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Comments on OMB Circular A-4, "Regulatory Analysis" (OMB-2022-0014)

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This brief paper offers comments on the draft of the US Management and Budget's revision to Circular A-4, on Regulatory Analysis. Circular A-4 was written in 2003. It was an excellent document for its time, bringing to bear the most up to date economic data and understanding of the economy. But in that same spirit, it is time the document be updated, especially in light of Executive Order of April 6, 2023 (Modernizing Regulatory Review). OMB is right to do so.

In what follows, I offer specific comment on select sections of the draft update to Circular A-4 (hereafter, "draft"). I take them in order, providing the headings from the draft.

Scope of Analysis

In the discussion of the geographic scope of the analysis, the draft begins by stating that "In many circumstances, your primary analysis should focus on the effects of a regulation that are experienced by citizens and residents of the United States . . . . When feasible and appropriate, all such important effects should be included, regardless of whether they result directly from a regulation's domestic applicability, or indirectly from a regulation's impact on foreign entities" (p. 9). This discussion makes a useful distinction between the *objective* evaluated in the analysis, namely, net benefits to citizens and residents of the US, and the effects which influence the attainment of that objective, which could be mediated through foreign entities. In other words, the question is what US citizens and residents are willing to pay for all global effects.

But in the following paragraphs, the draft segues to the possibility that "it may be particularly appropriate to include effects experienced by noncitizens residing abroad in your primary analysis" (p. 9). The discussion implies these "effects" are not just international effects evaluated by US citizens and residents, but *values* of noncitizens. It may well be appropriate to consider such values in secondary analysis, where the effects on noncitizens living abroad may be an important factor to policy makers. However, in giving agencies' analysts discretion to incorporate such considerations into their primary analysis, OMB is actually giving them the discretion to determine the political/policy *objective*. That is, they have the authority to determine whether the objective is to maximize net benefits for one group or for another. This takes them beyond the role of analyst and into the role of policy maker. BCA should evaluate social objectives, not determine them. To my knowledge, there is no mandate from either Congress or the President to change the objective in this way.

Developing an Analytical Baseline

The proposed revisions to Circular A-4 clarify that an appropriate standard of comparison, or baseline, is not necessarily the status quo. To the contrary, it is a forecast of the way the world would look absent the regulatory action being assessed. This clarification is a much needed improvement in the guidance.

Identifying the need for Federal Regulatory Action

This section is generally sound. It helpfully clarifies the fact that a case must be made for federal regulation and that the case should be made relative, not just to no action, but to alternative courses of action such as those by lower levels of government. As rightly explained in sub-section c (p. 20 ff), alternatives to federal action may be appropriate or at least analytically informative to consider.

Perhaps the word "need" in both the title of the section and in the discussion should be modified to "potential need." For example, the supposed "needs" for regulation listed in bullets at pp. 15-16 are not really so much need as they are facts in support of a prima facie case for regulation. Just because market failures exist, for example, it does not follow that we "need" regulation. It could be that all feasible regulations impose greater net cost than the status quo, even with the market failure. That, of course, is why we do BCA in the first place. In that case, we would be better off without any regulation. But if one is better off without it, then it can't be a need. In summary, the market failure is a reason to try to design regulations that yield net benefits, but does not itself establish that we need them.

On a more minor note, I would also add, at p. 21, that just as preventing a race to the bottom across jurisdictions should be considered, so should preventing a race to the top. When conducting BCA, for example, the question should be whether federal regulation increases net benefits relative to the alternatives considered. That question suggests a neutral posture about whether more or less stringent regulations would increase net benefits.

Distributional Effects

Perhaps the most important development in the new draft of Circular A-4 is its emphasis on distributional effects. Although existing guidance in both the previous draft and in E.O. 12866 clearly authorizes an analysis of such effects, as the preamble notes, such guidance has largely been ignored or even misunderstood. The new draft's emphasis provides a much needed corrective. Distributional effects are an obviously important impact of regulations, so it stands to reason that Regulatory Impact Analyses (RIAs) should document them.

Although the draft is commendable for nudging agencies to conduct more distributional analyses, I do have four comments. First, as agencies finally begin to incorporate distributional effects into RIAs, they will be setting new precedents. Consequently, it is important that they receive good guidance from Circular A-4. But it is equally important that they move slowly and incrementally, as they gain practice and experience. In my opinion, the current draft of Circular A-4, while properly nudging agencies to do more distributional analysis, errs on one side by allowing too much discretion to agencies on when and how to do such analysis, but also on the other by nudging them too quickly to weighted BCA.

