



October 19, 2020

**Via Regulations.gov**

**To:** Environmental Protection Agency

**Subject:** Monetizing Emissions Reductions in the Control of Air Pollution From Airplanes and Airplane Engines: GHG Emissions Standards and Test Procedures (Docket no. EPA-HQ-OAR-2018-0276) (RIN 2060-AT26)

**Submitted by:** Environmental Defense Fund, Institute for Policy Integrity at New York University School of Law, Montana Environmental Information Center, Natural Resources Defense Council, Sierra Club, Union of Concerned Scientists<sup>1</sup>

These comments respond to the Environmental Protection Agency's ("EPA") proposed rule, Control of Air Pollution From Airplanes and Airplane Engines: GHG Emission Standards and Test Procedures ("Proposed Rule").<sup>2</sup> EPA's proposal would finalize standards that have no effect on emissions and require no technological improvements; instead, it would adopt as a matter of domestic U.S. regulations international standards that themselves are a decade behind what the industry will achieve absent any regulatory effort. . Accordingly, EPA finds that the Proposed Rule would result in "limited costs" (\$16,000 per year in annual reporting costs) and no monetized benefits, including greenhouse gas emissions reductions, because "all U.S. airplane models (in-production and in-development...) should be in compliance with the proposed standards" when they go into effect.<sup>3</sup>

Although EPA does not explore any scenarios that would provide significant reductions in greenhouse gas emissions, one of the scenarios EPA analyzes in the Technical Support Document ("TSD") for the Proposed Rule,<sup>4</sup> Scenario 3, appears to have modest emissions reduction effects.<sup>5</sup> However, EPA downplays the climate benefits from Scenario 3 by using the flawed 'interim' social cost of greenhouse gases estimates. If EPA had used the Interagency Working Group on the Social Cost of Carbon's ("IWG" and "SCC") 2016 central social cost estimates, it would conclude that Scenario 3's carbon dioxide benefits would be roughly nine times greater than reported in the TSD.<sup>6</sup> As EPA continues to evaluate

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<sup>1</sup> Our organizations may separately and independently submit other comments on the Proposed Rule.

<sup>2</sup> U.S. Envi. Prot. Agency, Control of Air Pollution from Airplanes and Airplane Engines: GHG Emission Standards and Test Procedures, 85 Fed. Reg. 51,556 (proposed Aug. 20, 2020).

<sup>3</sup> *Id.* at 51,588.

<sup>4</sup> U.S. Envi. Prot. Agency, Draft Airplane Greenhouse Gas Standards Technical Support Document (TSD) (Jul. 2020) [hereinafter "TSD"].

<sup>5</sup> In fact, EPA acknowledges that Scenario 3 has no emissions reduction effects because the one aircraft model that would have been affected by that scenario, A380, will exit the market before the effective date of the Proposed Rule. TSD at 133 ("The early exit of A380 would result in no costs and no emission reductions from Scenario 3.").

<sup>6</sup> Scenario 3's benefits from carbon dioxide reductions for years 2023 through 2040 are reported in the TSD as \$630,000 in 2015\$ at a 7% discount rate. *Id.* at 140. This corresponds to \$679,140 in 2019\$, using a 7.8% cumulative inflation rate over that period (determined using the U.S Bureau of Labor Stat. CPI for All Urban Consumers (CPI-U), <https://data.bls.gov/timeseries/CUUR0000SA0>). However, according to our own calculations, benefits from CO<sub>2</sub> reductions would be \$60 million (2019\$) based on EPA's schedule of emissions reductions, *id.* at 140, if they were calculated using the

standards for airplane emissions—including both Scenario 3 as well as more ambitious proposals that would lead to real and substantial reductions of greenhouse gas emissions from the high-polluting aviation sector—it should apply the IWG’s estimates of the social cost of greenhouse gases, which have been widely recognized for accounting for the full damages from greenhouse gas emissions using the best available science. Notably, the IWG’s central estimates are considered by many economic and legal experts to reflect a conservative estimate of the true costs of greenhouse gas emissions and should be treated as a lower-bound estimate.<sup>7</sup>

Indeed, the TSD contains a number of flaws with respect to monetizing greenhouse gas emissions, and so disregards tens of millions of dollars in climate benefits just from the modest Scenario 3 alternative. First, EPA focuses only on domestic climate damages in its primary analysis, relegating global climate damages to an appendix.<sup>8</sup> Second, EPA inappropriately applies the 7% discount rate to climate damages.<sup>9</sup> By making these choices, EPA reduces the SCC to as little as \$1, thereby negating up to 97% of the benefits of carbon and nitrous oxide reduction as compared to the IWG’s central estimates.<sup>10</sup>

These comments detail EPA’s many flaws in relying on this problematic estimate of the social costs of carbon and nitrous oxide that arbitrarily ignore the real costs of greenhouse gas emissions:

- EPA arbitrarily attempts to limit its valuation of the social cost of carbon to purportedly domestic-only effects. Not only is a global perspective both required under principles of rational decisionmaking and consistent with the standards of *Circular A-4*, but the methodology and models that EPA uses both cannot calculate an accurate domestic-only value and also ignore important ways in which the global impacts of climate change harm the United States. Furthermore, EPA inconsistently counts alleged costs or cost savings that will ultimately accrue to foreign owners and foreign customers of U.S. firms, even as it excludes climate impacts that will fall on U.S. citizens due to the global effects of climate change.

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2016 IWG values (global damages at a 3% discount rate). We recognize that in the TSD, EPA reports present value climate benefits of \$49 million at the 3% discount rate. *Id.* at 154.

<sup>7</sup> See Richard L. Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, 508 NATURE 173 (2014); Tamma Carleton et al., *Valuing the Global Mortality Consequences of Climate Change Accounting for Adaptation Costs and Benefits* (Becker Friedmann Inst. Working Paper No. 2018-51) (finding substantial willingness to pay to avoid just climate-related mortalities); R.S. Pindyck, *The Social Cost of Carbon Revisited* (Nat’l Bureau of Econ. Res. Working Paper w22807, 2016) (estimating the social cost of carbon as between \$100 and \$200 per metric ton, based on expert elicitation to capture willingness to pay to avoid catastrophes). Even those estimates should be seen as lower bounds. Pindyck (2016) estimates the average SCC, and not the marginal SCC that IAMs estimate. Given that “we expect the [damage] function to be convex,” R.S. Pindyck, *Coase Lecture—Taxes, Targets, and the Social Cost of Carbon*, Economics (2017), the average SCC is less than the marginal SCC.

<sup>8</sup> *Id.* at 154.

<sup>9</sup> See *id.* at 138.

<sup>10</sup> In IWG’s 2016 Technical Support Document Update of the Social Cost of Carbon for Regulatory Impact Analysis, available at [https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/scc\\_tsd\\_final\\_clean\\_8\\_26\\_16.pdf](https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/scc_tsd_final_clean_8_26_16.pdf) [hereinafter “IWG 2016 TSD”], it reported the central estimate of the social cost of carbon at a 3% discount rate for year 2040 emissions as \$60 in 2007\$. Using a 23% cumulative inflation rate over that period (determined using the U.S Bureau of Labor Stat. CPI for All Urban Consumers (CPI-U), <https://data.bls.gov/timeseries/CUUR0000SA0>), that is worth \$73.80 in 2019\$. Compared to \$73.80, \$2 is a 97.3% reduction in value. Compared to IWG’s estimate at a 2.5% discount rate (\$103 for year 2040 emissions in 2019\$), EPA’s new interim estimates negate up to 98% of the value. In IWG’s 2016 Addendum to technical Support Document on Social Cost of Carbon for Regulatory Impact Analysis under Executive Order 12866: Application of the Methodology to Estimate the Social Cost of Methane and the Social Cost of Nitrous Oxide, available at: [https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/august\\_2016\\_sc\\_ch4\\_sc\\_n2o\\_addendum\\_final\\_8\\_26\\_16.pdf](https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/august_2016_sc_ch4_sc_n2o_addendum_final_8_26_16.pdf) [hereinafter IWG 2016 Addendum], the IWG reported the central estimate for the social cost of nitrous oxide at a 3% discount rate for year 2040 emissions at \$28,290 (2019\$). Compared to \$28,000, \$754 (the ‘interim’ social cost of nitrous oxide in 2015\$ is \$700) is a 97.3% reduction in value.

- EPA arbitrarily discounts future climate effects at a 7% discount rate in addition to a 3% rate. Applying a 7% discount rate to intergenerational effects is inconsistent with *Circular A-4*'s requirements to distinguish social discount rates from rates based on private returns to capital; to make plausible assumptions; to adequately address uncertainty, especially over long time horizons; and to rely on the best available economic data and literature.
- EPA arbitrarily fails to follow prescribed practices for dealing with uncertainty. Specifically, EPA fails to address uncertainty over catastrophic damages, tipping points, option value, and risk aversion (by, for example, giving appropriate weight to an estimate of the social cost of carbon at the 95<sup>th</sup> percentile). By failing to run such sensitivity analyses, EPA overlooks how different (and more plausible) assumptions would change its cost-benefit calculation.

EPA hides behind the label of “interim values” to cherry-pick only those methodological revisions that advance its predetermined goal of lower social costs of greenhouse gases. Any update to the Interagency Working Group’s 2016 estimates must be unbiased, fully engaging with all the most up-to-date literature and with all the recommendations issued by the National Academies of Sciences.

### **I. Using the Global Estimate of the Social Cost of Greenhouse Gases Is Consistent with Standards of Rational Decisionmaking**

EPA should use global estimates of the social costs of greenhouse gases to monetize the emission reduction benefits from Scenario 3 (as well as more stringent standards that EPA should also consider) for its primary analysis in TSD. Using the global estimate is not only consistent with standards of rational decisionmaking, and in line with existing federal guidance and case law, but is required by EPA’s “obligation under section 231 of the Clean Air Act to adopt [greenhouse gas] standards,”<sup>11</sup> for the benefit of “public health or welfare.”<sup>12</sup>

#### *a. Standards of Rationality Requires Attention to and Consistent Treatment of Important Factors*

The Administrative Procedure Act requires EPA to use the best available data and methodologies to account for the social cost of greenhouse gases. This mandate continues to remain in effect following the issuance of Executive Order 13,783. Indeed, agencies must continue to monetize the social cost of greenhouse gases using the best available science, as that order recognizes, and the IWG’s 2016 estimates of the social cost of carbon reflect the best available data and methods.

The Supreme Court defined the standard of rationality for agency actions under the Administrative Procedure Act as follows:

Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, *entirely failed to consider an important aspect of the problem*, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view of the product of agency expertise.<sup>13</sup>

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<sup>11</sup> 85 Fed. Reg. 51,556 (citing Finding That Greenhouse Gas Emissions From Aircraft Cause or Contribute to Air Pollution That May Reasonably Be Anticipated To Endanger Public Health and Welfare, 81 Fed. Reg. 54,421 (Aug. 15, 2016)).

<sup>12</sup> 42 U.S.C. § 7571(a)(2)(A).

<sup>13</sup> *Motor Vehicle Manufacturers Assoc. v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 41-43 (1983) (emphasis added); *see also id.* (“[W]e must ‘consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.’”).

Furthermore, the Court found that the standard requires agencies to “examine the relevant data and articulate . . . a rational connection between the facts found and the choice made.”<sup>14</sup>

Two federal courts of appeals have already applied arbitrary and capricious review to require the use of the social cost of greenhouse gases in agency decision-making.<sup>15</sup> In *Center for Biological Diversity v. National Highway Traffic Safety Administration*, the U.S. Court of Appeals for the U.S. Court of Appeals for the Ninth Circuit ruled that, because the agency had monetized other uncertain costs and benefits of its vehicle fuel efficiency standard, its “decision not to monetize the benefit of carbon emissions reduction was arbitrary and capricious.”<sup>16</sup> Specifically, it was arbitrary to “assign[ ] no value to *the most significant benefit* of more stringent [vehicle fuel efficiency] standards: reduction in carbon emissions.”<sup>17</sup> When an agency bases a rulemaking on cost-benefit analysis, it is arbitrary to “put a thumb on the scale by undervaluing the benefits and overvaluing the costs.”<sup>18</sup> The court also approvingly cited a partial consensus among experts around an estimate of “\$50 per ton of carbon (or \$13.60 per ton CO<sub>2</sub>),”<sup>19</sup> which, in the year 2006 when the rule was issued, would have been consistent with estimates of a global social cost of carbon.<sup>20</sup>

In *Zero Zone Inc. v. Department of Energy*, the U.S. Court of Appeals for the Seventh Circuit approved of the Department of Energy’s use of the IWG’s SCC estimates, holding that that “the expected reduction in environmental costs *needs* to be taken into account” in order for the Department “[t]o determine whether an energy conservation measure is appropriate under a cost-benefit analysis.”<sup>21</sup> Furthermore, the court specifically rejected petitioner’s challenge to the Department’s use of a global (rather than domestic) social cost of carbon, holding that Department had reasonably identified carbon pollution as “a global externality” and appropriately concluded that, because “national energy conservation has global effects, . . . those global effects are an appropriate consideration when looking at a national policy.”<sup>22</sup>

And finally, and perhaps most germane of all, a recent ruling from the U.S. District Court for the Northern District of California struck down as arbitrary the Bureau of Land Management’s (“BLM”) repeal of the Waste Prevention Rule in part because the agency had abandoned the peer-reviewed, global estimates of the social cost of greenhouse gases in favor of flawed “interim” estimates that looked only at effects within the U.S. borders. In discussing the legal standard not to ignore important aspects of the rulemaking, the court reminded agencies that they lack discretion to ignore data that points in the opposite direction from its conclusions, and that agencies need more detailed justifications when they reverse prior positions.<sup>23</sup> As the Court explained, BLM did not meet these standards for numerous reasons.

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<sup>14</sup> *Id.*

<sup>15</sup> A few courts have also applied arbitrary and capricious review to the use or non-use of the social cost of carbon in environmental impact statements under the National Environmental Policy Act. In *High Country Conservation Advocates v. Forest Service*, the U.S. District Court of Colorado found that it was “arbitrary and capricious to quantify the *benefits* of the lease modifications and then explain that a similar analysis of the *costs* was impossible when such an analysis was in fact possible”—specifically, by applying the IWG’s Social Cost of Carbon protocol. 52 F. Supp. 3d 1174, 1191 (D. Colo. 2014). The U.S. District Court of Oregon declined to follow suit in *League of Wilderness Defenders v. Connaughton*, but only because in that case the Forest Service had not conducted a quantitative analysis of either costs or benefits of climate change but rather addressed climate change qualitatively. No. 3:12-cv-02271-HZ, decided Dec. 9, 2014.

<sup>16</sup> 538 F.3d 1172, 1203 (9th Cir. 2008).

<sup>17</sup> *Id.* at 1199.

<sup>18</sup> *Id.* at 1198.

<sup>19</sup> 538 F.3d at 1199, 1201.

<sup>20</sup> See Average Fuel Economy Standards, Passenger Cars and Light Trucks; Model Years 2011-2015, 73 Fed. Reg. 24,352, 24,414 (May 2, 2008) (estimating that \$14 per ton of carbon dioxide approximated global benefits).

<sup>21</sup> 832 F.3d 654, 677 (7th Cir. 2016).

<sup>22</sup> *Id.* at 679.

<sup>23</sup> *California v. Bernhardt*, 2020 WL 4001480 (N.D. Cal. July 15, 2020), at \*24–25.

For one, the court critiqued BLM for using a rushed methodology that was completed “without *any* public comment or peer review,” noting that “a more comprehensive model [to measure domestic-only impacts] does not exist nor is there any indication that one was initiated.”<sup>24</sup> The court further noted that “focusing solely on domestic effects has been soundly rejected by economists as improper and unsupported by science,” explaining that the so-called “interim” model relied upon by BLM “ignores impacts on 8 million United States citizens living abroad, including thousands of United States military personnel; billions of dollars of physical assets owned by United States companies abroad; United States companies impacted by their trading partners and suppliers abroad; and global migration and geopolitical security.”<sup>25</sup> And the court reminded BLM that executive orders, including Executive Orders 12,866 and 13,783, require consideration of “all” costs and benefits, based on the “best reasonably obtainable scientific, technical, economic, and other information,” and concluded that “none of the regulatory rules or orders require exclusion of global impacts.”<sup>26</sup> In fact, the court urged BLM to take better account of the fact that not only does BLM admit that the domestic-only estimates are “underestimates,” but that the global estimates are also likely underestimated.<sup>27</sup>

In short, agencies must monetize important greenhouse gas effects when their decisions are grounded in cost-benefit analysis.<sup>28</sup> An assessment of greenhouse gas impacts that looks only at impacts within the U.S. borders does not meet this standard.

b. *Federal Guidance Requires Consideration of Global Climate Damages*

Opponents of climate regulation, some of whom EPA cites in its TSD,<sup>29</sup> have long challenged the global number in court and other forums, and often attempted to use the Office of Management and Budget’s *Circular A-4* guidance on regulatory impact analysis as support<sup>30</sup>—as EPA does here.<sup>31</sup> Specifically, opponents have seized on *Circular A-4*’s instructions to “focus” on effects to “citizens and residents of the United States,” while any significant effects occurring “beyond the borders of the United States . . . should be reported separately.”<sup>32</sup>

Yet *Circular A-4*’s reference to effects “beyond the borders” in fact confirms that it is appropriate for agencies to consider the global effects of U.S. greenhouse gas emissions. While *Circular A-4* may suggest that most typical decisions should focus on U.S. effects, the Circular cautions agencies that special cases call for different emphases:

[Y]ou cannot conduct a good regulatory analysis according to a formula. Conducting high-quality analysis requires competent professional judgment. ***Different regulations may call for different emphases*** in the analysis, ***depending on the nature and***

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<sup>24</sup> *Id.* at \*25.

<sup>25</sup> *Id.* at \*27.

<sup>26</sup> *Id.* at \*26 (internal quotation marks omitted).

<sup>27</sup> *Id.* at \*27.

<sup>28</sup> See generally Peter Howard & Jason Schwartz, *Think Global: International Reciprocity as Justification for a Global Social Cost of Carbon*, 42 COLUMBIA J. ENVTL. L. 203 (2017) for more on applying standards of rationality to the social cost of carbon.

<sup>29</sup> See TSD at 154, (citing, among others, Gayer & Viscusi, *infra* note 30).

<sup>30</sup> Ted Gayer & W. Kip Viscusi, *Determining the Proper Scope of Climate Change Policy Benefits in U.S. Regulatory Analyses: Domestic versus Global Approaches*, 10 REV. ENVTL. ECON. & POL’Y 245 (2016) (citing Circular A-4 to argue against a global perspective on the social cost of carbon); see also, e.g., Petitioners Brief on Procedural and Record-Based Issues at 70, in *West Virginia v. EPA*, No. 15-1363, (D.C. Cir., filed Feb. 19, 2016) (challenging EPA’s use of the global social cost of carbon).

<sup>31</sup> See TSD at 143, 147.

<sup>32</sup> Office of Mgmt. & Budget, Circular A-4 at 15 (2003). Note that Circular A-4 slightly conflates “accrue to citizens” with “borders of the United States”: U.S. citizens have financial and other interests tied to effects beyond the borders of the United States.

