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Subject: comments on Appendix C.

Below are comments on Appendix C, OMB Draft Guidelines for the Conduct of Regulatory Analysis and the Format of Accounting Statements

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Most of my comments concern part IV. C. on discounting. Generally, the emphasis on sensitivity analysis on rates above and below central values of 3 and 7% is an excellent suggestion. In greater defense of the emphasis on 3%, I would argue that not only do "the effects of regulations not always fall exclusively on the allocation of capital" as the discussion begins (p 5522), but many of the benefits associated with specifically environmental regulation are consumption benefits (e.g., health and mortality risk reduction). In that case, the return before tax return on capital is not relevant and the consumption rate of 3% is more appropriate.

While I would applaud the examination of low discount rates on an ethical basis, it is important to emphasize the broad application of this notion. In particular, if the policy offsets a one million dollar private investment that breaks even at 7%, for example, that offset investment will actually have a much higher opportunity cost when valued at 1%. That is, the whole stream of consequences from a policy, both costs and benefits, should be consistently evaluated at the same discount rate.

In the discussion of how uncertainty about future discount rates affects valuation, I would strike the sentence "aversion to uncertainty discourages any such long-term investments." This is meaningless out of context because risk-reducing investments would likely be ENCOURAGED by uncertainty. Meanwhile, the relevant line is three sentences later (except it is backwards): "Symmetric uncertainty ABOUT THE DISCOUNT RATE would have the effect of lowering the FUTURE (FORWARD) discount RATE (AND RAISING THE DISCOUNT FACTOR). Two hundred years in the future, the appropriate forward rate might be 1% even if the current rate is 4% based on this uncertainty.

Note that the uncertainty argument suggests that future FORWARD rates should be lower, but that you should still start off discounting the initial years at current rates. That is, the effective rate between year 200 and year 201 should be 1%, but the rate between now and year 200 would be declining from 4 to 1% and likely, by geometric average, to be closer to 2%.

Moving to Section D, I would applaud the allusion to option valuation in the middle of page 5523. "For example, when the uncertainty is due to a lack of data, you might consider deferring the decision, as an explicit regulatory alternative, pending further study to obtain sufficient data. We recognize that delaying a decision will also have costs, as will further efforts at data gathering and analysis. You will need to weigh the benefits of delay against these costs in making your decision."

More generally, I would encourage analyses of costs and benefits to consider the importance of irreversibilities in both capital investment and policy

(especially environmental) consequences. That is, delaying action until sufficient data is collected may be prudent--but so may acting in order to preserve various non-economic (e.g., environmental) opportunities.