

August 7, 2007

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Dear Dr. Theroux:

I appreciate being asked to review the draft 2007 Report to Congress on the Costs and Benefits of Federal Regulation<sup>1</sup>. In my opinion the annual reports are steadily generating useful information, although as often from special topics as from the annual “accounting” of costs and benefits. My comments follow, along with recommendations. The comments are roughly in order of appearance in the text.

## 1. Accounting format:

1.1 OIRA guidance states that best estimates, typically expected values, should be presented along with information about uncertainty. I see no reason why OIRA should not follow its own guidance in the various tables. My impression is that points within ranges are often interpreted as being equally likely although this is statistically seldom the case. Recommendation: report best or expected value estimate along with range, as in Table 1-1.

1.2 Accounting principles defining “Reliability” include “representational faithfulness” (FASB, Statement of Financial Accounting Concepts, No. 2). My understanding regarding some of the accounting scandals in recent years is that the some items were carried off the standard accounting books of the firm although faithful representation would have incorporated them. Similarly, the treatment of transfers in the annual report as primarily budgetary expenditures may not faithfully represent impact. Examples include health regulations on payments and some farm programs. Consider the counter-factual....suppose prospective health payments are not increased? Would there be a predictable impact on quantity of health care and health outcomes? If yes, it seems to me that representational faithfulness would look beyond the veneer of a “transfer” to the real outcome that is intended. Such measures may be in a different sub-category (regulations affected by budget).

1.3 Consistency: I appreciate the efforts OIRA has taken to improve consistency, as by adjusting dollars (although adjusting to report year dollars may make more sense to the reader) and by monetizing some values that are omitted (see discussion on p. 11.) However, I recommend that OIRA provide what amounts to default guidance ex-ante, while the agencies are developing their reports and not just at this annual reporting stage. Arrow, et al (Science) and GAO (GAO-05-796SP) have suggested the use of default common values from which agencies can depart if rationalized.

Recommendation: Provide default monetized values in guidance for some impacts in advance of the annual report to improve consistency across government.

1.4 OIRA may wish to consult with the BEA to the extent that the accounting statements might be framed as supplemental accounts to the National Income and Product Accounts.

2. Trends report: The overall package is useful and informative but care should be taken to maintain the objectivity of OIRA. For instance, the tone of the comparison of costs and benefits by Administrations and the discussion and ordering of evidence on the international links between regulation and economic activity have an element of partisanship about them (if XXX, a “liberal” think-tank created the “freedom index” would it be the motivating example?)

2.1 OIRA might consider regression analysis of trends and conditioning factors as in 2003 OECD presentations by Farrow and Harrington (<http://www.oecd.org/dataoecd/34/30/30401951.pdf> ).

3. Recommendations for reform: OMB guidance is one tool of reform although I didn't see any such recommendations.

Default guidance: see #3 above on default values.

Risk Assessment: Public statements have also been made by OIRA about reviving the guidance for risk, if so, the annual report could be a place to inform Congress and the public about future directions.

Decision analysis and benefit-cost: OMB has been silent on tools such as multi-attribute decision analysis while noting the absence of benefit-cost analysis in areas such as Homeland Security regulations. I believe that the decision –analysis tools are being used in place of benefit-cost analysis and recommend that OIRA develop guidance on whether and to what extent such substitution is acceptable, or what practices, if any, are acceptable.

4. BCA quality scorecard: This report uses minimum elements of a quality scorecard for rules from independent agencies, such as whether they included monetized benefits (p. 21.) A minimum public scorecard for all rules, whatever the source, would be useful, noting that there are many items mentioned in OIRA guidance such as A-94 or A-4 that do not seem of equal importance. Recommendation: determine minimum categories and standards for an acceptable benefit-cost analysis, with “outs” for statutory exemptions.

5. Links between ex-ante regulatory review, previous OIRA encouragement for ex-post review, GPRA and PART. The ex-ante regulatory analyses are the logical starting point for economic performance evaluation as in GPRA or for PART. Could some coordination with the budget side of OMB occur such that ex-post analyses are an expected element of PART after a period of XX years and on which this annual report could comment?

6. Information quality act: p.37. While the “output” of the process is of interest (appeals, corrections..), table 3-3 on peer review is also of interest. However, the population of reports potentially covered is not discussed. So for instance, in the USDA there were 19 peer reviews....but conducted on how many studies out of how many in process, or nearing completion or?

7. Dept. of Homeland Security: p. 53. Some benefits and costs of some rules seem to be monetized. While the report provides an anchoring point of one aircraft, totally lost; can something be said about the change in probability necessary to make the rule break-even, or to develop a delta probability/cost type measure? Even these limited examples suggest the usefulness of guidance in this area.

Feel free to contact me with any questions to follow-up these comments.

Sincerely,

Scott Farrow

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<sup>1</sup> In line with information quality guidance on peer review, I hereby disclose that I have worked with OIRA or its predecessor in both a Democratic and Republic Administration while being a part of the Executive Office, and also while Chief Economist at the GAO. I am economist by training and teach benefit-cost analysis and risk management.