*complexity* of the regulatory issues and the sensitivity of the benefit and cost estimates to the key assumptions.<sup>33</sup>

In fact, *Circular A-4* elsewhere assumes that agencies' analyses will not always be conducted from purely the perspective of the United States, as one of its instructions only applies "as long as the analysis is conducted from the United States perspective,"<sup>34</sup> suggesting that in some circumstances it is appropriate for the analysis to be global. For example, EPA and the Department of Transportation have adopted a global perspective on the analysis of potential monopsony benefits to U.S. consumers resulting from the reduced price of foreign oil imports following energy efficiency increases.<sup>35</sup>

Perhaps more than any other issue, a consideration of climate change requires precisely such a "different emphasis" from the default domestic-only assumption. To avoid a global "tragedy of the commons" that could irreparably damage all countries, including the United States, every nation should ideally set policy according to the global social cost of greenhouse gases.<sup>36</sup> Climate and clean air are global common resources, meaning they are freely available to all countries, but any one country's use—i.e., pollution—imposes harms on the polluting country as well as the rest of the world. Because greenhouse gas pollution does not stay within geographic borders but rather mixes in the atmosphere and affects climate worldwide, each ton emitted by the United States not only creates domestic harms, but also imposes large externalities on the rest of the world. Conversely, each ton of greenhouse gases abated in another country benefits the United States along with the rest of the world.

If all countries set their greenhouse emission levels based on only domestic costs and benefits, ignoring the large global externalities, the aggregate result would be substantially sub-optimal climate protections and significantly increased risks of severe harms to all nations, including the United States. Thus, basic economic principles demonstrate that the United States stands to benefit greatly if all countries apply global social cost of greenhouse gas values in their regulatory decisions and project reviews. Indeed, the United States stands to gain hundreds of billions or even trillions of dollars in direct benefits from efficient foreign action on climate change.<sup>37</sup>

Moreover, in order to ensure that other nations continue to use global social cost of greenhouse gas values, it is important that the United States itself do so.<sup>38</sup> The United States is engaged in a repeated strategic dynamic with several significant players—including the United Kingdom, Germany, Sweden, and others—that have already adopted a global framework for valuing the social cost of greenhouse gases.<sup>39</sup> For example, Canada and Mexico have explicitly borrowed the U.S. estimates of a global social cost of carbon to set their own fuel efficiency standards.<sup>40</sup> For the United States to depart from this collaborative dynamic by reverting to a domestic-only estimate would undermine the country's long-term

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<sup>33</sup> Circular A-4 at 3.

<sup>34</sup> *Id.* at 38 (counting international transfers as costs and benefits "as long as the analysis is conducted from the United States perspective").

<sup>35</sup> See Howard & Schwartz, *supra* note 25, at 268-69.

<sup>36</sup> See Garrett Hardin, *The Tragedy of the Commons*, 162 *Science* 1243 (1968) ("[E]ach pursuing [only its] own best interest . . . in a commons brings ruin to all.").

<sup>37</sup> Policy Integrity, *Foreign Action, Domestic Windfall: The U.S. Economy Stands to Gain Trillions from Foreign Climate Action* (2015), <http://policyintegrity.org/files/publications/ForeignActionDomesticWindfall.pdf>.

<sup>38</sup> See Robert Axelrod, *The Evolution of Cooperation* 10-11 (1984) (on repeated prisoner's dilemma games).

<sup>39</sup> See Howard & Schwartz, *supra* note 25, at Appendix B.

<sup>40</sup> See Heavy-Duty Vehicle and Engine Greenhouse Gas Emission Regulations, SOR/2013-24, 147 *Can. Gazette* pt. II, 450, 544 (Can.), available at <http://canadagazette.gc.ca/rp-pr/p2/2013/2013-03-13/html/sor-dors24-eng.html> ("The values used by Environment Canada are based on the extensive work of the U.S. Interagency Working Group on the Social Cost of Carbon."); Jason Furman & Brian Deese, *The Economic Benefits of a 50 Percent Target for Clean Energy Generation by 2025*, White House Blog, June 29, 2016 (summarizing the North American Leader's Summit announcement that U.S., Canada, and Mexico would "align" their SCC estimates).

interests and could jeopardize emissions reductions underway in other countries, which are already benefiting the United States.

For these and other reasons, reliance on a domestic-only valuation is inappropriate. In the past, some agencies have, in addition to the global estimate, also disclosed a “highly speculative”<sup>41</sup> estimate of the domestic-only effects of climate change. Such an approach is consistent with *Circular A-4*’s suggestion that agencies may disclose domestic effects separately from global effects. However, as we have discussed, reliance on a domestic-only methodology would be inconsistent with both the inherent nature of climate change and the standards of *Circular A-4*. Consequently, under *Circular A-4*, EPA should use in its primary analysis the global social costs of carbon and nitrous oxide.

For more details on the justification for a global value of the social cost of greenhouse gases, including the applicable standards of rational decisionmaking, please see Peter Howard & Jason Schwartz, *Think Global: International Reciprocity as Justification for a Global Social Cost of Carbon*, 42 Columbia J. Envtl. L. 203 (2017). Another strong defense of the global valuation as consistent with best economic practices appears in a letter published in *The Review of Environmental Economics and Policy*, co-authored by Nobel laureate Kenneth Arrow. As Arrow and his co-authors explained: “To solve the unprecedented global commons problem posed by climate change, all nations must internalize the global externalities of their emissions[.] . . . [O]therwise, collective abatement efforts will never achieve an efficient, stable climate outcome.”<sup>42</sup>

*c. Benefits and Costs that “Accrue to Citizens and Residents of the United States” Extend Far Beyond U.S. Borders*

To follow *Circular A-4*’s instruction to analyze all significant effects that “accrue to [U.S.] citizens,” agencies must look beyond “the borders of the United States” to a much broader range of climate effects. For one, because of our world’s interconnected financial, political, health, security, and environmental systems, climate impacts occurring initially beyond the geographic borders of the United States cause significant costs that accrue to U.S. citizens and residents. Second, because U.S. climate policy impacts the climate policies of other nations, deregulatory actions such as this proposal have an indirect effect on foreign emissions and thus cause climate-related domestic impacts that are not accounted for in EPA’s methodology. And third, U.S. citizens have direct interests in climate-related impacts that will occur overseas, including those affecting citizens living abroad or harming international habitats or species that U.S. citizens value. EPA makes no effort to address this reality, rather saying the agency follows the guidance of *Circular A-4* by “focus[ing] on the direct impacts of climate change that are anticipated to occur within U.S. borders.”<sup>43</sup> Below, we detail each of these three important aspects of climate damages for which the EPA’s “domestic-only” valuation fails to account.

**International Spillovers:** First, EPA’s valuation of the social costs of greenhouse gases ignores significant, indirect costs to trade, human health, and security likely to “spill over” to the United States as other regions experience climate change damages.<sup>44</sup> As a federal court recently explained, this is “because

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<sup>41</sup> See e.g., DOE, 2016-12 Final Rule Technical Support Document: Energy Efficiency Program for Consumer Products and Commercial and Industrial Equipment: Air Compressors, 14-3 n. B.

<sup>42</sup> Richard Revesz, Kenneth Arrow et al., *The Social Cost of Carbon: A Global Imperative*, 11 REVIEW OF ENVTL. ECON. & POLICY 172 (2017).

<sup>43</sup> 2020 TSD at 14-1.

<sup>44</sup> Indeed, the integrated assessment models used to develop the global SCC estimates largely ignore inter-regional costs entirely. See Peter Howard, *Omitted Damages: What’s Missing from the Social Cost of Carbon* (Cost of Carbon Project Report, 2014). Though some positive spillover effects are also possible, such as technology spillovers that reduce the cost of mitigation or adaptation, see S. Rao et al., *Importance of Technological Change and Spillovers in Long-Term Climate Policy*, 27 ENERGY J. 123-39 (2006), overall spillovers likely mean that the U.S. share of the global SCC is underestimated, see Jody Freeman & Andrew Guzman, *Climate Change and U.S. Interests*, 109 COLUMBIA L. REV. 1531 (2009).

emissions of most greenhouse gases contribute to damages around the world and the world's economies are now highly interconnected.<sup>45</sup> These spillover effects, “such as on trade and migration... must be considered in any attempt to estimate domestic impacts.”<sup>46</sup> Due to its unique place among countries—both as the largest economy with trade- and investment-dependent links throughout the world, and as a military superpower—the United States is particularly vulnerable to effects that will spill over from other regions of the world. Spillover scenarios could entail a variety of serious costs to the United States as unchecked climate change devastates other countries.

Correspondingly, mitigation or adaptation efforts that avoid climate damages to foreign countries will radiate benefits back to the United States as well.<sup>47</sup> While the current integrated assessment models (“IAMs”) provide reliable but conservative estimates of global damages, they currently cannot calculate reliable region-specific estimates, in part because they do not model such spillovers.

As climate change disrupts the economies of other countries, decreased availability of imported inputs, intermediary goods, and consumption goods may cause supply shocks to the U.S. economy. Shocks to the supply of energy, technological, and agricultural goods could be especially damaging. For example, when Thailand—the world's second-largest producer of hard-drives—experienced flooding in 2011, U.S. consumers faced higher prices for many electronic goods, from computers to cameras.<sup>48</sup> A recent economic study explored how heat stress-induced reductions in productivity worldwide will ripple through the interconnected global supply network.<sup>49</sup> Similarly, the U.S. economy could experience demand shocks as climate-affected countries decrease their demand for U.S. goods. Financial markets may also suffer as foreign countries become less able to loan money to the United States and as the value of U.S. firms declines with shrinking foreign profits. As seen historically, economic disruptions in one country can cause financial crises that reverberate globally at a breakneck pace.<sup>50</sup>

The human dimension of climate spillovers includes migration and health effects. Water and food scarcity, flooding or extreme weather events, violent conflicts, economic collapses, and a number of other climate damages could precipitate mass migration to the United States from regions worldwide, especially, perhaps, from Latin America. For example, a 10% decline in crop yields could trigger the emigration of 2% of the entire Mexican population to other regions, mostly to the United States.<sup>51</sup> Such an influx could strain the U.S. economy and will likely lead to increased U.S. expenditures on migration prevention. Infectious disease could also spill across the U.S. borders, exacerbated by ecological collapses, the breakdown of public infrastructure in poorer nations, declining resources available for prevention, shifting habitats for disease vectors, and mass migration.

Finally, climate change is predicted to exacerbate existing security threats—and possibly catalyze new security threats—to the United States.<sup>52</sup> Besides threats to U.S. military installations and operations at home and abroad from flooding, storms, extreme heat, and wildfires,<sup>53</sup> climate change is also a “source[] of conflict around the world” requiring U.S. response, according to a Department of Defense report issued

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<sup>45</sup> *California*, 2020 WL 4001480, at \*23.

<sup>46</sup> *Id.* at \*28.

<sup>47</sup> See Freeman & Guzman, *supra* note 43, at 1563-93.

<sup>48</sup> See Charles Arthur, *Thailand's Devastating Floods Are Hitting PC Hard Drive Supplies*, THE GUARDIAN (Oct. 25, 2011).

<sup>49</sup> Leonie Wenz & Anders Levermann, *Enhanced Economic Connectivity to Foster Heat Stress-Related Losses*, SCIENCE ADVANCES (June 10, 2016).

<sup>50</sup> See Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 249 (2008) (observing that financial collapse in one country is inevitably felt beyond that country's borders).

<sup>51</sup> Shuaizhang Feng, Alan B. Krueger & Michael Oppenheimer, *Linkages Among Climate Change, Crop Yields and Mexico-U.S. Cross-Border Migration*, 107 PROC. NAT'L ACAD. SCI. 14,257 (2010).

<sup>52</sup> See CNA Military Advisory Board, *National Security and the Accelerating Risks of Climate Change* (2014).

<sup>53</sup> U.S. Gov't Accountability Office, GAO-14-446 *Climate Change Adaptation: DOD Can Improve Infrastructure Planning and Processes to Better Account for Potential Impacts* (2014); Union of Concerned Scientists, *The U.S. Military on the Front Lines of Rising Seas* (2016).



last year.<sup>54</sup> This report corroborates a 2014 Department of Defense report declaring that climate effects “are threat multipliers that will aggravate stressors abroad such as poverty, environmental degradation, political instability, and social tensions—conditions that can enable terrorist activity and other forms of violence,” and as a result “climate change may increase the frequency, scale, and complexity of future missions, including defense support to civil authorities, while at the same time undermining the capacity of our domestic installations to support training activities.”<sup>55</sup> As an example of the climate-security-migration nexus, prolonged drought in Syria likely exacerbated the social and political tensions that erupted into an ongoing civil war,<sup>56</sup> which has triggered an international migration and humanitarian crisis.<sup>57</sup>

Because of these interconnections, attempts to artificially segregate a U.S.-only portion of climate damages will inevitably result in misleading underestimates. Some experts on the social cost of carbon have concluded that, given that integrated assessment models currently do not capture many of these key inter-regional costs, use of the global social cost of greenhouse gas estimates may be further justified as a proxy to capturing all spillover effects.<sup>58</sup> Though not all climate damages will spill back to affect the United States, many will, and together with other justifications, the likelihood of significant spillovers makes a global valuation the better, more transparent accounting of the full range of costs and benefits that matter to U.S. policymakers and the public.

**Reciprocal Foreign Actions:** Second, an indirect consequence of the United States using a global social cost of greenhouse gas to justify actions that protect against climate damages is that foreign countries take reciprocal actions that benefit the United States. Yet EPA arbitrarily fails to account for this likely significant impact. *Circular A-4* requires that the “same standards of information and analysis quality that apply to direct benefits and costs should be applied to ancillary benefits and countervailing risks.”<sup>59</sup> Consequently, any attempt to estimate a domestic-only value of the social cost of greenhouse gas must include indirect effects from reciprocal foreign actions.

As detailed more in Howard & Schwartz (2017), because the world’s climate is a single interconnected system, the United States benefits greatly when foreign countries consider the global externalities of their greenhouse gas pollution and cut emissions accordingly. Game theory predicts that one viable strategy for the United States to encourage other countries to think globally in setting their climate policies is for the United States to do the same, in a tit-for-tat, lead-by-example, or coalition-building dynamic. In fact, most other countries with climate policies already use a global social cost of carbon or set their carbon taxes or allowances at prices above their domestic-only costs, consistent with the global perspective used to date

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<sup>54</sup> U.S. Dep’t of Defense, Report on Effects of a Changing Climate to the Dep’t of Defense 8 (Jan. 2019), available at <https://media.defense.gov/2019/Jan/29/2002084200/-1/-1/1/CLIMATE-CHANGE-REPORT-2019.PDF>. Recently-departed Secretary of Defense James Mattis has also explained that “[c]limate change is impacting stability in areas of the world where our troops are operating today.” Andrew Revkin, *Trump’s Defense Secretary Cites Climate Change as National Security Challenge*, ProPublica, Mar. 14, 2017.

<sup>55</sup> U.S. Dep’t of Defense, *Quadrennial Defense Review 2014* vi, 8 (2014).; see also U.S. Dep’t of Defense, *Report to Congress: National Security Implications of Climate-Related Risks and a Changing Climate* (2015), available at <http://archive.defense.gov/pubs/150724-congressional-report-on-national-implications-of-climate-change.pdf?source=govdelivery> (“Global climate change will have wide-ranging implications for U.S. national security interests over the foreseeable future because it will aggravate existing problems—such as poverty, social tensions, environmental degradation, ineffectual leadership, and weak political institutions—that threaten domestic stability in a number of countries.”)

<sup>56</sup> See Center for American Progress et al., *The Arab Spring and Climate Change: A Climate and Security Correlations Series* (2013); Colin P. Kelley et al., *Climate Change in the Fertile Crescent and Implications of the Recent Syrian Drought*, 112 PROC. NAT’L ACAD. SCI. 3241 (2014); Peter H. Gleick, *Water, Drought, Climate Change, and Conflict in Syria*, 6 WEATHER, CLIMATE & SOCIETY, 331 (2014).

<sup>57</sup> See, e.g., *Ending Syria War Key to Migrant Crisis, Says U.S. General*, BBC.COM (Sept. 14, 2015).

<sup>58</sup> See Robert E. Kopp & Bryan K. Mignone, *Circumspection, Reciprocity, and Optimal Carbon Prices*, 120 CLIMATE CHANGE 831, 833 (2013).

<sup>59</sup> Circular A-4 at 26.

by U.S. agencies to value the cost of greenhouse gases. Both Republican and Democratic administrations have recognized that the analytical and regulatory choices of U.S. agencies can affect the actions of foreign countries, which in turn affect U.S. citizens.<sup>60</sup> This impact can be incredibly significant: According to one study, by 2030, direct U.S. benefits from global climate policies already in effect could reach over \$2 trillion.<sup>61</sup> Any attempt to estimate a domestic-only value of the social cost of greenhouse gases must include such indirect effects from reciprocal foreign actions.<sup>62</sup>

**Extraterritorial Interests:** *Circular A-4* requires agencies to count all significant costs and benefits, and specifically explains the importance of including “non-use” values like “bequest and existence values”. Yet by “ignoring these values” in calculating the social cost of carbon, contrary to *Circular A-4*’s explicit instructions, EPA “significantly understate[s] the ... costs” of the proposed change in methodology.<sup>63</sup> Similarly, *Circular A-4* recognizes that U.S. citizens may have “altruism for the health and welfare of others,” and instructs agencies that when “there is evidence of selective altruism, it needs to be considered specifically in both benefits and costs.”<sup>64</sup> Many costs and benefits accrue to U.S. citizens from use values, non-use values, and altruism attached to climate effects occurring outside the U.S. borders, and DOE’s valuation of the social cost of carbon fails to account for these significant effects.

A domestic-only estimate based on some rigid conception of geographic borders or U.S. share of world GDP will fail to capture all the climate-related costs and benefits that matter to U.S. citizens,<sup>65</sup> including significant U.S. ownership interests in foreign businesses, properties, and other assets, as well as consumption abroad including tourism,<sup>66</sup> and even the 8.7 million Americans living abroad.<sup>67</sup>

The United States also has a willingness to pay—as well as a legal obligation—to protect the global commons of the oceans and Antarctica from climate damages. For example, the Madrid Protocol on Environmental Protection to the Antarctic Treaty commits the United States and other parties to the “comprehensive protection of the Antarctic environment,” including “regular and effective monitoring” of “effects of activities carried on both within and outside the Antarctic Treaty area on the Antarctic

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<sup>60</sup> Howard & Schwartz, *supra* note 25, at 232-37 (citing acknowledgement of this phenomenon by both the Bush administration and the Obama administration).

<sup>61</sup> Policy Integrity, *Foreign Action, Domestic Windfall: The U.S. Economy Stands to Gain Trillions from Foreign Climate Action* 11 (2015), <http://policyintegrity.org/files/publications/ForeignActionDomesticWindfall.pdf>.

