regulatory analysis.

been made, regulatory analysis becomes an exercise in supporting the rulemaking rather than one that informs regulatory decisions.

To address this issue, I believe the Administration should consider adopting a formal "early" review process for key regulatory issues—a process covering all major rules resulting in annual benefits or costs in excess of $1 billion plus additional particularly significant rulemakings. This early review process would cover perhaps a total of 20 key rulemakings a year. Under this early review process, OIRA would formally designate key rulemakings after consultation with the affected agencies and other offices within the Executive Office of the President. After designation of a rulemaking by OIRA for early review, an interagency review group would be formed to play an active role in agency identification of issues and options and in the development of the associated regulatory analysis needed to inform decisionmaking. This process would encourage a broader discussion of options and issues at an early stage in the development of these rulemakings and provide greater policy consensus within the Administration on regulatory decisions. In doing so, it would address the "endgame" confrontations between OIRA and the agencies and the resulting delays that arise under the current Executive Order process.

Second, the current Executive Order does not require independent agencies to submit their rulemakings to OMB for review. These independent agencies (for example, Federal Communications Commission, Federal Energy Regulatory Commission, Nuclear Regulatory Commission, Securities Exchange Commission) adopt regulations of enormous consequence to the nation. [2] These regulatory decisions should also be subject to Executive Order review.

If the Administration adopts these changes to the Executive Order process, they will require significant OIRA resources. I am acutely aware that OIRA staff already face substantial demands each day. In taking on these additional responsibilities, OIRA management will have to reassess the current level of staffing and staff priorities. In making decisions on staffing priorities, please keep in mind that there are substantial benefits associated with the current level of regulatory review in coordinating regulatory review and in providing a second opinion—both in terms of reviewing options and alternatives and in considering the "details" of a regulation that may impose substantial costs.

Role of Benefit/Cost Analysis

Benefit/cost analysis provides an extremely useful framework for decision-making for (1) identifying and evaluating alternative regulatory (and non-regulatory) approaches and options and (2) organizing this information in a consistent, coherent, and comprehensive way. I do not believe, however, that it can serve as the sole basis for regulatory decisions. A variety of other factors—for example, uncertainties in the analysis,

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[2] Note that the regulatory analyses prepared by the independent agencies typically focus on an estimate of the administrative (paperwork) costs, and often ignore the overall social benefits and costs of the rulemaking.

unquantified benefit and/or cost categories, and distributional effects—also need to be considered by the decisionmaker.

There are alternatives to performing benefit/cost analysis. Some have suggested, for example, that cost-effectiveness analysis might be adopted in place of benefit/cost analysis. In my view, cost-effectiveness analysis can be a useful supplement to benefit/cost analysis by offering a different perspective on the analysis. [3] I am concerned, however, that a decision to adopt cost-effectiveness analysis—without conducting a benefit/cost analysis—would narrow the scope of the analysis and result in limiting the inquiry into alternative approaches and the possible effects of unintended consequences. While this is not a necessary consequence of a shift to cost-effectiveness analysis, the dynamics of agency rule development would tend to produce more routine, limited analyses of regulatory actions. In addition, cost-effectiveness analysis faces its own set of difficulties in terms of the choice of the best measure of effectiveness. A consistent preference for benefit/cost analysis would avoid the adoption of cost-effectiveness measures that are not directly linked to conventional measures of welfare.

OMB's Circular A-4 provides guidance to the agencies and serves as a cornerstone in the development of a regulatory analysis. OMB published Circular A-4 in 2003 after peer review and public comment on a draft. In preparing the final Circular A-4, key issues identified in the peer review and public comment process were reviewed by an interagency group of economists. It presents a reasonable and balanced set of requirements and best practices for preparing a regulatory analysis and should be retained. There are, however, elements of Circular A-4 that have attracted some controversy and deserve further discussion.

Discount Rates – Circular A-4 requires "For regulatory analysis, you should provide estimates of net benefits using (a discount rate of) both 3 percent and 7 percent." There are good reasons, as presented in the economic literature, for considering a discount rate that reflects both the social cost of capital (on the order of 7 percent) and the social rate of time preference (roughly 3 percent). Presentation of benefit and cost estimates using both discount rates will help policy makers understand the sensitivity of the benefit and cost estimates to alternative discount rates and the effects of the regulatory action in terms of both consumption and investment behavior within the economy.

For regulatory actions yielding benefits and imposing costs across generations, Circular A-4 provides that "If your rule will have important intergenerational benefits or costs you might consider a further sensitivity analysis using a lower but positive discount rate in addition to calculating net benefits using discount rates of 3 percent and 7 percent." This guidance establishes 3 and 7 percent as default values and allows policy makers to assess the sensitivity of alternative regulatory options to lower discount rates. The flexibility provided by this approach should be retained.

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[3] OMB's Circular A-4 specifically requires that agencies should prepare a cost-effectiveness analysis as a part of their regulatory analysis for major health and safety related rules.

Treatment of Uncertainty – One of the most difficult tasks of regulatory analysis is to convey the extent of the uncertainty in the analysis. Circular A-4 requires that the regulatory analysis consider and present the important uncertainties in the analysis. For rules with annual benefits or costs that exceed $1 billion, Circular A-4 requires a quantitative uncertainty analysis and, in doing so, agencies should also try to provide some estimate of the probability distribution of estimated benefits and costs. In addition, Circular A-4 states that "…you should provide some estimates of the central tendency (e.g., mean and median) along with any other information you think will be useful such as ranges, variances, specified low-end and high-end percentile estimates,…" [4] For rules with annual benefits or costs in the range from $100 million to $1 billion, agencies are encouraged to use more rigorous (quantitative) approaches with higher consequence rules. Circular A-4 further states:

"The treatment of uncertainty must be guided by the same principles of full disclosure and transparency that apply to other elements of your regulatory analysis. Your analysis should be credible, objective, realistic, and scientifically balanced. Any data and models that you use to analyze uncertainty should be fully identified. You should also discuss the quality of the available data used. Inferences and assumptions used in your analysis should be identified, and your analytical choices should be explicitly evaluated and adequately justified. In your presentation, you should delineate the strengths of your analysis along with any uncertainties about its conclusions. Your presentation should also explain how your analytical choices have affected your results."

Agencies are just beginning to carry out and experiment with approaches to characterize the uncertainty in their regulatory analysis. OIRA should continue to encourage these agency efforts through the Executive Order review of major rules and through specific pilot projects designed to advance the science and practice of uncertainty analysis.

Distributional Effects – Circular A-4 specifically states that a regulatory analysis should include a description of distributional effects. Further, Circular A-4 states that where these effects may play an important role in decision-making, the analysis should present to the extent possible, quantified estimates of both the benefits and costs for the affected sub-groups (e.g., different income groups). It is important to conduct a full evaluation of the benefits and costs for each sub-group because regulatory actions are sometimes regressive (i.e., the action imposes net costs on lower income groups or on other specific sub-groups of concern). Finally, even in cases where a regulatory action is not regressive, regulatory action generally represents a relatively ineffective way of addressing concerns about income distribution because the benefits of regulatory action are not fungible and cannot be converted into goods that may yield greater satisfaction.

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[4] Circular A-4 also notes that "Worst-case or conservative analyses are not usually adequate because they do not convey the complete probability distribution of outcomes, and they do not permit calculation of an expected value of net benfits."

I very much appreciate the opportunity to comment on this important subject. I am now retired from Federal service and the views presented above are solely my own; I do not present them on behalf of any third party. If you have questions about these comments, please feel free to contact me.

Sincerely yours,

Arthur G. Fraas