In the current draft, OMB offers agencies a great deal of discretion in when and how they analyze distributional effects, as well as which socio-economic groups to consider. OMB makes a good case for such discretion, insofar as appropriate analyses will depend critically on the policy context, which differ across agencies. However, the latitude provided also leaves scope for agencies to cherry pick when to conduct such analyses, perhaps only doing so when they "look good" for the agency. OMB heads off this problem to some extent, emphasizing that agencies should "maintain consistency when identifying groups of interest across their regulations" (p. 62). Nevertheless, it remains insofar as agencies can choose when and how to incorporate such effects. To counter this potential problem, OMB should provide guidance on what rules are significant enough to require distributional analyses.

As already suggested, a second problem with the current draft is that it moves too quickly to weighted benefit-cost analysis (sub-section e). Weighted BCA has the potential to be a valuable tool in distributional analysis. But it also raises many uncomfortable questions. In particular, it introduces—even imposes—judgements about the relative value of different groups, judgements which cannot be grounded in facts in the same way as can other aspects of BCA. For example, even if the "curvature" of individuals' cardinal utility functions is known, it is a philosophical leap from there to the required weights, as Lionel Robbins (1935) explained many years ago. This leap is illustrated by the preamble, which makes the common mistake of stating, "a standard assumption in economics is $100 for poor increases welfare more than $100 for a rich person." Actually, the standard assumption is that the same person would value a $100 more if poor than if rich. The leap is from that claim to the interpersonal comparisons.

Such interpersonal comparisons can and must be made by decision makers. Whether it will ever be the role of the BCA practitioner to do so is another question. That BCA practitioners do not yet have the credibility to make such controversial and politically charged tradeoffs is harder to dispute. For that reason, we should move more slowly. I suggest that, at this time, it is more appropriate to document distributional effects in secondary analyses, which show the impacts to various groups in tabular form, without imposing weights and collapsing the effects with a scalar-valued function. Such work would be consistent with the point, made at p. 2, that costs and benefits can include "qualitative measures … that are difficult to quantify, but nevertheless essential to consider." Elsewhere, I have presented these views in more detail (Banzhaf 2023).

A third comment is that, when distributional effects are incorporated, agencies should reconsider their long-standing practice of using uniform values across groups for different services, such as uniform values of statistical life. In fact, it is well documented that there is heterogeneity in such values. Different groups have differing willingness to pay (WTP) for a given service. Often, richer groups have greater WTP, for the simple reason that they can afford to pay more. When distributional analyses were not possible, uniform values were understandably imposed, despite the best evidence, to avoid weighting the rich more than the poor. But when distributional analyses are explicitly considered, this justification evaporates.

This is important, because imposing such uniformity, while understandable, does create new problems. In particular, when costs and benefits both affect a particular group, using some average WTP rather than that group's own WTP can result in policies that make that group worse off. The benefit-cost test is biased. Again, I have laid out these arguments previously (Banzhaf 2011, 2023).

A final comment on distributional effects is that the guidance should emphasize that analysis of such effects should treat the costs and benefits of regulations symmetrically. To be sure, a close reading of the draft does make it clear that this is the best guidance. However, I believe it could be emphasized more. My sense is that, so far, agencies have tended to prefer to show the distribution of beneficial effects of regulations, while ignoring costs (see also Cecot 2023). This practice should be explicitly discouraged. The effects of regulation on employment outcomes and on the prices of energy, consumer goods, and housing (through "capitalization" of amenities) can all have important distributional implications.

Treatment of Uncertainty

On the whole, this section gives clear and appropriate guidance on evaluating policies in the presence of uncertainty. It may be appropriate to make a sharper distinction between sub-section (a), on quantifying the uncertain effects of regulations, and (b), on individual valuations of uncertain outcomes. For example, a regulation designed to save lives may have an uncertain effects on mortality risks, because of uncertainty in the science and so forth. However even if—hypothetically—these effects were known with complete certainty, it would still be the case that individuals face risks, and valuation should be based on those risks. In this sense, Section 11(b) may relate to Section 7 (developing benefit and cost estimates) as to Section 11(a).

Additionally, the draft does a good job of explaining that risk aversion is widespread, but that analysts should be mindful that not all parties are risk averse, such as firms (p. 71). It would be helpful to be further mindful of the fact that even risk-averse parties might evaluate some effects in a risk-neutral way, if those risks are fully insurable.

Discount Rates

The current guidance on discounting is out of date and badly in need of revision. The draft's guidance to use a thirty year average real discount rate, using TIPS where available, is appropriate. Currently, this results in a discount rate of 1.7% It was not clear to me whether OMB proposes to lock in this 1.7%, or to update the thirty-year moving average annually. The latter seems more appropriate.

I will leave it to others with more expertise to comment on shadow price approach to discounting and discounting the very long run.

Summary

As stated in the introduction, it is time to revise Circular A-4. OMB has done an admirable job of incorporating the best of contemporary economic science into its guidance. This draft represents a tremendous leap forward. I submit these comments in the hope that they will be constructive and contribute to OMB's efforts.

References

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