<sup>62</sup> Kotchen shows that the optimally strategic social cost of greenhouse gas value will be strictly higher than the domestic value for all countries. Matthew J. Kotchen, *Which Social Cost of Carbon? A Theoretical Perspective* (NBER Working Paper, 2016). See also Comments from Robert Pindyck to BLM on the Social Cost of Methane in the Proposed Suspension of the Waste Prevention Rule (submitted Nov. 5, 2017) for a discussion of Kotchen (2016), and for a related discussion of why a domestic social cost of carbon is not in the United States’ interest.

<sup>63</sup> Circular A-4 at 22.

<sup>64</sup> *Id.*

<sup>65</sup> As the Northern District of California recently explained, the so-called “interim” Social Cost of Carbon “ignores impacts on 8 million United States citizens living abroad, including thousands of United States military personnel; billions of dollars of physical assets owned by United States companies abroad; United States companies impacted by their trading partners and suppliers abroad; and global migration and geopolitical security.” Thus, the court held, reliance on this estimate in rulemaking unlawfully “fail[s] to consider . . . important aspect[s] of the problem” and “runs counter to the evidence before the agency.” *California*, 2020 WL 4001480, at \*23 (internal quotation marks omitted).

<sup>66</sup> “U.S. residents spend millions each year on foreign travel, including travel to places that are at substantial risk from climate change, such as European cities like Venice and tropical destinations like the Caribbean islands.” David A. Dana, *Valuing Foreign Lives and Civilizations in Cost-Benefit Analysis: The Case of the United States and Climate Change Policy* (Northwestern Faculty Working Paper 196, 2009), <http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1195&context=facultyworkingpaper>.

<sup>67</sup> Assoc. of Americans Resident Overseas, 8.7 million Americans (excluding military) live in 160-plus countries, available at <https://www.aaro.org/about-aaro/8m-americans-abroad>. Admittedly, 8.7 million is only 0.1% of the total population living outside the United States.

environment.”<sup>68</sup> The share of climate damages for which the United States is responsible is not limited to our geographic borders.

Similarly, U.S. citizens value natural resources and plant and animal lives abroad, even if they never use those resources or see those plants or animals. For example, the “existence value” of restoring the Prince William Sound after the 1989 Exxon Valdez oil tanker disaster—that is, the benefits derived by Americans who would never visit Alaska but nevertheless felt strongly about preserving the existence of this pristine environment—was estimated in the billions of dollars.<sup>69</sup> Though the methodologies for calculating existence value remain controversial,<sup>70</sup> U.S. citizens certainly have a non-zero willingness to pay to protect rainforests, charismatic megafauna like pandas, and other life and environments existing in foreign countries. U.S. citizens also have an altruistic willingness to pay to protect foreign citizens’ health and welfare.<sup>71</sup> This altruism is “selective altruism,” consistent with *Circular A-4*, because the United States is directly responsible for a huge amount of the historic emissions contributing to climate change.<sup>72</sup>

## II. Using a Domestic-Only Social Cost of Greenhouse Gases Estimate Is Arbitrary and Capricious

EPA should not base the proposed greenhouse gas emissions standards for airplanes on a domestic-only social cost of greenhouse gases, but rather should continue to focus on a global value. Not only is it inconsistent with *Circular A-4* and best economic practices to fail to estimate the global damages of U.S. greenhouse gas emissions in regulatory analyses, but existing methods for estimating a “domestic-only” value are unreliable, incomplete, and therefore inconsistent with *Circular A-4*. Indeed, in 2015, the Office of Management and Budget concluded, along with several other agencies, that “good methodologies for estimating domestic damages do not currently exist.”<sup>73</sup> Moreover, a domestic-only estimate misapplies models that were not built for the purpose of calculating regional damages, ignores recent literature on significant U.S. climate damages, and fails to reflect international spillovers to the United States, U.S. benefits from foreign reciprocal actions, and the extraterritorial interests of U.S. citizens including financial interests and altruism.

*a. A federal court has ruled that use of the “interim” domestic-only social cost of greenhouse gases is arbitrary and capricious*

In July 2020, the U.S. District Court for the Northern District of California ruled that the Bureau of Land Management’s use of the “interim,” domestic-only estimates for the social cost of greenhouse gases in its justification to rescind the 2016 Waste Prevention Rule was arbitrary and capricious.<sup>74</sup> The court found that not only did BLM “revers[e] [its] prior position” about the proper Social Cost of Carbon value without sufficient justification,<sup>75</sup> but also that the domestic-only social cost of greenhouse gases is methodologically flawed and inappropriate for use by federal agencies. The court noted that “focusing

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<sup>68</sup> Madrid Protocol on Environmental Protection to the Antarctic Treaty (1991), [http://www.ats.aq/documents/recatt/Att006\\_e.pdf](http://www.ats.aq/documents/recatt/Att006_e.pdf)

<sup>69</sup> RICHARD REVESZ & MICHAEL LIVERMORE, *RETAKING RATIONALITY* 121 (2008).

<sup>70</sup> *Id.* at 129.

<sup>71</sup> See Arden Rowell, *Foreign Impacts and Climate Change*, 39 HARV. ENV’T L. REV. 371 (2015); Dana, *supra* note 65 (discussing U.S. charitable giving abroad and foreign aid, and how those metrics likely severely underestimate true U.S. willingness to pay to protect foreign welfare).

<sup>72</sup> Datablog, *A History of CO<sub>2</sub> Emissions*, THE GUARDIAN (Sept. 2, 2009) (from 1900-2004, the United States emitted 314,772.1 million metric tons of carbon dioxide; Russia and China follow, with only around 89,000 million metric tons each).

<sup>73</sup> In November 2013, OMB requested public comments on the social cost of carbon. In 2015, OMB along with the rest of the Interagency Working Group issued a formal response to those comments. Interagency Working Group on the Social Cost of Carbon, *Response to Comments: Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12,866* at 36 (July 2015).

<sup>74</sup> *California*, 2020 WL 4001480, at \*28.

<sup>75</sup> *Id.* at \*18.

solely on domestic effects has been soundly rejected by economists as improper and unsupported by science.”<sup>76</sup> And by omitting global effects, BLM’s

analysis ignores impacts on 8 million United States citizens living abroad, including thousands of United States military personnel; billions of dollars of physical assets owned by United States companies abroad; United States companies impacted by their trading partners and suppliers broad; and global migration and geopolitical security.<sup>77</sup>

In other words, even though BLM claimed that its “interim” estimates captured the effects accruing to the United States, the agency in fact overlooked the tremendous damages to U.S. interests resulting from climate impacts occurring from outside the country’s geographical borders. In addition, the Northern District of California explained that by ignoring the National Academies’ findings “that international effects can have significant spill-over effects in the United States, such as on trade and migration, which must be considered in any attempt to estimate domestic impacts,” BLM casted aside the best available science.<sup>78</sup> Nor was the fact that President Trump rescinded the IWG’s documents by Executive Order of legal relevance, since “[t]he Executive Order in and of itself has no legal impact on the consensus that IWG’s estimates constitute the best available science about monetizing the impacts of greenhouse gas emissions.”<sup>79</sup>

EPA is committing the same errors in its TSD for the Proposed Rule as BLM did its justification for the rescission of the Waste Prevention Rule. Such obfuscation of global climate damages is inconsistent with the best available science and economics, and without providing “evidence of specialists’ conflicting views or alternative scientific models” to support its change from its prior position (i.e. use of the IWG’s social cost of carbon estimates),<sup>80</sup> reliance on the “interim” domestic-only social cost of greenhouse gases is arbitrary and capricious.

*b. No current methodology for estimating a “domestic-only” value is consistent with practices for reasoned decisionmaking, as confirmed in a recent GAO report*

The Office of Management and Budget, the National Academies of Sciences, the Government Accountability Office, and the economic literature all agree that existing methodologies for calculating a “domestic-only” value of the social cost of greenhouse gases are deeply flawed and result in severe and misleading underestimates.

In developing the social cost of carbon, the IWG did offer some such domestic estimates. Using the results of one economic model (FUND) as well as the U.S. share of global gross domestic product (“GDP”), the group generated an “approximate, provisional, and *highly speculative*” range of 7–23% of the global social cost of carbon as an estimate of the purely direct climate effects to the United States.<sup>81</sup> Yet, as the IWG itself acknowledged, this range is almost certainly an underestimate because it ignores significant, indirect costs to trade, human health, and security that are likely to spill over into the United States as other regions experience climate change damages, among other effects.<sup>82</sup>

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<sup>76</sup> *Id.* at \*27.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at \*28.

<sup>79</sup> *Id.* at \*25.

<sup>80</sup> *Id.* at \*27.

<sup>81</sup> INTERAGENCY WORKING GROUP ON SOCIAL COST OF CARBON, TECHNICAL SUPPORT DOCUMENT: SOCIAL COST OF CARBON FOR REGULATORY IMPACT ANALYSIS 11 (2010) [hereinafter “IWG 2010 TSD”] (emphasis added).

<sup>82</sup> *Id.* (explaining that the IAMs, like FUND, do “not account for how damages in other regions could affect the United States (e.g., global migration, economic and political destabilization”).

Neither the existing IAMs nor a share of global GDP are an appropriate basis for calculating a domestic-only estimate. The IAMs were never designed to calculate a domestic SCC, since a global SCC is the economically efficient value. FUND, like other IAMs, includes some simplifying assumptions: of relevance, FUND and the other IAMs are not able to capture the adverse effects that the impacts of climate change in other countries will have on the United States through trade linkages, national security, migration, and other forces.<sup>83</sup> This is why the IWG characterized the domestic-only estimate from FUND as a “highly speculative” underestimate. Similarly, a domestic-only estimate based on some rigid conception of geographic borders or U.S. share of world GDP will fail to capture all the climate-related costs and benefits that matter to U.S. citizens.<sup>84</sup> U.S. citizens have economic and other interests abroad that are not fully reflected in the U.S. share of global GDP. GDP is a “monetary value of final goods and services—that is, those that are bought by the final user—produced in a country in a given period of time.”<sup>85</sup> GDP therefore does not reflect significant U.S. ownership interests in foreign businesses, properties, and other assets, as well as consumption abroad including tourism,<sup>86</sup> or even the 8 million Americans living abroad.<sup>87</sup>

At the same time, GDP is also over-inclusive, counting productive operations in the United States that are owned by foreigners. Gross National Income (“GNI”), by contrast, defines its scope not by location but by ownership interests.<sup>88</sup> However, not only has GNI fallen out of favor as a metric used in international economic policy,<sup>89</sup> but using a domestic-only SCC based on GNI would make the SCC metrics incommensurable with other costs in regulatory impact analyses, since most regulatory costs are calculated by U.S. agencies regardless of whether they fall to U.S.-owned entities or to foreign-owned entities operating in the United States.<sup>90</sup> Furthermore, both GDP and GNI are dependent on what happens in other countries, due to trade and the international flow of capital. The artificial constraints of both metrics counsel against a rigid split based on either U.S. GDP or U.S. GNI.<sup>91</sup>

As a result, in 2015, OMB concluded, along with several other agencies, that “good methodologies for estimating domestic damages do not currently exist.”<sup>92</sup> Similarly, the NAS recently concluded that current IAMs cannot accurately estimate the domestic social cost of greenhouse gases, and that estimates based

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<sup>83</sup> See, e.g., Dept. of Defense, *National Security Implications of Climate-Related Risks and a Changing Climate* (2015), available at <http://archive.defense.gov/pubs/150724-congressional-report-on-national-implications-of-climate-change.pdf?source=govdelivery>.

<sup>84</sup> A domestic-only SCC would fail to “provide to the public and to OMB a careful and transparent analysis of the anticipated consequences of economically significant regulatory actions.” Office of Information and Regulatory Affairs, *Regulatory Impact Analysis: A Primer 2* (2011).

<sup>85</sup> Tim Callen, *Gross Domestic Product: An Economy’s All*, IMF, <http://www.imf.org/external/pubs/ft/fandd/basics/gdp.htm> (last updated Mar. 28, 2012).

<sup>86</sup> “U.S. residents spend millions each year on foreign travel, including travel to places that are at substantial risk from climate change, such as European cities like Venice and tropical destinations like the Caribbean islands.” Dana, *supra* note 65.

<sup>87</sup> Assoc. of Americans Resident Overseas, <https://www.aaro.org/about-aaro/6m-americans-abroad>. Admittedly 8 million is only 0.1% of the total population living outside the United States.

<sup>88</sup> *GNI, Atlas Method (Current US\$)*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GNP.ATLS.CD>.

<sup>89</sup> *Id.*

<sup>90</sup> U.S. Office of Management and Budget & Secretariat General of the European Commission, *Review of Application of EU and US Regulatory Impact Assessment Guidelines on the Analysis of Impacts on International Trade and Development* 13 (2008).

<sup>91</sup> Advanced Notice of Proposed Rulemaking on Regulating Greenhouse Gas Emissions Under the Clean Air Act, 73 Fed. Reg. 44,354, 44,415 (July 30, 2008) (“Furthermore, international effects of climate change may also affect domestic benefits directly and indirectly to the extent U.S. citizens value international impacts (e.g., for tourism reasons, concerns for the existence of ecosystems, and/or concern for others); U.S. international interests are affected (e.g., risks to U.S. national security, or the U.S. economy from potential disruptions in other nations).”).

<sup>92</sup> In November 2013, OMB requested public comments on the social cost of carbon. In 2015, OMB along with the rest of the Interagency Working Group issued a formal response to those comments. Interagency Working Group on the Social Cost of Carbon, Response to Comments: Social Cost of Carbon for Regulatory Impact Analysis under Executive Order 12,866, at 36 (July 2015) [hereinafter, OMB 2015 Response to Comments].

on U.S. share of global GDP would be likewise insufficient.<sup>93</sup> William Nordhaus, the developer of the DICE model, cautioned earlier this year that “regional damage estimates are both incomplete and poorly understood,” and “there is little agreement on the distribution of the SCC by region.”<sup>94</sup> In short, any domestic-only estimate will be inaccurate, misleading, and out of step with the best available economic literature, in violation of *Circular A-4*’s standards for information quality.

Consistent with this longstanding consensus, in June 2020 the Government Accountability Office (“GAO”) published a report critiquing the federal government’s reliance on the “interim” social cost of carbon and its failure to implement the National Academies’ recommendations on updating the social cost of carbon estimates.<sup>95</sup> GAO concluded that the integrated assessment models EPA used to derive its domestic-only social cost of carbon “were not premised or calibrated to provide estimates of the social cost of carbon based on domestic damages.”<sup>96</sup> GAO further noted that the National Academies found that country-specific social costs of carbon estimates were “limited by existing methodologies, which focus primarily on global estimates and do not model all relevant interactions among regions.”<sup>97</sup> Moreover, it explained, the National Academies concluded that “accurately estimating the damages from carbon dioxide emissions for the United States would involve more than examining the direct impacts of climate change that occur within U.S. physical borders,” as “U.S.-specific damages would need to consider how climate change and emissions reductions in other parts of the world could also affect the United States.”<sup>98</sup>

GAO also concluded that “[t]he federal government has no plans to address the recommendations of the National Academies [] for updating the methodologies used to develop the federal estimates of the social cost of carbon,” and “therefore, the federal government may not be well positioned to ensure agencies’ future regulatory analyses are using the best available science until the agencies finalize federal estimates that consider the National Academies’ implemented recommendations.”<sup>99</sup>

Given the federal government’s failure to act on the National Academies’ recommendations to update the social cost of greenhouse gases estimates so that they *are* reflective of the best available science and economics, and given that the National Academies and many other organizations and economists aver that the IAMs are inappropriate for calculating domestic-only damages, EPA should not rely on so-called “interim” estimates.

*c. EPA Relies on Sources that Cannot Accurately Calculate a Domestic-Only Estimate and that Explicitly Caution Against Using Domestic-Only Estimates*

Despite broad consensus that there are no existing methodologies that accurately project domestic climate damages, EPA attempts to derive a domestic estimate anyway using existing international damage estimates.

In particular, in the TSD, EPA reports that its domestic-only estimates are “calculated directly” from the models FUND and PAGE; for the model DICE, EPA simply assumes that U.S. damages are 10% of global damages.<sup>100</sup> EPA thus uses these models in ways they were never designed for—indeed, in ways their designers specifically cautioned against. EPA furthermore fails to assess the most up-to-date

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<sup>93</sup> NATIONAL ACADEMIES OF SCIENCES, ENGINEERING, AND MEDICINE, VALUING CLIMATE DAMAGES: UPDATING ESTIMATION OF THE SOCIAL COST OF CARBON DIOXIDE 53 (2017) [hereinafter NAS Second Report].

<sup>94</sup> William Nordhaus, *Revisiting the Social Cost of Carbon*, 114 PNAS 1518, 1522 (2017).

<sup>95</sup> GAO, SOCIAL COST OF CARBON: IDENTIFYING A FEDERAL ENTITY TO ADDRESS THE NATIONAL ACADEMIES’ RECOMMENDATIONS COULD STRENGTHEN REGULATORY ANALYSIS, GAO-20-254 (June 2020) [Attached].

<sup>96</sup> *Id.* at 29.

<sup>97</sup> *Id.* at 26.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 29.

<sup>100</sup> TSD at 147.

literature on U.S. damages and fails to take steps to reflect spillover effects, reciprocal benefits, or U.S. interests beyond our borders. EPA’s methodology is deeply flawed.

The integrated assessment models used by the agency to calculate the social cost of greenhouse gases were designed to create global estimates and are best suited for those purposes. The models are limited in how accurately and fully they can estimate domestic values of the social cost of greenhouse gases. For example, the models make simplifying assumptions about the extent of heterogeneity in crucial parameters like relative prices and discount rates.<sup>101</sup> The models also simplify or ignore completely global spillovers from trade, migration, and other sources.<sup>102</sup> These types of spillovers will not, in many cases, affect the global estimate of climate change damages, but they will change (perhaps dramatically so) the domestic estimates. For example, trade effects will net to zero globally: A decrease in exports by one country must correspond to a decrease in imports for another country.<sup>103</sup> Global estimates will also generally be more accurate than domestic estimates because aggregation of multiple values reduces the error of the overall estimate.<sup>104</sup>

An examination of the individual models used to calculate the “interim” domestic social cost of greenhouse gases—PAGE 2009, FUND 3.8, and DICE 2010<sup>105</sup>—highlights the current limitations to calculating of a domestic value of the social cost of greenhouse gases. For example, the only way that the PAGE model “calculate[s] directly” regional impacts is through its “regional scaling factors,” which are “based on the length of each region’s coastline relative to the [European Union]. Because of the long coastline in the EU, other regions are, on average, [deemed to be] less vulnerable than the EU for the same sea level and temperature increase.”<sup>106</sup> In other words, PAGE calculates climate impacts occurring within U.S. borders by first estimating the climate damages that an additional ton of methane will cause in Europe, and then scaling down that value because the United States has a coastline that is three times shorter than Europe’s.<sup>107</sup>

While relative coastline length may provide a reasonable scaling factor for certain climate damages, such as from coastal flooding, coastal storms, and other sea-level rise issues, it likely understates many other key climate damages—perhaps dramatically so—to the United States, where increases in mortality, agricultural losses, and other important climate effects will also occur in inland, warm areas of the country,<sup>108</sup> and will occur regardless of relative coastline length. Accordingly, EPA’s methodology for calculating domestic climate damages from the PAGE model—one of just three models that the “interim” estimate incorporates—completely disregards significant damage categories.

The other two models on which the “interim” domestic social cost of greenhouse gases estimate relies similarly overlook substantial damage categories. The FUND model generally estimates domestic damages from climate change by scaling estimates according to gross domestic product or population. For instance, forestry damages are “mapped to the FUND regions assuming that the impact is uniform

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<sup>101</sup> Christian Gollier & James K. Hammitt, *The Long-Run Discount Rate Controversy*, 6 ANNU. REV. RESOUR. ECON. 273–295 (2014) at 287-289.

<sup>102</sup> See generally Howard & Schwartz, *supra* note 28.

<sup>103</sup> See, e.g. PAUL R. KRUGMAN, MAURICE OBSTFELD & MARC J. MELITZ, INTERNATIONAL ECONOMICS: THEORY AND POLICY (10 ed. 2015). Such changes could have an effect on overall levels of trade, in turn effecting global damage estimates.

<sup>104</sup> See, e.g. SIDNEY I RESNICK, A PROBABILITY PATH (2013) at 203.

<sup>105</sup> TSD at 147.

<sup>106</sup> INTERAGENCY WORKING GROUP ON THE SOCIAL COST OF GREENHOUSE GASES, TECHNICAL SUPPORT DOCUMENT: TECHNICAL UPDATE OF THE SOCIAL COST OF CARBON FOR REGULATORY IMPACT ANALYSIS 17 (2016).

<sup>107</sup> According to the CIA’s World Factbook, EU’s coastline is over three times longer than the U.S. coastline. Compare <https://www.cia.gov/library/publications/the-world-factbook/geos/ee.html>, with <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

<sup>108</sup> Solomon Hsiang et al., *Economic Damage from Climate Change in the United States*, 356 SCIENCE 1362–69 (2017).

[relative] to GDP.”<sup>109</sup> Similarly, domestic energy consumption changes are a function of gross domestic product, and the authors note that “heating demand is linear in the number of people” in a FUND region.<sup>110</sup> Scaling damages by gross domestic product and population will fail to capture important differences between countries like pre-existing climate, interconnectedness of trade relationships, climate change preparedness, and preferences.

These issues are readily apparent in the case of agricultural damage estimates in FUND. Agriculture is one of the most important sectors driving the relatively low damages in the FUND model. Yet, recent evidence on this sector that incorporates cutting-edge estimates of crop yield changes finds that the FUND model substantially understates the agricultural damages from climate change.<sup>111</sup> Particularly for domestic damages, new research shows that FUND dramatically understates the effect of warming on agricultural outcomes globally and for individual countries like the United States.<sup>112</sup> These higher damage estimates come from updates to the relationship between warming and crop yield but also from a more thorough modeling of international trade in agricultural products.

Finally, the author of DICE 2010 has explicitly warned against using a domestic-only value. In a recent article, William Nordhaus states, “The regional estimates [of the social cost of greenhouse gases] are poorly understood, often varying by a factor of 2 across the three models. Moreover, regional damage estimates are highly correlated with output shares.” He later reiterates that “the regional damage estimates are both incomplete and poorly understood.”<sup>113</sup> These statements reinforce the conclusion of OMB that “good methodologies for estimating domestic damages do not currently exist.”<sup>114</sup>

In conclusion, EPA’s methodology to calculate a domestic-only interim social cost of greenhouse gases ignores “important aspect[s] of the problem” and fails to articulate a rational connection between the data and the choice made, and is therefore arbitrary and capricious in violation of the Administrative Procedure Act.<sup>115</sup>

*d. EPA Inconsistently Counts in Full the Portion of Cost that Will Accrue to Foreign Owners, While Ignoring Benefits from Global Climate Impacts*

In addition to its failure to account for significant domestic costs, EPA also effectively treats costs and benefits inconsistently by counting considerable benefits that will accrue to foreign residents from the proposed change in methodology. Therefore, the agency has unlawfully “put a thumb on the scale” by counting certain purported foreign benefits while ignoring foreign costs.<sup>116</sup>

In the Proposed Rule, EPA estimates compliance costs for manufacturers. The technical support document at issue here lists several manufacturers that will have to comply with the proposed standards.<sup>117</sup> The list includes a number of foreign-owned companies, such as Airbus,<sup>118</sup> Bombardier,<sup>119</sup>

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<sup>109</sup> DAVID ANTHOFF & RICHARD S. J. TOL, THE CLIMATE FRAMEWORK FOR UNCERTAINTY, NEGOTIATION, AND DISTRIBUTION (FUND), TECHNICAL DESCRIPTION, VERSION 3.8 (2014) at 8.

<sup>110</sup> *Id.* at 10.

<sup>111</sup> Frances C. Moore et al., Economic Impacts of Climate Change on Agriculture: A Comparison of Process-Based and Statistical Yield Models, 12 *Envtl. Research Letters* (2017).

<sup>112</sup> F. C. Moore et al., *New Science of Climate Change Impacts on Agriculture Implies Higher Social Cost of Carbon*, 1–43 (2017).

<sup>113</sup> William D Nordhaus, *Revisiting the social cost of carbon*, 114 *PROC. NATL. ACAD. SCI. U. S. A.* 1518–1523 (2017) at 1522.

<sup>114</sup> OMB 2015 Response to Comments, *supra* note 92.

<sup>115</sup> *State Farm*, 463 U.S. at 41-42 (applying the standards of review to deregulatory action and concluding that when “rescinding a rule” an agency “is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance”); *see also* 5 U.S.C. § 706.

<sup>116</sup> *Ctr. for Biological Diversity*, 538 F.3d at 1198.

<sup>117</sup> TSD at 9.

<sup>118</sup> Based in the Netherlands, <https://www.airbus.com/company.html>.



and Dassault.<sup>120</sup> Additionally, as detailed below, the list includes numerous U.S.-based companies with substantial foreign ownership.

Yet nowhere in this proposal does EPA ever suggest that the agency will separate out cost effects to foreign interests, or relegate such effects to an appendix, in future rulemakings. Given the ownership of the corporations that produce aircraft engines, however, a significant portion of the costs from the Proposed Rule will ultimately accrue to foreign owners and customers. Consequently, EPA's choice to ignore U.S. financial interests in global climate benefits is a starkly arbitrary and inconsistent treatment of costs and benefits.

Indeed, a significant portion of the effects of the Proposed Rule accrues to foreign entities. All industry compliance costs ultimately fall on the owners, employees, and customers of regulated and affected firms. At a minimum, many if not all regulated and affected firms that are public companies have significant foreign ownership of stock and corporate debt. As noted above, some of these companies are themselves foreign-based. For example, Airbus SE is a public company based in the Netherlands. And while foreign-based investment banks and funds will have U.S. investors, U.S.-based funds that invest heavily in Airbus, like BlackRock,<sup>121</sup> will similarly have foreign investors.

Additionally, the major shareholders of the primary affected U.S.-based manufacturer, Boeing Co., are institutional investors with significant global portfolios.<sup>122</sup> Economy-wide, between 20-30% of U.S. stocks and 35% of U.S. corporate debt are held by foreigners,<sup>123</sup> with significant foreign direct investment in U.S. mining and fossil fuel extraction, in U.S. utilities, and in U.S. manufacturing.<sup>124</sup> A significant portion of the regulatory effects passing through publicly-traded regulated companies would ultimately be experienced by such foreign owners.

Furthermore, whether or not affected companies have foreign ownership, many will have direct or indirect foreign consumers, since a relatively few aircraft engine manufacturers sell their goods worldwide.<sup>125</sup> Yet despite counting in full these effects to foreign owners and customers of U.S. firms, EPA ignores effects caused by climate change occurring outside U.S. borders. This inconsistent treatment of costs and benefits is patently arbitrary and capricious.

EPA has arbitrarily drawn different geographic lines around which costs and benefits it chooses to consider. EPA should consider all significant global harms for a global pollutant like greenhouse gases, instead of inconsistently treating the costs and benefits that accrue to foreign versus domestic entities.

*e. A Global Focus Is Required by the Clean Air Act*<sup>126</sup>

Section 231 of the Clean Air Act charges EPA with protecting “public health [and] welfare,”<sup>127</sup> with “welfare” defined to include “effects on . . . weather . . . and climate.”<sup>128</sup> When interpreting similar

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<sup>119</sup> Based in Canada, <https://www.bombardier.com/en/about-us.html>.

<sup>120</sup> Based in France, <https://www.dassault-aviation.com/en/group/about-us/company-profile/>.

<sup>121</sup> Blackrock owns 0.11% of Airbus, according to CNN. See <https://perma.cc/TTT8-EJG4>.

<sup>122</sup> E.g. BlackRock, the Vanguard Group.

<sup>123</sup> Heather Long, *Foreign Investors Can't Get Enough of the U.S.*, CNN, Oct. 1, 2015, <http://money.cnn.com/2015/10/01/investing/foreign-investors-buy-us-stocks-bonds/index.html>.

<sup>124</sup> Dept. of Treasury et al., *U.S. Portfolio Holdings of Foreign Securities as of June 30, 2016* (2017), [https://www.treasury.gov/press-center/press-releases/Documents/shl2016\\_final\\_20170421.pdf](https://www.treasury.gov/press-center/press-releases/Documents/shl2016_final_20170421.pdf) (see exhibit 19: market value of foreign holdings of U.S. securities, by industry, as of June 30, 2016).

<sup>125</sup> E.g. in 2019, 55% of Boeing's revenue was from non-U.S. customers. See Boeing Co., 2019 Annual Report at 12 (2019), [https://s2.q4cdn.com/661678649/files/doc\\_financials/2019/ar/2019\\_Boeing\\_Annual\\_Report.pdf](https://s2.q4cdn.com/661678649/files/doc_financials/2019/ar/2019_Boeing_Annual_Report.pdf).

<sup>126</sup> This subsection draws from Howard & Schwartz, *supra* note 28.

language in Section 202 of the Clean Air Act, the Supreme Court found “there is nothing counterintuitive to the notion that EPA can curtail the emission of substances that are putting the *global* climate out of kilter.”<sup>129</sup> In other words, Section 231 calls for more than simply a domestic focus when EPA regulates to protect the global climate. Indeed, when industry challenged another EPA climate program by arguing that the Clean Air Act “was concerned about local, not global, effects,” the U.S. Court of Appeals for the D.C. Circuit had “little trouble disposing of Industry Petitioners’ argument that the [Clean Air Act’s prevention of significant deterioration] program is specifically focused solely on localized air pollution,” finding instead that the statute was “meant to address a much broader range of harms,” including “precisely the types of harms caused by greenhouse gases.”<sup>130</sup>

To assess the necessary protections of public welfare under Section 231 of the Clean Air Act, EPA must value not only domestic welfare changes from climate effects occurring within U.S. borders, but also other significant U.S. welfare interests affected by climate—including U.S. interests in foreign businesses and property, in global tourism, in global commons like the oceans, and in global existence values and altruism; U.S. benefits from reciprocal foreign actions on climate; and U.S. effects that spill over from foreign climate damages through our interconnected economy, national security, and public health—as well as other significant global effects. Using the global estimate of climate damages—as opposed to a domestic-only value—is the only defensible way to accurately capture the full costs of climate pollution to public welfare.

Given the international nature of air travel in general, a global perspective in rulemakings, including by using the global SCC, under Section 231 is appropriate. In the Proposed Rule, EPA notes that the proposed emissions standards must “be at least as stringent as the [International Civil Aviation Organization (“ICAO”)] Airplane CO<sub>2</sub> Emission Standards in order to ensure global acceptance of FAA airworthiness certification,”<sup>131</sup> highlighting both the international importance of U.S. standards and the willingness of the U.S. to cooperate with international partners on global issues. However, EPA is proposing standards that merely meet the 2017 ICAO standards, rather than anticipating updated international standards with which the U.S. will eventually have to comply, further emphasizing why EPA should consider more stringent alternatives.

### **III. EPA Should Use Other Assumptions Made by the IWG**

EPA has made serious errors in the TSD regarding the treatment of critical parameters used to estimate climate damages such as the discount rate and the time horizon. Accordingly, we emphasize that EPA should continue to apply the IWG’s recommendations on these fronts.

#### *a. EPA Must Rely on a 3% or Lower Discount Rate for Intergenerational Effects—or a Declining Discount Rate*

Because of the long lifespan of greenhouse gases and the long-term or irreversible consequences of climate change, the effects of today’s emissions changes will stretch out over the next several centuries. The time horizon for an agency’s analysis of climate effects, as well as the discount rate applied to future

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<sup>127</sup> 42 U.S.C. § 7571(a)(2)(A) (“The Administrator shall, from time to time, issue proposed emission standards applicable to the emission of any air pollutant from any class or classes of aircraft engines which in his judgment causes, or contributes to, air pollution which may reasonably be anticipated to endanger public health or welfare.”).

<sup>128</sup> 42 U.S.C. § 7602(h); *Massachusetts v. EPA*, 127 S.Ct. 1438, 1447 (2007).

<sup>129</sup> *Mass. v. EPA*, 127 S.Ct. at 1461 (emphasis added).

<sup>130</sup> *Coalition for Responsible Regulation v. EPA*, 684 F.3d 102, 138 (D.C. Cir. 2012), aff’d in part *Util. Air Regulatory Grp. v. EPA*, 134 S.Ct. 2427 (2014).

<sup>131</sup> 85 Fed. Reg. 51,561.

costs and benefits, determines how an agency treats future generations. Traditionally, federal agencies have focused on a central estimate of the social cost of greenhouse gases calculated at a 3% discount rate. In the TSD, EPA's "interim" estimate gives equal consideration to 7% discount rate, alleging that this is recommended by *Circular A-4*.<sup>132</sup> This is wrong.

A 7% rate for intergenerational climate effects is inconsistent with best economic practices, including under *Circular A-4*. In 2015, OMB explained that "Circular A-4 is a living document. . . . [T]he use of 7 percent is ***not considered appropriate*** for intergenerational discounting. There is wide support for this view in the academic literature, and it is recognized in Circular A-4 itself."<sup>133</sup> While *Circular A-4* tells agencies generally to use a 7% discount rate in addition to lower rates for typical rules,<sup>134</sup> the guidance does not intend for default assumptions to produce analyses inconsistent with best economic practices. *Circular A-4* clearly supports using lower rates to the exclusion of a 7% rate for the costs and benefits occurring over the extremely long, 300-year time horizon of climate effects.

#### *A 7% Discount Rate Is Not "Sound and Defensible" or "Appropriate" for Climate Effects*

*Circular A-4* clearly requires agency analysts to do more than rigidly apply default assumptions: "You cannot conduct a good regulatory analysis according to a formula. Conducting high-quality analysis requires competent professional judgment."<sup>135</sup> As such, analysis must be "based on the best reasonably obtainable scientific, technical, and economic information available,"<sup>136</sup> and agencies must "[u]se sound and defensible values or procedures to monetize benefits and costs, and ensure that key analytical assumptions are defensible."<sup>137</sup> Rather than assume a 7% discount rate should be applied automatically to every analysis, *Circular A-4* requires agencies to justify the choice of discount rates for each analysis: "[S]tate in your report what assumptions were used, such as . . . the discount rates applied to future benefits and costs," and explain "clearly how you arrived at your estimates."<sup>138</sup> Based on *Circular A-4*'s criteria, there are numerous reasons why applying a 7% discount rate to climate effects that occur over a 300-year time horizon would be unjustifiable.

First, basing the discount rate on the **consumption rate of interest** is the correct framework for analysis of climate effects; a discount rate based on the private return to capital is inappropriate. *Circular A-4* does suggest that 7% should be a "default position" that reflects regulations that primarily displace capital investments; however, the Circular explains that "[w]hen regulation primarily and directly affects private consumption . . . a lower discount rate is appropriate."<sup>139</sup> The 7% discount rate is based on a private sector rate of return on capital, but private market participants typically have short time horizons. By contrast, climate change concerns the public well-being broadly. Rather than evaluating an optimal outcome from the narrow perspective of investors alone, economic theory requires analysts to make the optimal choices based on societal preferences and social discount rates. Moreover, because climate change is expected to largely affect large-scale consumption, as opposed to capital investment,<sup>140</sup> a 7% rate is inappropriate.

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<sup>132</sup> TSD at 151-52.

<sup>133</sup> OMB 2015 Response to Comments, *supra* note 92, at 36 (emphasis added).

<sup>134</sup> Circular A-4 at 36 ("For regulatory analysis, you should provide estimates of net benefits using both 3 percent and 7 percent. . . . 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 and 7 percent.").

<sup>135</sup> Circular A-4 at 3.

<sup>136</sup> *Id.* at 17.

<sup>137</sup> *Id.* at 27 (emphasis added).

<sup>138</sup> *Id.* at 3.

<sup>139</sup> *Id.* at 33.

<sup>140</sup> Maureen Cropper, *How Should Benefits and Costs Be Discounted in an Intergenerational Context?*, 183 RESOURCES 30, 33 (2013) ("There are two rationales for discounting future benefits—one based on consumption and the other on investment. The

In 2013, OMB called for public comments on the social cost of greenhouse gases. In its 2015 Response to Comment document,<sup>141</sup> OMB (together with the other agencies from the IWG) explained that

[T]he consumption rate of interest is the correct concept to use . . . as the impacts of climate change are measured in consumption-equivalent units in the three IAMs used to estimate the SCC. This is consistent with OMB guidance in Circular A-4, which states that when a regulation is expected to primarily affect private consumption—for instance, via higher prices for goods and services—it is appropriate to use the consumption rate of interest to reflect how private individuals trade-off current and future consumption.<sup>142</sup>

The Council of Economic Advisers similarly interprets *Circular A-4* as requiring agencies to choose the appropriate discount rate based on the nature of the regulation: “[I]n Circular A-4 by the Office of Management and Budget (OMB) the appropriate discount rate to use in evaluating the net costs or benefits of a regulation depends on whether the regulation primarily and directly affects private consumption or private capital.”<sup>143</sup> The NAS also explained that a consumption rate of interest is the appropriate basis for a discount rate for climate effects.<sup>144</sup> There is also strong consensus through the economic literature that a capital discount rate like 7% is inappropriate for climate change.<sup>145</sup> Finally, each of the three integrated assessment models upon which EPA bases its analysis—DICE, FUND, and PAGE—uses consumption discount rates; a capital discount rate is thus inconsistent with the underlying models. (See the technical appendix on discounting attached to these comments for more details.) For these reasons, 7% is an inappropriate choice of discount rate for the impacts of climate change.

Second, **uncertainty over the long time horizon** of climate effects should drive analysts to select a lower discount rate. As an example of when a 7% discount rate is appropriate, *Circular A-4* identifies an EPA rule with a 30-year timeframe of costs and benefits.<sup>146</sup> By contrast, greenhouse gas emissions generate

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consumption rate of discount reflects the rate at which society is willing to trade consumption in the future for consumption today. Basically, we discount the consumption of future generations because we assume future generations will be wealthier than we are and that the utility people receive from consumption declines as their level of consumption increases. . . . The investment approach says that, as long as the rate of return to investment is positive, we need to invest less than a dollar today to obtain a dollar of benefits in the future. Under the investment approach, the discount rate is the rate of return on investment. If there were no distortions or inefficiencies in markets, the consumption rate of discount would equal the rate of return on investment. There are, however, many reasons why the two may differ. As a result, using a consumption rather than investment approach will often lead to very different discount rates.”); *see also* Richard G. Newell & William A. Pizer, *Uncertain Discount Rates in Climate Policy Analysis*, 32 ENERGY POL’Y 519, 521 (2004) (“Because climate policy decisions ultimately concern the future welfare of people—not firms—the consumption interest rate is more appropriate.”).

<sup>141</sup> Note that this document was not withdrawn by Executive Order 13,783.

<sup>142</sup> OMB 2015 Response to Comments, *supra* note 92, at 22.

<sup>143</sup> Council of Econ. Advisers, *Discounting for Public Policy: Theory and Recent Evidence on the Merits of Updating the Discount Rate* at 1 [hereinafter “CEA Issue Brief”], available at [https://obamawhitehouse.archives.gov/sites/default/files/page/files/201701\\_cea\\_discounting\\_issue\\_brief.pdf](https://obamawhitehouse.archives.gov/sites/default/files/page/files/201701_cea_discounting_issue_brief.pdf). In theory, the two rates would be the same, but “given distortions in the economy from taxation, imperfect capital markets, externalities, and other sources, the SRTP and the marginal product of capital need not coincide, and analysts face a choice between the appropriate opportunity cost of a project and the appropriate discount rate for its benefits.” *Id.* at 9. The correct discount rate for climate change is the social return to capital (i.e., returns minus the costs of externalities), not the private return to capital (which measures solely the returns).

<sup>144</sup> NAS Second Report, *supra* note 93, at 28; *see also* Kenneth Arrow et al., *Is There a Role for Benefit-Cost Analysis in Environmental, Health, and Safety Regulation?*, 272 SCIENCE 221 (1996) (explaining that a consumption-based discount rate is appropriate for climate change).

<sup>145</sup> In addition to the CEA and NAS reports, *see, for example*, this article by the former chair of the NAS panel on the social cost of greenhouse gases: Richard Newell (2017, October 10). *Unpacking the Administration’s Revised Social Cost of Carbon*. Available at <http://www.rff.org/blog/2017/unpacking-administration-s-revised-social-cost-carbon>. *See also* Comments from Robert Pindyck, to BLM, on the Social Cost of Methane in the Proposed Suspension of the Waste Prevention Rule (submitted Nov. 5, 2017).

<sup>146</sup> *Circular A-4* at 34; *see also* OMB 2015 Response to Comments, *supra* note 92, at 21 (noting that “most regulatory impact analysis is conducted over a time frame in the range of 20 to 50 years,” and thus do not fully implicate “special ethical considerations [that] arise when comparing benefits and costs across generations”).

effects stretching out across 300 years. As *Circular A-4* notes, “[p]rivate market rates provide a reliable reference for determining how society values time within a generation, but for extremely long time periods no comparable private rates exist.”<sup>147</sup>

*Circular A-4* discusses how uncertainty over long time horizons drives the discount rate lower: “the longer the horizon for the analysis,” the greater the “uncertainty about the appropriate value of the discount rate,” which supports a lower rate.<sup>148</sup> *Circular A-4* cites the work of renowned economist Martin Weitzman and concludes that the “certainty-equivalent discount factor . . . corresponds to ***the minimum discount rate having any substantial positive probability***.”<sup>149</sup> The National Academies of Sciences makes the same point about discount rates and uncertainty.<sup>150</sup> In fact, as discussed more below and in the technical appendix on discounting, uncertainty over the discount rate is best addressed by adopting a declining discount rate framework.

Third, a 7% discount rate **ignores catastrophic risks and the welfare of future generations**. In the TSD, the 7% rate truncates the long right-hand tail of social costs relative to the 3% rate’s distribution.<sup>151</sup> The long right-hand tail represents the possibility of catastrophic damages. The 7% discount rate effectively assumes that present-day Americans are barely willing to pay anything at all to prevent medium- to long-term catastrophes. At the same time, the 7% distribution also misleadingly exaggerates the possibility of negative estimates of the social cost of greenhouse gases.<sup>152</sup> A negative social cost of carbon implies a discount rate so high that society is willing to sacrifice serious impacts to future generations for the sake of small, short-term benefits (such as slightly and temporarily improved fertilization for agriculture).

Fourth, a 7% discount rate would be inappropriate for climate change because it is based on **outdated data and diverges from the current economic consensus**. *Circular A-4* requires that assumptions—including discount rate choices—are “based on the best reasonably obtainable scientific, technical, and economic information available.”<sup>153</sup> Yet *Circular A-4*’s own default assumption of a 7% discount rate was published 16 years ago and was based on data from decades ago.<sup>154</sup> *Circular A-4*’s guidance on discount rates is in need of an update, as the Council of Economic Advisers detailed recently after reviewing the best available economic data and theory:

The discount rate guidance for Federal policies and projects was last revised in 2003. Since then a general reduction in interest rates along with a reduction in the forecast of long-run interest rates,

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<sup>147</sup> *Circular A-4* at 36.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*; see also CEA Issue Brief, *supra* note 143, at 9: “Weitzman (1998, 2001) showed theoretically and Newell and Pizer (2003) and Groom et al. (2007) confirm empirically that discount rate uncertainty can have a large effect on net present values. A main result from these studies is that if there is a persistent element to the uncertainty in the discount rate (e.g., the rate follows a random walk), then it will result in an effective (or certainty-equivalent) discount rate that declines over time. Consequently, lower discount rates tend to dominate over the very long term, regardless of whether the estimated investment effects are predominantly measured in private capital or consumption terms (see Weitzman 1998, 2001; Newell and Pizer 2003; Groom et al. 2005, 2007; Gollier 2008; Summers and Zeckhauser 2008; and Gollier and Weitzman 2010).”

<sup>150</sup> NAS Second Report, *supra* note 93, at 27.

<sup>151</sup> TSD at 151, Fig. 6-6 & 6-7.

<sup>152</sup> In the Monte Carlo simulation data, the 7% discount rate doubles the frequency of negative estimates compared to the 3% discount rate simulations, from a frequency of 4% to 8%.

<sup>153</sup> *Circular A-4* at 17.

<sup>154</sup> The 7% rate was based on a 1992 report; the 3% rate was based on data from the 30 years preceding the publication of *Circular A-4* in 2003. *Id.* at 33–34.

warrants serious consideration for a reduction in the discount rates used for benefit-cost analysis.<sup>155</sup>

In addition to recommending a value below 7% as the discount rate based on private capital returns, the Council of Economic Advisers further explains that, because long-term interest rates have fallen, a discount rate based on the consumption rate of interest “should be at most 2 percent.”<sup>156</sup> The latest OMB updates to Circular A-94, the document on which *Circular A-4* based its discount rates,<sup>157</sup> also show that more up-to-date long-run discount rates are historically low. In the February 2018 update to Circular A-94’s discount rates, the OMB found that the real, 30-year discount rate is 0.6 percent,<sup>158</sup> the lowest rate since the OMB began tracking the number.<sup>159</sup> Notably, the OMB also shows that the current real interest rate is negative for maturities less than 10 years.<sup>160</sup>

These low interest rates further confirm that applying a 7% rate to a context like climate change would be wildly out of step with the latest data and theory. Similarly, recent expert elicitations—a technique supported by *Circular A-4* for filling in gaps in knowledge<sup>161</sup>—indicate that a growing consensus among experts in climate economics for a discount rate between 2% and 3%; 5% represents the upper range of values recommended by experts, and few to no experts support discount rates greater than 5% being applied to the costs and benefits of climate change.<sup>162</sup> Based on current economic data and theory, the most appropriate discount rate for climate change is 3% or lower.

Fifth, *Circular A-4* requires more than giving all possible assumptions and scenarios equal attention in a sensitivity analysis; if alternate assumptions would fundamentally change the decision, *Circular A-4* requires analysts to select the **most appropriate assumptions from the sensitivity analysis**.

*Circular A-4* indicates that significant intergenerational effects will warrant a special sensitivity analysis focused on discount rates even lower than 3%:

Special ethical considerations arise when comparing benefits and costs across generations. . . It may not be appropriate for society to demonstrate a similar preference when deciding between the well-being of current and future generations. . . If your rule will have important intergenerational

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<sup>155</sup> CEA Issue Brief, *supra* note 143, at 1; *see also id.* at 3 (“In general the evidence supports lowering these discount rates, with a plausible best guess based on the available information being that the lower discount rate should be at most 2 percent while the upper discount rate should also likely be reduced.”); *id.* at 6 (“The Congressional Budget Office, the Blue Chip consensus forecasts, and the Administration forecasts all place the ten year treasury yield at less than 4 percent in the future, while at the same time forecasting CPI inflation of 2.3 or 2.4 percent per year. The implied real ten year Treasury yield is thus below 2 percent in all these forecasts.”).

<sup>156</sup> *Id.* at 1.

<sup>157</sup> Circular A-4 at 33.

<sup>158</sup> OMB Circular A-94 Appendix C (2018).

<sup>159</sup> <https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a94/dischist-2017.pdf>

<sup>160</sup> Circular A-94 Appendix C, *supra* note 15888.

<sup>161</sup> Circular A-4 at 41.

<sup>162</sup> Peter Howard & Derek Sylvan, *The Economic Climate: Establishing Expert Consensus on the Economics of Climate Change*, INST. POLICY INTEGRITY WORKING PAPER 33–34 (2015) [hereinafter “Expert Consensus”]; M.A. Drupp, et al., *Discounting Disentangled: An Expert Survey on the Determinants of the Long-Term Social Discount Rate* (London School of Economics and Political Science Working Paper, May 2015) (finding consensus on social discount rates between 1-3%). Pindyck, in a survey of 534 experts on climate change, finds a mean discount rate of 2.9% in the climate change context and this rate drops to 2.6% when he omits individuals that lack confidence in their knowledge. Pindyck, R. S. (2016). *The social cost of carbon revisited* (No. w22807). National Bureau of Economic Research. Unlike Howard and Sylvan (2015), Pindyck (2016) combines economists and natural scientists in his survey, though the mean constant discount rate drops to 2.7% when including only economists. Again, this further supports the finding that the appropriate discount rate is between 2% and 3%.

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 and 7 percent.<sup>163</sup>

Elsewhere in *Circular A-4*, OMB clarifies that sensitivity analysis should not result in a rigid application of all available assumptions regardless of plausibility. *Circular A-4* instructs agencies to depart from default assumptions when special issues “call for different emphases” depending on “the sensitivity of the benefit and cost estimates to the key assumptions.”<sup>164</sup> More specifically:

If benefit or cost estimates depend heavily on certain assumptions, you should make those assumptions explicit and carry out *sensitivity analyses using plausible alternative assumptions*. If the value of net benefits changes from positive to negative (or vice versa) or if the relative ranking of regulatory options changes with alternative plausible assumptions, you should conduct further analysis to determine *which of the alternative assumptions is more appropriate*.<sup>165</sup>

In other words, if using a 7% discount rate would fundamentally change the agency’s decision compared to using a 3% or lower discount rate, the agency must evaluate which assumption is most appropriate. Since OMB, the Council of Economic Advisers, the National Academies of Sciences, and the economic literature all conclude that a 7% rate is inappropriate for climate change, agencies should select a 3% or lower rate. EPA’s selection of a 7% discount rate cannot be justified as “based on the best reasonably obtainable scientific, technical, and economic information available” and so is inconsistent with best practices for cost-benefit analysis under *Circular A-4*.<sup>166</sup> It is therefore arbitrary for EPA to apply a 7% discount rate to the social costs of greenhouse gases.

#### *Application of a Declining Discount Rate Is Actionable Under the Current Economic Literature*

*Circular A-4* contemplates the use of declining discount rates in its reference to the work of Weitzman.<sup>167</sup> As the Council of Economic Advisers explained, Weitzman and others developed the foundation for a declining discount rate approach, wherein rates start relatively higher for near-term costs and benefits but steadily decline over time according to a predetermined schedule until, in the very long-term, very low rates dominate due to uncertainty.<sup>168</sup> The National Academies of Sciences’ report also strongly endorses a declining discount rate approach.<sup>169</sup>

One possible schedule of declining discount rates was proposed by Weitzman.<sup>170</sup> It is derived from a broad survey of top economists and other climate experts and explicitly incorporates arguments around

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<sup>163</sup> Circular A-4 at 35-36.

<sup>164</sup> *Id.* at 3.

<sup>165</sup> *Id.* at 42 (emphasis added).

<sup>166</sup> *Id.* at 17.

<sup>167</sup> Circular A-4 at 36, cites to Weitzman’s chapter in Portney & Weyant, eds. (1999); that chapter, at page 29, recommends a declining discount rate approach: “a sliding-scale social discounting strategy” with the rate at 3-4% through year 25; then around 2% until year 75; then around 1% until year 300; and then 0% after year 300.

<sup>168</sup> CEA Issue Brief, *supra* note 143, at 9 (“[A]nother way to incorporate uncertainty when discounting the benefits and costs of policies and projects that accrue in the far future—applying discount rates that decline over time. This approach uses a higher discount rate initially, but then applies a graduated schedule of lower discount rates further out in time. The first argument is based on the application of the Ramsey framework in a stochastic setting (Gollier 2013), and the second is based on Weitzman’s ‘expected net present value’ approach (Weitzman 1998, Gollier and Weitzman 2010). In light of these arguments, the governments of the United Kingdom and France apply declining discount rates to their official public project evaluations.”).

<sup>169</sup> NAS Second Report, *supra* note 93, at 166.

<sup>170</sup> Martin L. Weitzman, *Gamma Discounting*, 91 AM. ECON. REV. 260, 270 (2001). Weitzman’s schedule is as follows:

1-5 years	6-25 years	26-75 years	76-300 years	300+ years
4%	3%	2%	1%	0%

interest rate uncertainty. Work by Arrow *et al*, Cropper *et al*, and Gollier and Weitzman, among others, similarly argue for a declining interest rate schedule and lay out the fundamental logic.<sup>171</sup> Another schedule of declining discount rates has been adopted by the United Kingdom.<sup>172</sup>

Though it is buried in an appendix, EPA does conduct a sensitivity analysis using a 2.5% discount rate,<sup>173</sup> which the IWG intended to be a proxy for a declining discount rate.<sup>174</sup> However, EPA does not address that the results of this analysis deliver \$77 million in climate benefits compared to about half a million dollars in benefits that are reported for the 7% discount rate. This further demonstrates why EPA should not use the 7% discount rate in its primary analysis, but rather focus on the 3% and 2.5% discount rates or a declining discount rate.

The technical appendix on discounting attached to these comments more thoroughly reviews the various schedules of declining discount rates available for agencies to select and explains why agencies not only can, but should adopt a declining discount framework to address uncertainty.

### *A 300-Year Time Horizon Is Required*

Related to the choice of discount rate, a 300-year time horizon for analysis of climate effects is required by best economic practices. In 2017, the National Academies of Sciences issued a report stressing the importance of a longer time horizon for calculating the social cost of greenhouse gases, finding that “[i]n the context of the socioeconomic, damage, and discounting assumptions, the time horizon needs to be long enough to capture the vast majority of the present value of damages.”<sup>175</sup> The report goes on to note that the length of the time horizon is dependent “on the rate at which undiscounted damages grow over time and on the rate at which they are discounted. Longer time horizons allow for representation and evaluation of longer-run geophysical system dynamics, such as sea level change and the carbon cycle.”<sup>176</sup> In other words, after selecting the appropriate discount rate based on theory and data (in this case, 3% or below), analysts should determine the time horizon necessary to capture all costs and benefits that will have important net present values at the discount rate. Therefore, a 3% or lower discount rate for climate change implies the need for a 300-year horizon to capture all significant values. The National Academies of Science reviewed the best available, peer-reviewed scientific literature and concluded that the effects

<sup>171</sup> Kenneth J. Arrow et al., *Determining Benefits and Costs for Future Generations*, 341 SCIENCE 349 (2013); Kenneth J. Arrow et al., *Should Governments Use a Declining Discount Rate in Project Analysis?*, REV ENVIRON ECON POLICY 8 (2014); Maureen L. Cropper et al., *Declining Discount Rates*, AMERICAN ECONOMIC REVIEW: PAPERS AND PROCEEDINGS (2014); Christian Gollier & Martin L. Weitzman, *How Should the Distant Future Be Discounted When Discount Rates Are Uncertain?* 107 ECONOMICS LETTERS 3 (2010).

<sup>172</sup> Joseph Lowe, H.M. Treasury, U.K., *Intergenerational Wealth Transfers and Social Discounting: Supplementary Green Book Guidance 5* (2008), available at [http://www.hm-treasury.gov.uk/d/4\(5\).pdf](http://www.hm-treasury.gov.uk/d/4(5).pdf). The U.K. declining discount rate schedule that subtracts out a time preference value is as follows:

0-30 years	31-75 years	76-125 years	126-200 years	201-300 years	301+ years
3.00%	2.57%	2.14%	1.71%	1.29%	0.86%

<sup>173</sup> See TSD at 154.

<sup>174</sup> IWG 2010 TSD, *supra* note 81, at 23 (“The low value, 2.5 percent, is included to incorporate the concern that interest rates are highly uncertain over time. It represents the average certainty-equivalent rate using the mean-reverting and random walk approaches from Newell and Pizer (2003) starting at a discount rate of 3 percent. Using this approach, the certainty equivalent is about 2.2 percent using the random walk model and 2.8 percent using the mean reverting approach. Without giving preference to a particular model, the average of the two rates is 2.5 percent. Further, a rate below the riskless rate would be justified if climate investments are negatively correlated with the overall market rate of return. Use of this lower value also responds to certain judgments using the prescriptive or normative approach and to ethical objections that have been raised about rates of 3 percent or higher.”).

<sup>175</sup> NAS Second Report, *supra* note 93, at 78.

<sup>176</sup> *Id.*



of greenhouse gas emissions over a 300-year period are sufficiently well established and reliable as to merit consideration in estimates of the social cost of greenhouse gases.<sup>177</sup>

#### **IV. EPA Should Use the Interagency Working Group’s 2016 Estimates of the Social Cost of Carbon, the Social Cost of Nitrous Oxide, and the Social Cost of Methane**

In 2016, the IWG published updated central estimates for the social cost of greenhouse gases: about \$52 per ton of carbon dioxide, \$1,480 per ton of methane, and \$18,500 per ton of nitrous oxide (in 2019 dollars for year 2020 emissions).<sup>178</sup> Agencies must continue to use estimates of a similar or higher<sup>179</sup> value in their analyses and decisionmaking.

##### *a. IWG’s Methodology Is Rigorous, Transparent, and Based on the Best Available Data*

Beginning in 2009, the IWG assembled experts from a dozen federal agencies and White House offices to “estimate the monetized damages associated with an incremental increase in carbon emissions in a given year” based on “a defensible set of input assumptions that are grounded in the existing scientific and economic literature.”<sup>180</sup> IWG’s methods combined three frequently used models built to predict the economic costs of the physical impacts of each additional ton of carbon.<sup>181</sup> The models together incorporate such damage categories as: agricultural and forestry impacts, coastal impacts due to sea level rise, impacts from extreme weather events, impacts to vulnerable market sectors, human health impacts including malaria and pollution, outdoor recreation impacts and other non-market amenities, impacts to human settlements and ecosystems, and some catastrophic impacts.<sup>182</sup> IWG ran these models using a baseline scenario including inputs and assumptions drawn from the peer-reviewed literature, and then ran the models again with an additional unit of carbon emissions to determine the increased economic damages.<sup>183</sup> IWG’s social cost of carbon estimates were first issued in 2010 and have been updated several times to reflect the latest and best scientific and economic data.<sup>184</sup>

Following the development of estimates for carbon dioxide, the same basic methodology was used in 2016 to develop the social cost of methane and social cost of nitrous oxide—estimates that capture the distinct heating potential of methane and nitrous oxide emissions.<sup>185</sup> These additional metrics used the same economic models, the same treatment of uncertainty, and the same methodological assumptions that IWG applied to the social cost of carbon, and these new estimates underwent rigorous peer-review.<sup>186</sup>

IWG’s methodology has been repeatedly endorsed by reviewers. In 2014, the U.S. Government Accountability Office concluded that IWG had followed a “consensus-based” approach, relied on peer-reviewed academic literature, disclosed relevant limitations, and adequately planned to incorporate new

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<sup>177</sup> Nat’l Acad. Of Sci., *Assessment of Approaches to Updating the Social Cost of Carbon* 49 (2016), at 32.

<sup>178</sup> IWG 2016 TSD, *supra* note 10; IWG 2016 Addendum, *supra* note 10. Though these documents present cost values in 2007\$, we have converted those values to 2019\$ using the Bureau of Labor Statistics’ consumer price index data, which is available at <https://data.bls.gov/timeseries/CUUR0000SA0>. As this data provides, 2007\$ can be converted to 2019\$ by multiplying by approximately 1.23.

<sup>179</sup> *See, e.g.*, Richard L. Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, 508 NATURE 173 (2014) (explaining that current estimates omit key damage categories and, therefore, are very likely underestimates).

<sup>180</sup> IWG 2010 TSD, *supra* note 81.

<sup>181</sup> *Id.* at 5. These models are DICE (the Dynamic Integrated Model of Climate and the Economy), FUND (the Climate Framework for Uncertainty, Negotiation, and Distribution), and PAGE (Policy Analysis of the Greenhouse Effect).

<sup>182</sup> *Id.* at 6–8.

<sup>183</sup> *Id.* at 24–25.

<sup>184</sup> IWG 2016 TSD, *supra* note 10, at 5–29.

<sup>185</sup> *See* IWG 2016 Addendum, *supra* note 10, at 2.

<sup>186</sup> *Id.* at 3.

information through public comments and updated research.<sup>187</sup> In 2016 and 2017, the National Academies of Sciences, Engineering, and Medicine issued two reports that, while recommending future improvements to the methodology, supported the continued use of the existing IWG estimates.<sup>188</sup> And in 2016, the U.S. Court of Appeals for the Seventh Circuit held that the Department of Energy’s reliance on IWG’s social cost of carbon was reasonable.<sup>189</sup> It is, therefore, unsurprising that leading economists and climate policy experts have endorsed the IWG’s values as the best available estimates.<sup>190</sup>

Furthermore, uncertainty over the values or range of values included in the IWG’s social costs of greenhouse gases metric is not a reason to abandon the social cost of greenhouse gas methodologies;<sup>191</sup> quite the contrary, uncertainty supports higher estimates of the social cost of greenhouse gases, because most uncertainties regarding climate change entail tipping points, catastrophic risks, and unknown unknowns about the damages of climate change. Because the key uncertainties of climate change include the risk of irreversible catastrophes, applying an options value framework to the regulatory context strengthens the case for ambitious regulatory action to reduce greenhouse gas emissions.

Not only was justifying omitted climate damages due to uncertainty rejected by the Ninth Circuit in *Center for Biological Diversity*—“while . . . there is a range of values, the value of carbon emissions reduction is certainly not zero”<sup>192</sup>—but the range of values recommended by the IWG<sup>193</sup> and endorsed by the National Academies of Sciences<sup>194</sup> is rather manageable. In 2016, the IWG recommended values at discount rates from 2.5% to 5%, calculated as between \$12 and \$62 for year 2020 emissions.<sup>195</sup> Numerous federal agencies have had no difficulty either applying this range in their environmental impact statements or else focusing on the central estimate at a 3% discount rate.<sup>196</sup>

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<sup>187</sup> Gov’t Accountability Office, *Regulatory Impact Analysis: Development of Social Cost of Carbon Estimates* 12–19 (2014). Available at <http://www.gao.gov/assets/670/665016.pdf>.

<sup>188</sup> Nat’l Acad. Sci., Engineering & Med., *Valuing Climate Damages: Updating Estimation of the Social Cost of Carbon Dioxide* 3 (2017), <https://www.nap.edu/read/24651/chapter/1>; Nat’l Acad. Sci., Engineering & Med., *Assessment of Approaches to Updating the Social Cost of Carbon: Phase 1 Report on a Near-Term Update* 1–2 (2016); <https://www.nap.edu/read/21898/chapter/1>.

<sup>189</sup> *Zero Zone, Inc. v. U.S. Dep’t of Energy*, 832 F.3d 654, 678 (7th Cir. 2016).

<sup>190</sup> See, e.g., Richard Revesz et al., *Best Cost Estimate of Greenhouse Gases*, 357 *Science* 655 (2017); Michael Greenstone et al., *Developing a Social Cost of Carbon for U.S. Regulatory Analysis: A Methodology and Interpretation*, 7 *Rev. Envtl. Econ. & Pol’y* 23, 42 (2013); Revesz, *Global Warming: Improve Economic Models of Climate Change*, *supra* note 207.

<sup>191</sup> *Center for Biological Diversity v. NHTSA*, 538 F.3d 1172, 1200 (9th Cir. 2008) (“[W]hile the record shows that there is a range of values, the value of carbon emissions reductions is certainly not zero.”).

<sup>192</sup> 538 F.3d at 1200.

<sup>193</sup> See Interagency Working Group on the Social Cost of Greenhouse Gases, *Technical Update* (2016) (hereinafter 2016 TSD).

<sup>194</sup> See National Academies of Sciences, *Assessment of Approaches to Updating the Social Cost of Carbon* (2016) (hereinafter First NAS Report) (endorsing continued near-term use of the IWG numbers; in 2017, the NAS recommended moving to a declining discount rate, see National Academies of Sciences, *Valuing Climate Damages* (2017) (hereinafter Second NAS Report).

<sup>195</sup> IWG 2016 TSD, *supra* note 10. The values given here are in 2007\$. The IWG also recommended a 95<sup>th</sup> percentile value of \$123.

<sup>196</sup> BLM, *Envtl. Assessment—Waste Prevention, Prod. Subject to Royalties, and Res. Conservation* at 52 (2016); BLM, *Final Envtl. Assessment: Little Willow Creek Protective Oil and Gas Lease*, DOI-BLM-ID-B010-2014-0036-EA, at 82 (2015); Office of Surface Mining, *Final Envtl. Impact Statement—Four Corners Power Plant and Navajo Mine Energy Project* at 4.2-26 to 4.2-27 (2015) (explaining the social cost of greenhouse gases “provide[s] further context and enhance[s] the discussion of climate change impacts in the NEPA analysis.”); U.S. Army Corps of Engineers, *Draft Envtl. Impact Statement for the Missouri River Recovery Mgmt. Project* at 3-335 (2016); U.S. Forest Serv., *Rulemaking for Colorado Roadless Areas: Supplemental Final Envtl. Impact Statement* at 120–23 (Nov. 2016) (using both the social cost of carbon and social cost of methane relating to coal leases); NHTSA EIS, Available at [http://www.nhtsa.gov/staticfiles/rulemaking/pdf/cafe/FINAL\\_EIS.pdf](http://www.nhtsa.gov/staticfiles/rulemaking/pdf/cafe/FINAL_EIS.pdf) at 9-77.

b. *A Recent Executive Order Does Not Change the Requirements to Monetize Climate Damages*

In March 2017, President Trump disbanded the IWG and withdrew its technical support documents through Executive Order 13,783.<sup>197</sup> Nevertheless, Executive Order 13,783 assumes that federal agencies will continue to “monetiz[e] the value of changes in greenhouse gas emissions” and instructs agencies to ensure such estimates are “consistent with the guidance contained in OMB Circular A-4.”<sup>198</sup> Consequently, while federal agencies no longer benefit from ongoing technical support from the IWG on using the social cost of greenhouse gases, by no means does the new Executive Order imply that agencies should not monetize potentially significant effects in their environmental impact statements.

The Executive Order does not prohibit agencies from relying on the same choice of models as the IWG, the same inputs and assumptions as the IWG, the same statistical methodologies as the IWG, or the same ultimate values as derived by the IWG. To the contrary, because the Executive Order requires consistency with *Circular A-4*, as agencies follow the Circular’s standards for using the best available data and methodologies, they will necessarily choose similar data, methodologies, and estimates as the IWG, since the IWG’s work continues to represent the best available estimates.<sup>199</sup> The Executive Order does not preclude agencies from using the same range of estimates as developed by the IWG, so long as the agency explains that the data and methodology that produced those estimates are consistent with *Circular A-4* and, more broadly, with standards for rational decisionmaking.

Indeed, as noted above, a federal court recently explained that “[t]he Executive Order in and of itself has no legal impact on the consensus that IWG’s estimates constitute the best available science about monetizing the impacts of greenhouse gas emissions.”<sup>200</sup> And notably, some agencies under the Trump administration, have continued to use the IWG estimates even following the Executive Order. For example, in energy conservation program rules for air compressors,<sup>201</sup> commercial packaged boilers,<sup>202</sup> portable air conditioners,<sup>203</sup> and uninterruptible power supplies,<sup>204</sup> all released on January 10, 2020, the Department of Energy (“DOE”) used the IWG social cost of carbon estimates.<sup>205</sup> DOE used the range of social cost of carbon estimates of global damages, including the estimates calculated at 2.5-percent, 3-percent, and 5-percent discount rates, as well as the 95<sup>th</sup> percentile estimate.<sup>206</sup> In fact, in announcing the final standards, DOE explained: “The CO<sub>2</sub> reduction is a benefit that accrues globally. DOE maintains that consideration of global benefits is appropriate because of the global nature of the climate change problem.”<sup>207</sup> The Department further stated that “preference is given to consideration of the global benefits of reducing CO<sub>2</sub> emissions,”<sup>208</sup> over domestic-only benefits of emissions reductions. For all the reasons detailed above, EPA should do the same here.

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<sup>197</sup> Exec. Order No. 13,783 § 5(b), 82 Fed. Reg. 16,093 (Mar. 28, 2017).

<sup>198</sup> *Id.* § 5(c).

<sup>199</sup> See Richard L. Revesz et al., *Best Cost Estimate of Greenhouse Gases*, 357 SCIENCE 6352 (2017) (explaining that, even after Trump’s Executive Order, the social cost of greenhouse gas estimate of around \$50 per ton of carbon dioxide is still the best estimate).

<sup>200</sup> *State of California v. Bernhardt*, 2020 WL 4001480, at \*25.

<sup>201</sup> 85 Fed. Reg. 1504 (Jan. 10, 2020).

<sup>202</sup> 85 Fed. Reg. 1592 (Jan. 10, 2020).

<sup>203</sup> 85 Fed. Reg. 1378 (Jan. 10, 2020).

<sup>204</sup> 85 Fed. Reg. 1447 (Jan. 10, 2020).

<sup>205</sup> 85 Fed. Reg. at 1506; see also 85 Fed. Reg. at 1649; 85 Fed. Reg. at 1381; 85 Fed. Reg. at 1477.

<sup>206</sup> See, e.g., 85 Fed. Reg. at 1507, tbl I.3 (Summary of Economic Benefits and Costs of Adopted Energy Conservation Standards for Air Compressors).

<sup>207</sup> *Id.* at 1508.

<sup>208</sup> *Id.* at 1564.

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\*No part of this document purports to present New York University School of Law's views, if any.

**Appendices:**

- Technical Appendix on Uncertainty
- Technical Appendix on Discounting

**Attachments:**

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## Technical Appendix: Uncertainty

Contrary to the arguments made by many opposed to strong federal climate action, uncertainty about the full effects of climate change *raises* the social cost of greenhouse gases and warrants *more* stringent climate policy.<sup>1</sup> Integrated assessment models (IAMs) currently used to calculate the social cost of carbon (SCC) show that the net effect of uncertainty about economic damage resulting from climate change, costs of mitigation, future economic development, and many other parameters raises the SCC compared to the case where models simply use our current best guesses of these parameters.<sup>2</sup> Even so, IAMs still underestimate the impact of uncertainty on the SCC by not accounting for a host of fundamental features of the climate problem: the irreversibility of climate change, society's aversion to risk and other social preferences, option value, and many catastrophic impacts.<sup>3</sup> Rather than being a reason not to take action, uncertainty increases the SCC and should lead to more stringent policy to address climate change.<sup>4</sup>

### *Types of Uncertainty in the IAMs*

IAMs incorporate two types of uncertainty: parametric uncertainty and stochastic uncertainty. Parametric uncertainty covers uncertainty in model design and inputs, including the selected parameters, correct functional forms, appropriate probability distribution functions, and model structure. With learning, these uncertainties should decline over time as more information becomes available.<sup>5</sup> Stochastic uncertainty is persistent randomness in the economic-climate system, including various environmental phenomena such as volcanic eruptions and sun spots.<sup>6</sup> Uncertainties are present in each component of the IAMs: socio-economic scenarios, the simple climate model, the damage and abatement cost functions, and the social welfare function (including the discount rate).<sup>7</sup>

When modeling climate change uncertainty, scientists and economists have long emphasized the importance of accounting for the potential of catastrophic climate change.<sup>8</sup> Catastrophic outcomes combine several overlapping concepts including unlucky states of the world (i.e., bad draws), deep

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<sup>1</sup> Peterson (2006) states "Most modeling results show (as can be expected) that there is optimally more emission abatement if uncertainties in parameters or the possibility of catastrophic events are considered." Peterson, S. (2006). Uncertainty and economic analysis of climate change: A survey of approaches and findings. *Environmental Modeling & Assessment*, 11(1), 1-17.

<sup>2</sup> Tol, R. S. (1999). Safe policies in an uncertain climate: an application of FUND. *Global Environmental Change*, 9(3), 221-232; Peterson, S. (2006). Uncertainty and economic analysis of climate change: A survey of approaches and findings. *Environmental Modeling & Assessment*, 11(1), 1-17; Interagency Working Group on Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12,866 (2016).

<sup>3</sup> Pindyck, R. S. (2007). Uncertainty in environmental economics. *Review of environmental economics and policy*, 1(1), 45-65; Golub, A., Narita, D., & Schmidt, M. G. (2014). Uncertainty in integrated assessment models of climate change: Alternative analytical approaches. *Environmental Modeling & Assessment*, 19(2), 99-109; Lemoine, D., & Rudik, I. (2017). Managing Climate Change Under Uncertainty: Recursive Integrated Assessment at an Inflection Point. *Annual Review of Resource Economics* 9:18.1-18.26.

<sup>4</sup> See cites *supra* note 3.

<sup>5</sup> Learning comes in multiple forms: passive learning of anticipated information that arrives exogenous to the emission policy (such as academic research), active learning of information that directly stems from the choice of the GHG emission level (via the policy process), and learning of unanticipated information (Kann and Weyant, 2000; Lemoine and Rudik, 2017).

<sup>6</sup> Kann, A., & Weyant, J. P. (2000). Approaches for performing uncertainty analysis in large-scale energy/economic policy models. *Environmental Modeling & Assessment*, 5(1), 29-46; Peterson (2006), *supra* note 1; Golub et al. *supra* note 3.

A potential third type of uncertainty arises due to ethical or value judgements: normative uncertainty. Peterson (2006) *supra* note 1; Heal, G., & Millner, A. (2014). Reflections: Uncertainty and decision making in climate change economics. *Review of Environmental Economics and Policy*, 8(1), 120-137. For example, there is some normative debate over the appropriate consumption discount rate to apply in climate economics, though widespread consensus exists that using the social opportunity cost of capital is inappropriate (see earlier discussion). Preference uncertainty should be modeled as a declining discount rate over time (see earlier discussion), not using uncertain parameters. Kann & Weyant, *supra* note 6.

<sup>7</sup> Peterson (2006), *supra* note 1; Pindyck (2007), *supra* note 3; Heal & Millner, *supra* note 6.

<sup>8</sup> Nordhaus, W. D. (2008). A question of balance: Weighing the options on global warming policies. Yale University Press; Kopp, R. E., Shwom, R. L., Wagner, G., & Yuan, J. (2016). Tipping elements and climate-economic shocks: Pathways toward integrated assessment. *Earth's Future*, 4(8), 346-372.

uncertainty, and climate tipping points and elements.<sup>9</sup> Traditionally, IAM developers address uncertainty by specifying probability distributions over various climate and economic parameters. This type of uncertainty implies the possibility of an especially bad draw if multiple uncertain parameters turn out to be lower than we expect, causing actual climate damages to greatly exceed expected damages.

Our understanding of the climate and economic systems is also affected by so-called “deep uncertainty,” which can be thought of as uncertainty over the true probability distributions for specific climate and economic parameters.<sup>10</sup> The mean and variance of many uncertain climate phenomena are unknown due to lack of data, resulting in “fat-tailed distributions”—i.e., the tail of the distributions decline to zero slower than the normal distribution. Fat-tailed distributions result when the best guess of the distribution is derived under learning.<sup>11</sup> Given the general opinion that bad surprises are likely to outweigh good surprises in the case of climate change,<sup>12</sup> modelers capture deep uncertainty by selecting probability distributions with a fat upper tail which reflects the greater likelihood of extreme events.<sup>13</sup> The possibility of fat tails increases the likelihood of a “very” bad draw with high economic costs, and can result in a very high (and potentially infinite) expected cost of climate change (a phenomenon known as the dismal theory).<sup>14</sup>

Climate tipping elements are environmental thresholds where a small change in climate forcing can lead to large, non-linear shifts in the future state of the climate (over short and long periods of time) through positive feedback (i.e., snowball) effects.<sup>15</sup> Tipping points refer to economically relevant thresholds after which change occurs rapidly (i.e., Gladwellian tipping points), such that opportunities for adaptation and intervention are limited.<sup>16</sup> Tipping point examples include the reorganization of the Atlantic meridional overturning circulation (AMOC) and a shift to a more persistent El Niño regime in the Pacific Ocean.<sup>17</sup> Social tipping points—including climate-induced migration and conflict—also exist. These various tipping points interact, such that triggering one tipping point may affect the probabilities of triggering other tipping points.<sup>18</sup> There is some overlap between tipping point events and fat tails in that the probability distributions for how likely, how quick, and how damaging tipping points will be are unknown.<sup>19</sup> Accounting fully for these most pressing, and potentially most dramatic, uncertainties in the

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<sup>9</sup> Kopp et al. (2016), *supra* note 8.

<sup>10</sup> *Id.*

<sup>11</sup> Nordhaus, W. D. (2009). An Analysis of the Dismal Theorem (No. 1686). Cowles Foundation Discussion Paper; Weitzman, M. L. (2011). Fat-tailed uncertainty in the economics of catastrophic climate change. *Review of Environmental Economics and Policy*, 5(2), 275-292; Pindyck, R. S. (2011). Fat tails, thin tails, and climate change policy. *Review of Environmental Economics and Policy*, 5(2), 258-274.

<sup>12</sup> Mastrandrea, M. D. (2009). Calculating the benefits of climate policy: examining the assumptions of integrated assessment models. Pew Center on Global Climate Change Working Paper; Tol, R. S. (2012). On the uncertainty about the total economic impact of climate change. *Environmental and Resource Economics*, 53(1), 97-116.

<sup>13</sup> Weitzman (2011), *supra* note 11, makes clear that “deep structural uncertainty about the unknown unknowns of what might go very wrong is coupled with essentially unlimited downside liability on possible planetary damages. This is a recipe for producing what are called ‘fat tails’ in the extreme of critical probability distributions.”

<sup>14</sup> Weitzman, M. L. (2009). On modeling and interpreting the economics of catastrophic climate change. *The Review of Economics and Statistics*, 91(1), 1-19; Nordhaus (2009), *supra* note 11; Weitzman (2011), *supra* note 11.

<sup>15</sup> Tipping elements are characterized by: (1) deep uncertainty, (2) absence from climate models, (3) larger resulting changes relative to the initial change crossing the relevant threshold, and (4) irreversibility. Kopp et al. (2016), *supra* note 8.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*; Kriegler, E., Hall, J. W., Held, H., Dawson, R., & Schellnhuber, H. J. (2009). Imprecise probability assessment of tipping points in the climate system. *Proceedings of the national Academy of Sciences*, 106(13), 5041-5046; Diaz, D., & Keller, K. (2016). A potential disintegration of the West Antarctic Ice Sheet: Implications for economic analyses of climate policy. *The American Economic Review*, 106(5), 607-611. See Table 1 of Kopp et al. (2016) *supra* note 8, for a full list of known tipping elements and points.

<sup>18</sup> Kriegler et al. (2009), *supra* note 17; Cai, Y., Lenton, T. M., & Lontzek, T. S. (2016). Risk of multiple interacting tipping points should encourage rapid CO<sub>2</sub> emission reduction; Kopp et al. (2016) *supra* note 8.

<sup>19</sup> Peter Howard, *Omitted Damages: What's Missing from the Social Cost of Carbon 5* (Cost of Carbon Project Report, 2014), <http://costofcarbon.org/>; Kopp et al. (2016) *supra* note 8.

climate-economic system matter because humans are risk averse and tipping points—like many other aspects of climate change—are, by definition, irreversible

### *How IAMs and the IWG Account for Uncertainty*

Currently, IAMs (including all of those used by the IWG) capture uncertainty in two ways: deterministically and through uncertainty propagation. For the deterministic method, the modeler assumes away uncertainty (and thus the possibility of bad draws and fat tails) by setting parameters equal to their most likely (median) value. Using these values, the modeler calculates the median SCC value. Typically, the modeler conducts sensitivity analysis over key parameters—one at a time or jointly—to determine the robustness of the modeling results. This is the approach employed by Nordhaus in the preferred specification of the DICE model<sup>20</sup> used by the IWG.

Uncertainty propagation is most commonly carried out using Monte Carlo simulation. In these simulations, the modeler randomly draws parameter values from each of the model's probability distributions, calculates the SCC for the draw, and then repeats this exercise thousands of times to calculate a mean social cost of carbon.<sup>21</sup> Tol, Anthoff, and Hope employ this technique in FUND and PAGE—as did the IWG (2010, 2013, and 2016)—by specifying probability distributions for the climate and economic parameters in the models. These models are especially helpful for assessing the net effect of different parametric and stochastic uncertainties. For instance, both the costs of mitigation and the damage from climate change are uncertain. Higher costs would warrant less stringent climate policies, while higher damages lead to more stringent policy, so theoretically, the effect of these two factors on climate policy could be ambiguous. Uncertainty propagation in an IAM calibrated to empirically motivated distributions, however, shows that climate damage uncertainty outweighs the effect of cost uncertainty, leading to a stricter policy when uncertainty is taken into account than when it is ignored.<sup>22</sup> This can be seen in the resulting right-skewed distribution of the SCC (see Figure 1 in IWG (2016)) where the mean (Monte Carlo) SCC value clearly exceeds the median (deterministic) SCC value.

The IWG was rigorous in addressing uncertainty. First, it conducted Monte Carlo simulations over the above IAMs specifying different possible outcomes for climate sensitivity (represented by a right skewed, fat tailed distribution to capture the potential of higher than expected warming). It also used scenario analysis: five different emissions growth scenarios and three discount rates. Second, the IWG (2016) reported the various moments and percentiles—including the 95<sup>th</sup> percentile—of the resulting SCC estimates. Third, the IWG put in place an updating process, e.g., the 2013 and 2016 revisions, which updates the models as new information becomes available.<sup>23</sup> As such, the IWG used the various tools that economists have developed over time to address the uncertainty inherent in estimating the economic cost of pollution: reporting various measures of uncertainty, using Monte Carlo simulations, and updating estimates as evolving research advances our knowledge of climate change. Even so, the IWG underestimates the SCC by failing to capture key features of the climate problem.

### *Current IAMs Underestimate the SCC by Failing to Sufficiently Model Uncertainty*

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<sup>20</sup> Nordhaus, W. & Satorc, P. (2013). DICE 2013: Introduction & User's Manual. Retrieved from Yale University, Department of Economics website: <http://www.econ.yale.edu/~nordhaus/homepage/documents/Dicemanualfull>

<sup>21</sup> In alternative calculation method, the modeler “performs optimization of policies for a large number of possible parameter combinations individually and estimates their probability weighted sum.” Golub et al. *supra* note 3. In more recent DICE-2016, Nordhaus conducts a three-parameter analysis using this method to determine a SCC confidence interval. Given that PAGE and FUND model hundred(s) of uncertainty parameters, this methodology appears limited in the number of uncertain variables that can be easily specified.

<sup>22</sup> Tol (1999), *supra* note 2, in characterizing the FUND model, states, “Uncertainties about climate change impacts are more serious than uncertainties about emission reduction costs, so that welfare-maximizing policies are stricter under uncertainty than under certainty.”

<sup>23</sup> IWG (2010).

Given the current treatment of uncertainty by the IWG (2016) and the three IAMs that they employ, the IWG (2016) estimates represent an underestimate of the SCC. DICE clearly underestimates the true value of the SCC by effectively eliminating the possibility of bad draws and fat tails through a deterministic model that relies on the median SCC value. Even with their calculation of the mean SCC, the FUND and PAGE also underestimate the metric's true value by ignoring key features of the climate-economic problem. Properly addressing the limitations of these models' treatment of uncertainty would further increase the SCC.

First, current IAMs insufficiently model catastrophic impacts. DICE fails to model both the possibility of bad draws and fat tails by applying the deterministic approach. Alternatively, FUND and PAGE ignore deep uncertainty by relying predominately on the thin-tailed triangular and gamma distributions.<sup>24</sup> The IWG (2010) only partially addresses this oversight by replacing the ECS parameter in DICE, FUND, and PAGE with a fat-tailed, right-skewed distribution calibrated to the IPCC's assumptions (2007), even though many other economic and climate phenomenon in IAMs are likely characterized by fat tails, including climate damages from high temperature levels, positive climate feedback effects, and tipping points.<sup>25</sup> Recent work in stochastic dynamic programming tends to better integrate fat tails – particularly with respect to tipping points (see below) – and address additional aversion to this type of uncertainty (also known as ambiguity aversion); doing so can further increase the SCC under uncertainty.<sup>26</sup>

In contrast to their approach to fat tails, the IAMs used by the IWG (2010; 2013; 2016) sometimes address climate tipping points, though they do not apply state-of-the-art methods for doing so. In early versions of DICE (DICE-2010 and earlier), Nordhaus implicitly attributes larger portions of the SCC to tipping points by including certainty equivalent damages of catastrophic events - representing two-thirds to three-quarter of damages in DICE – calibrated to an earlier Nordhaus (1994) survey of experts.<sup>27</sup> In PAGE09, Hope also explicitly models climate tipping points as a singular, discrete event (of a 5% to 25% loss in GDP) that has a probability (which grows as temperature increases) of occurring in each time period.<sup>28</sup> Though not in the preferred versions of the IAMs employed by the IWG, some research also integrates specific tipping points into these IAMs finding even higher SCC estimates.<sup>29</sup> Despite the obvious methodological basis for addressing tipping points, the latest versions of DICE<sup>30</sup> and FUND exclude tipping points in their preferred specifications. Research shows that if these models were to

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<sup>24</sup> Howard (2014), *supra* note 19. While both FUND and PAGE employ thin tailed distributions, the resulting distribution of the SCC is not always thin-tailed. In PAGE09, the ECS parameter is endogenous, such that the distribution of the ECS has a long tail following the IPCC (2007). See Chen, Z., Marquis, M., Averyt, K. B., Tignor, M., & Miller, H. L. (2007). Contribution of working group I to the fourth assessment report of the intergovernmental panel on climate change. Cambridge, UK and New York: Cambridge University Press, 996p. Similarly, while Anthoff and Tol do not explicitly utilize fat-tail distributions, the distribution of net present welfare from a Monte Carlos simulation is fat tailed. Anthoff, D., & Tol, R. S. (2014). The Climate Framework for Uncertainty, Negotiation and Distribution (FUND): Technical description, Version 3.8. Available at [www.fund-model.org](http://www.fund-model.org). Explicitly modeling parameter distributions as fat tailed may further increase the SCC.

<sup>25</sup> Weitzman (2011), *supra* note 11; Kopp et al. (2016) *supra* note 8.

<sup>26</sup> Lemoine, D., & Traeger, C. P. (2016a). Ambiguous tipping points. *Journal of Economic Behavior & Organization*, 132, 5-18; Lemoine & Rudik (2017), *supra* note 3. IAM modelers currently assume that society is equally averse to known unknown and known unknowns. Lemoine & Traeger, *supra* note 26.

<sup>27</sup> Nordhaus, W. D., & Boyer, J. (2000). *Warning the World: Economic Models of Global Warming*. MIT Press (MA); Nordhaus, W. D. (2008). *A question of balance: Weighing the options on global warming policies*. Yale University Press; Howard (2014), *supra* note 19; Kopp et al. (2016) *supra* note 8.

<sup>28</sup> Hope (2006) also calibrated a discontinuous damage function in PAGE-99 used by IWG (2010). Howard (2014), *supra* note 19.

<sup>29</sup> Kopp et al. (2016) *supra* note 8.

<sup>30</sup> For DICE-2013 and DICE-2016, Nordhaus calibrates the DICE damage function using a meta-analysis based on estimates that mostly exclude tipping point damages. Howard, P. H., & Sterner, T. (2016). Few and Not So Far Between: A Meta-analysis of Climate Damage Estimates. *Environmental and Resource Economics*, 1-29.

correctly account for the full range of climate impacts—including tipping points—the resulting SCC estimates would increase.<sup>31</sup>

The IWG approach also fails to include a risk premium—that is, the amount of money society would require in order to accept the uncertainty (i.e., variance) over the magnitude of warming and the resulting damages from climate change relative to mean damages (IWG, 2010; IWG, 2015)). The mean of a distribution, which is a measure of a distribution’s central tendency, represents only one descriptor or “moment” of a distribution’s shape. Each IAM parameter and the resulting SCC distributions have differing levels of variance (i.e., spread around the mean), skewness (i.e., a measure of asymmetry), and kurtosis (which, like skewness, is another descriptor of a distribution’s tail) as well as means.<sup>32</sup> It is generally understood that people are risk averse in that they prefer input parameter distributions and (the resulting) SCC distributions with lower variances, holding the mean constant.<sup>33</sup> While the IWG assumes a risk-neutral central planner by using a constant discount rate (setting the risk premium to zero), this assumption does not correspond with empirical evidence,<sup>34</sup> current IAM assumptions,<sup>35</sup> the NAS (2017) recommendations, nor with the IWG’s own discussion (2010) of the possible values of the elasticity of the marginal utility of consumption. Evidence from behavioral experiments indicate that people and society are also averse to other attributes of parameter distributions – specifically to the thickness of the tails of distributions – leading to an additional ambiguity premium (Heal and Millner, 2014).<sup>36</sup> Designing IAMs to properly account for the risk and ambiguity premiums from uncertain climate damages would increase the resulting SCC values they generate.

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<sup>31</sup> Using FUND, Link and Tol (2010) find that a collapse of the AMOC would decrease GDP (and thus increase the SCC) by a small amount. Earlier modeling of this collapse in DICE find a more significance increase. Keller, K., Tan, K., Morel, F. M., & Bradford, D. F. (2000). Preserving the ocean circulation: implications for climate policy. *Climatic Change*, 47, 17-43; Mastrandrea, M. D., & Schneider, S. H. (2001). Integrated assessment of abrupt climatic changes. *Climate Policy*, 1(4), 433-449; Keller, K., Bolker, B. M., & Bradford, D. F. (2004). Uncertain climate thresholds and optimal economic growth. *Journal of Environmental Economics and management*, 48(1), 723-741. With respect to thawing of the permafrost, Hope and Schaefer (2016), Economic impacts of carbon dioxide and methane released from thawing permafrost. *Nature Climate Change*, 6(1), 56-59, and Gonzalez-Eguino and Neumann (2016), González-Eguino, M., & Neumann, M. B. (2016). Significant implications of permafrost thawing for climate change control. *Climatic Change*, 136(2), 381-388, find increases in damages (and thus an increase in the SCC) when integrating this tipping element into the PAGE09 and DICE-2013R, respectively. Looking at the collapse of the West Antarctic Ice sheet, Nicholls et al. (2008) find a potential for significant increases in costs (and thus the SCC) in FUND. Nicholls, R. J., Tol, R. S., & Vafeidis, A. T. (2008). Global estimates of the impact of a collapse of the West Antarctic ice sheet: an application of FUND. *Climatic Change*, 91(1), 171-191. Ceronsky et al. (2011) model three tipping points (collapse of the Atlantic Ocean Meridional Overturning Circulation, large scale dissociation of oceanic methane hydrates; and a high equilibrium climate sensitivity parameter), and finds a large increase in the SCC in some cases. Ceronsky, M., Anthoff, D., Hepburn, C., & Tol, R. S. (2011). *Checking the price tag on catastrophe: The social cost of carbon under non-linear climate response* (No. 392). ESRI working paper.

<sup>32</sup> Golub, A., & Brody, M. (2017). Uncertainty, climate change, and irreversible environmental effects: application of real options to environmental benefit-cost analysis. *Journal of Environmental Studies and Sciences*, 1-8; see Figure 1 in IWG (2016).

<sup>33</sup> In other words, society prefers a narrow distribution of climate damages around mean level of damages X to a wider distribution of damages also centered on the same mean of X because they avoid the potential for very high damages even at the cost of eliminating the chance of very low damages.

<sup>34</sup> IWG 2010, *supra* note 23; Cai et al., 2016, *supra* note 18, at 521.

<sup>35</sup> The developers of each of the three IAMs used by the IWG (2010; 2013; 2016) assume a risk aversion society. Nordhaus and Sztorc (2013), *supra* note 20; Anthoff, D., & Tol, R. S. (2010). The Climate Framework for Uncertainty, Negotiation and Distribution (FUND): Technical description, Version 3.5. Available at [www.fund-model.org](http://www.fund-model.org); Anthoff, D., & Tol, R. S. (2014). The Climate Framework for Uncertainty, Negotiation and Distribution (FUND): Technical description, Version 3.8. Available at [www.fund-model.org](http://www.fund-model.org); Hope, C. (2013). Critical issues for the calculation of the social cost of CO2: why the estimates from PAGE09 are higher than those from PAGE2002. *Climatic Change*, 117(3), 531-543.

<sup>36</sup> According to Heal and Millner (2014), *supra*, there is an ongoing debate of whether ambiguity aversion is rational or a behavioral mistake. Given the strong possibility that this debate is unlikely to be resolved, the authors recommend exploring both assumptions.

Even under the IWG’s current assumption of risk neutrality, the mean SCC from uncertainty propagation excludes the (real) option value of preventing marginal CO<sub>2</sub> emissions.<sup>37</sup> Option value reflects the value of future flexibility due to uncertainty and irreversibility; in this case, the irreversibility of CO<sub>2</sub> emissions due to their long life in the atmosphere.<sup>38</sup> If society exercises the option of emitting an additional unit of CO<sub>2</sub> emissions today, “we will lose future flexibility that the [mitigation] option gave” leading to possible “regret and...a desire to ‘undo’” the additional emission because it “constrains future behavior.”<sup>39</sup> Given that the SCC is calculated on the Business as Usual (BAU) emission pathway, option value will undoubtedly be positive for an incremental emission because society will regret this emission in most possible futures.

Though sometimes the social cost of carbon and a carbon tax are thought of as interchangeable ways to value climate damages, agencies should be careful to distinguish two categories of the literature. The first is the economic literature that calculates the optimal carbon tax in a scenario where the world has shifted to an optimal emissions pathway. The second is literature that assesses the social cost of carbon on the business-as-usual (BAU) emissions pathway; the world is currently on the BAU pathway, since optimal climate policies have not been implemented. There are currently no numerical estimates of the risk premium and option value associated with an incremental emission on the BAU emissions path. Although there are stochastic dynamic optimization models that implicitly account for these two values, they analyze *optimal*, sequential decision making under climate uncertainty.<sup>40</sup> By nature of being optimization models (instead of policy models), these complex models focus on calculating the optimal tax and not the social cost of carbon, which differ in that the former is the present value of marginal damages on the optimal emissions path rather than on the BAU emissions path.<sup>41</sup> While society faces the irreversibility of emissions on the BAU emissions path when abatement is essentially near zero (i.e., far below the optimal level even in the deterministic problem),<sup>42</sup> the stochastic dynamic optimization model must also account

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<sup>37</sup> Arrow, K. J., & Fisher, A. C. (1974). Environmental preservation, uncertainty, and irreversibility. *The Quarterly Journal of Economics*, 312-319; Dixit, A.K., Pindyck, R.S., 1994. *Investment Under Uncertainty*. Princeton University Press, Princeton, NJ; Traeger, C. P. (2014). On option values in environmental and resource economics. *Resource and Energy Economics*, 37, 242-252.

In the discrete emission case, there are two overlapping types of option value: real option value and quasi-option value. Real option value is the full value of future flexibility of maintaining the option to mitigate, and mathematically equals the maximal value that can be derived from the option to [emit] now or later (incorporating learning) less the maximal value that can be derived from the possibility to [emit] now or never. Traeger, C. P. (2014). On option values in environmental and resource economics. *Resource and Energy Economics*, 37, 242-252, equation 5. Quasi-option value is the value of future learning conditional on delaying the emission decision, which mathematically equals the value of mitigation to the decision maker who anticipates learning less the value of mitigation to the decision maker who anticipates only the ability to delay his/her decision, and not learning. *Id.* The two values are related, such that real option value can be decomposed into:

$$DPOV = \text{Max}\{QOV + SOV - \text{Max}\{NPV, 0\}, 0\} = \text{Max}\{QOV + SOV - SCC, 0\}$$

where DPOV is the real option value, QOV is quasi-option value, SOV is simple option value (the value of the option to emit in the future condition on mitigating now), and NPV is the expected net present value of emitting the additional unit or the mean SCC in our case. *Id.*

<sup>38</sup> Even if society drastically reduced CO<sub>2</sub> emissions, CO<sub>2</sub> concentrations would continue to rise in the near future and many impacts would occur regardless due to lags in the climate system. Pindyck (2007), *supra* note 3. Uncertainty in environmental economics. *Review of environmental economics and policy*, 1(1), 45-65.

<sup>39</sup> Pindyck (2007), *supra* note 3.

<sup>40</sup> Kann & Weyant, *supra* note 6; Pindyck (2007), *supra* note 3; Golub et al. (2014), *supra* note 3.

<sup>41</sup> Nordhaus (2014) makes this difference clear when he clarifies that “With an optimized climate policy...the SCC will equal the carbon price...In the more realistic case where climate policy is not optimized, it is conventional to measure the SCC as the marginal damage of emissions along the actual path. There is some inconsistency in the literature on the definition of the path along which the SCC should be calculated. This paper will generally define the SCC as the marginal damages along the baseline path of emissions and output and not along the optimized emissions path.” Nordhaus, W. (2014). Estimates of the social cost of carbon: concepts and results from the DICE-2013R model and alternative approaches. *Journal of the Association of Environmental and Resource Economists*, 1(1/2), 273-312.

<sup>42</sup> On the BAU path, emissions far exceed their optimal level even without considering uncertainty. As a consequence, society is likely to regret an additional emission of CO<sub>2</sub> in most future states of the world. Alternatively, society is unlikely to regret

for a potential counteracting abatement cost irreversibility – the sunk costs of investing in abatement technology if we learn that climate change is less severe than expected – by the nature of being on the optimal emissions path that balances the cost of emissions and abatement. In the optimal case, uncertainty and irreversibility of abatement *can theoretically* lead to a lower optimal emissions tax, unlike the social cost of carbon. The difference in the implication for the optimal tax and the SCC means that the stochastic dynamic modeling results are less applicable to the SCC.

*What can we learn from new literature on stochastic dynamic programming models?*

Bearing in mind the limitations of stochastic dynamic modeling, some new research provides valuable insights that are relevant to calculation of the social cost of greenhouse gases. The new and growing stochastic dynamic optimization literature implies that the IWG's SCC estimates are downward biased. The literature is made up of three models – real option, finite horizon, and infinite horizon models – of which the infinite time horizon (i.e., stochastic dynamic programming (SDP)) models are the most comprehensive for analyzing the impact of uncertainty on optimal sequential abatement policies.<sup>43</sup> Recent computational advancements in SDP are helping overcome the need for strong simplifying assumptions in this literature for purpose of tractability. Traditionally, these simplifications led to unrealistically fast rates of learning – leading to incorrect outcomes – and difficulty in comparing results across papers (due to differing uncertain parameters, models of learning, and model types). Even so, newer methods still only allow for a handful of uncertain parameters compared to the hundreds of uncertain parameters in FUND and PAGE. Despite these limitations, the literature supports the above finding that the SCC, if anything, increases under uncertainty.<sup>44</sup>

First, uncertainty increases the optimal emissions tax under realistic parameter values and modeling scenarios. While the impact of uncertainty on the optimal emissions tax (relative to the deterministic problem) depends on the uncertain parameters considered, the type of learning, and the model type (real option, finite horizon, and infinite horizon), the optimal tax clearly increases when tipping points or black swan events are included in stochastic optimization problems.<sup>45</sup> For SDP models, uncertainty tends to strengthen the optimal emissions path relative to the determinist case even without tipping points,<sup>46</sup> and these results are strengthened under realistic preference assumptions.<sup>47</sup> Given that there is no counterbalancing tipping abatement cost,<sup>48</sup> the complete modeling of climate uncertainty – which fully accounts for tipping points and fat tails – increases the optimal tax. Uncertainty leads to a stricter optimal emissions policy even if with irreversible mitigation costs, highlighting that the SCC would also increase when

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current abatement levels unless the extremely unlikely scenarios that there is little to no warming and/or damages from climate change.

<sup>43</sup> Kann and Weyant (2000), *supra* note 6; Pindyck (2007), *supra* note 3; Golub et al. (2014), *supra* note 3.

<sup>44</sup> Kann and Weyant (2000), *supra* note 6; Pindyck (2007), *supra* note 3; Golub et al. (2014), *supra* note 3; Lemoine & Rudik (2017), *supra* note 3. Comparing the optimal tax to the mean SCC is made further difficult by the frequent use of DICE as the base from which most stochastic dynamic optimization models are built. As a consequence, deterministic model runs are frequently the base of comparison for these models. Lemoine & Rudik (2017), *supra* note 3.

<sup>45</sup> The real options literature tends to find an increase in the optimal emissions path under uncertainty relative to the deterministic case (Pindyck, 2007), though the opposite is true when modelers account for the possibility of large damages (i.e., tipping point or black swan events) even with a risk-neutral society (Pindyck, 2007; Golub et al., 2014). Solving finite horizon models employing non-recursive methods, modelers find that the results differ depending on the model of learning – the research demonstrates stricter emission paths under uncertainty without learning (with emission reductions up to 30% in some cases) and the impact under passive learning has a relatively small impact due the presence of sunken mitigation investment costs - except when tipping thresholds are included. *See* Golub et al. (2014), *supra* note 3.

<sup>46</sup> Using SDP, modelers find that uncertainty over the equilibrium climate sensitivity parameter generally increases the optimal tax by a small amount, though the magnitude of this impact is unclear. *See* Golub et al. (2014), *supra* note 3; Lemoine & Rudik (2017), *supra* note 3. Similarly, non-catastrophic damages can have opposing effects dependent on the parameters changed, though emissions appear to decline overall when you consider their uncertainty jointly.

<sup>47</sup> Pindyck (2007), *supra* note 3; Golub et al. (2014), *supra* note 3; Lemoine & Rudik (2017), *supra* note 3.

<sup>48</sup> Pindyck (2007), *supra* note 3.



factoring in risk aversion and irreversibility given that abatement costs are very low on the BAU emissions path.

Second, given the importance of catastrophic impacts under uncertainty (as shown in the previous paragraph), the full and accurate modeling of tipping points and unknown knowns is critical when modeling climate change. The most sophisticated climate-economic models of tipping points – which include the possibility of multiple correlated tipping points in stochastic dynamic IAMs – find an increase in the optimal tax by 100%<sup>49</sup> to 800%<sup>50</sup> relative to the deterministic case without them. More realistic modeling of tipping points will also increase the SCC.

Finally, improved modeling of preferences will amplify the impact of uncertainty on the SCC. Adopting Epstein-Zin preferences that disentangle risk aversion and time preferences can significantly increase the SCC under uncertainty.<sup>51</sup> Recent research has shown that accurate estimation of decisions under uncertainty crucially depends on distinguishing between risk and time preferences.<sup>52</sup> By conflating risk and time preferences, current models substantially understate the degree of risk aversion exhibited by most individuals, artificially lowering the SCC. Similarly, adopting ambiguity aversion increase the SCC, but to a much lesser extent than risk aversion.<sup>53</sup> Finally, allowing for the price of non-market goods to increase with their relative scarcity can amplify the positive effect that even small tipping points have on the SCC if the tipping point impacts non-market services.<sup>54</sup> Including more realistic preference assumptions in IAMs would further increase the SCC under uncertainty.

Introducing stochastic dynamic modeling (which captures option value and risk premiums), updating the representation of tipping points, and including more realistic preference structures in traditional IAMs will – as in the optimal tax – further increase the SCC under uncertainty

### *Conclusion: Uncertainty Raises the Social Cost of Greenhouse Gases*

Overall, the message is clear: climate uncertainty is *never* a rationale for ignoring the SCC or shortening the time horizon of IAMs. Instead, our best estimates suggest that increased variability implies a higher SCC and a need for more stringent emission regulations.<sup>55</sup> Current omission of key features of the climate

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<sup>49</sup> Lemoine, D., & Traeger, C. P. (2016b). Economics of tipping the climate dominoes. *Nature Climate Change*.

<sup>50</sup> Cai et al., 2016.

<sup>51</sup> Cai et al., 2016; Lemoine & Rudik (2017), *supra* note 3. The standard utility function adopted in IAMs with constant relative risk version implies that the elasticity of substitution equals the inversion of relative risk aversion. As a consequence, the society's preferences for the intra-generational distribution of consumption, the intergenerational distribution of consumption, and risk aversion hold a fixed relationship. For purposes of stochastic dynamic programming, this is problematic because this assumption conflates intertemporal consumption smoothing and risk aversion. Botzen, W. W., & van den Bergh, J. C. (2014). Specifications of social welfare in economic studies of climate policy: overview of criteria and related policy insights. *Environmental and Resource Economics*, 58(1), 1-33. By adopting the Epstein-Zinn utility function which separates these two parameters, modelers can calibrate them according to empirical evidence. For example, Cai et al. (2016) replace the DICE risk aversion of 1.45 and elasticity parameter of 1/1.45 with values of 3.066 and 1.5, respectively.

<sup>52</sup> James Andreoni & Charles Sprenger, *Risk Preferences Are Not Time Preferences*, 102 AM. ECON. REV. 3357–3376 (2012).

<sup>53</sup> Lemoine, D., & Traeger, C. P. (2016b). Economics of tipping the climate dominoes. *Nature Climate Change*; Lemoine & Rudik (2017), *supra* note 3.

<sup>54</sup> Typically, IAMs assume constant relative prices of consumption goods. Gerlagh, R., and B.C.C. Van der Zwaan. 2002. "Long-term substitutability between environmental and man-made goods." *Journal of Environmental Economics and Management* 44(2):329-345; Sterner, T., and U.M. Persson. 2008. "An Even Sterner Review: Introducing Relative Prices into the Discounting Debate." *Review of Environmental Economics and Policy* 2(1):61-76. By replacing the standard isoelastic utility function in IAMs with a nested CES utility function following Sterner and Persson (2008), Cai et al. (2015) find that even a relatively small tipping point (i.e., a 5% loss) can substantially increase the SCC in the stochastic dynamic setting. Cai, Y., Judd, K. L., Lenton, T. M., Lontzek, T. S., & Narita, D. (2015). Environmental tipping points significantly affect the cost–benefit assessment of climate policies. *Proceedings of the National Academy of Sciences*, 112(15), 4606-4611.

<sup>55</sup> Golub et al. (2014), *supra* note 3, states: "The most important general policy implication from the literature is that despite a wide variety of analytical approaches addressing different types of climate change uncertainty, none of those studies supports the

problem under uncertainty (the risk and climate premiums, option value, and fat tailed probability distributions) and incomplete modeling of tipping points imply that the SCC will further increase with the improved modeling of uncertainty in IAMs.

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argument that no action against climate change should be taken until uncertainty is resolved. On the contrary, uncertainty despite its resolution in the future is often found to favor a stricter policy.” *See also* Comments from Robert Pindyck, to BLM, on the Social Cost of Methane in the Proposed Suspension of the Waste Prevention Rule (submitted Nov. 5, 2017) (“Specifically, my expert opinion about the uncertainty associated with Integrated Assessment Models (IAMs) was used to justify setting the SC-CH<sub>4</sub> to zero until this uncertainty is resolved. That conclusion does not logically follow and I have rejected it in the past, and I reiterate my rejection of that view again here. While at this time we do not know the Social Cost of Carbon (SCC) or the Social Cost of Methane with precision, we do know that the correct values are well above zero...Because of my concerns about the IAMs used by the now-disbanded Interagency Working Group to compute the SCC and SC-CH<sub>4</sub>, I have undertaken two lines of research that do not rely on IAMs...[They lead] me to believe that the SCC is larger than the value estimated by the U.S. Government.”

## Technical Appendix: Discounting

### *The Underlying IAMs All Use a Consumption Discount Rate*

Employing a consumption discount rate would also ensure that the U.S. government is consistent with the assumptions employed by the underlying IAM models: DICE, FUND, and PAGE. Each of these IAMs employs consumption discount rates calibrated using the standard Ramsey formula (Newell, 2017). In DICE-2010, the elasticity of the pure rate of time preference is 1.5 and an elasticity of the marginal utility of consumption ( $\eta$ ) of 2.0. Together with its assumed per capita consumption growth path, the average discount rate over the next three hundred years is 2.4%.<sup>1</sup> However, more recent versions of DICE (DICE-2013R and DICE-2016) update  $\eta$  to 1.45; this implies an increase of the average discount rate over the timespan of the models to between 3.1% and 3.2% depending on the consumption growth path.<sup>2</sup> In FUND 3.8 and (the mode values in) PAGE09, both model parameters are equal to 1.0. Based on the assumed growth rate of the U.S. economy (without climate damages), the average U.S. discount rate in FUND 3.8 is 2.0% over the timespan of the model (without considering climate damages). Unlike FUND 3.8, PAGE09 specifies triangular distributions for both parameters with a pure rate of time preference of between 0.1 and 2 with a mean of 1.03 and an elasticity of the marginal utility of consumption of between 0.5 and 2 with a mean 1.17. Using the PAGE09's mode values (without accounting for climate damages), the average discount rate over the timespan of the models is approximately 3.3% with a range of 1.2% to 6.5%. Rounding up the annual growth rate over the last 50 years to approximately 2%,<sup>3</sup> the range of best estimates of the SDR implied in the short-run by these three models is approximately 3% (PAGE09's mode estimate and FUND 3.8) to 4.4% (DICE-2016), though the PAGE09 model alone implies a range of 1.1% to 6.0% with a central estimate of 3%. The range of potential consumption discount rates in these IAMs is relatively consistent with IWG (2010; 2013; 2016) in the short-run, though the discount rates of the IAMs employed by the IWG decline over time (due to declining growth rates over time) implying a potential upward bias to the IWG consumption discount rates.

### *A Declining Discount Rate is Justified to Address Discount Rate Uncertainty*

A strong consensus has developed in economics that the appropriate way to discount intergenerational benefits is through a declining discount rate (Arrow et al., 2013; Arrow et al., 2014; Gollier & Hammitt, 2014; Cropper et al., 2014).<sup>4</sup> Not only are declining discount rate theoretically correct, they are actionable (i.e., doable given our current knowledge) and consistent with OMB's *Circular A-4*. Perhaps the best reason to adopt a declining discount rate is the simple fact that there is considerable uncertainty around which discount rate to use. The uncertainty in the rate points directly to the need to use a declining rate, as the impact of the uncertainty grows exponentially over time such that the correct discount rate is not an arithmetic average of possible discount rates.<sup>5</sup> Uncertainty about future discount rates could stem from a number of sources particularly salient in the context of climate change, including uncertainty about

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<sup>1</sup> Due to a slowing of global growth, DICE-2010 implies a declining discount rate schedule of 5.1% in 2015, 3.9% from 2015 to 2050; 2.9% from 2055 to 2100; 2.2% from 2105 to 2200, and 1.9% from 2205 to 2300. This would be a steeper decline if Nordhaus accounted for the positive and normative uncertainty underlying the SDR.

<sup>2</sup> Due to a slowing of global growth, DICE-2016 implies a declining discount rate schedule of 5.1% in 2015, 4.7% from 2015 to 2050; 4.1% from 2055 to 2100; 3.1% from 2105 to 2200, and 2.5% from 2205 to 2300.

<sup>3</sup> According to the World Bank, the average global and United States per capita growth rates were 1.7% and 1.9%, respectively.

<sup>4</sup> Arrow et al. (2014) at 160-161 states that "We have argued that theory provides compelling arguments for using a declining certainty-equivalent discount rate," and concludes the paper by stating "Establishing a procedure for estimating a [declining discount rate] for project analysis would be an improvement over the OMB's current practice of recommending fixed discount rates that are rarely updated."

<sup>5</sup> Karp (2005) states that mathematical "intuition for this result is that as [time] increases, smaller values of  $r$  in the support of the distribution are relatively more important in determining the expectation of  $e^{-rt}$ " where  $r$  is the constant discount rate." Or as Hepburn et al. (2003) puts it, "The intuition behind this idea is that scenarios with a higher discount rate are given less weight as time passes, precisely because their discount factor is falling more rapidly" over time.

future economic growth, consumption, the consumption rate of interest, and preferences. Additionally, economic theory shows that if there is debate or disagreement over which discount rate to use, this should lead to the use of a declining discount rate (Weitzman, 2001; Heal & Millner, 2014). Though, the range of potential discount rates is limited by theory to potential consumption discount rates (see earlier discussion), which is certainly less than 7%.

*There is a consensus that declining discount rates are appropriate for intergenerational discounting*

Since the IWG undertook its initial analysis and before the most recent estimates of the SCC, a large and growing majority of leading climate economists' consensus (Arrow et al., 2013) has come out in favor of using a declining discount rate for climate damages to reflect long-term uncertainty in interest rates. This consensus view is held whether economists favor descriptive (i.e., market) or prescriptive (i.e., normative) approaches to discounting (Freeman et al., 2015). Several key papers (Arrow et al., 2013; Arrow et al., 2014; Gollier & Hammitt, 2014; Cropper et al., 2014) outline this consensus and present the arguments that strongly support the use of declining discount rates for long-term benefit-cost analysis in both the normative and positive contexts. Finally, in a recent survey of experts on the economics of climate change, Howard and Sylvan (2015) found that experts support using a declining discount rate relative to a constant discount rate at a ratio of approximately 2 to 1.

Economists have recently highlighted two main motivations for using a declining discount rate, which we elaborate on in what follows. First, if the discount rate for a project is fixed but uncertain, then the certainty-equivalent discount rate will decline over time, meaning that benefits should be discounted using a declining rate.<sup>6</sup> Second, uncertainty about the growth rate of consumption or output also implies that a declining discount rate should be used, so long as shocks to consumption are positively correlated over time.<sup>7</sup> In addition to these two arguments, other motivations for declining discount rates have long been recognized. For instance, if the growth rate of consumption declines over time, the Ramsey rule<sup>8</sup> for discounting will lead to a declining discount rate.<sup>9</sup>

In the descriptive setting adopted by the IWG (2010), economists have demonstrated that calculating the expected net present value of a project is equivalent to discounting at a declining certainty equivalent discount rate when (1) discount rates are uncertain, and (2) discount rates are positively correlated (Arrow et al., 2014 at 157). Real consumption interest rates are uncertain given that there are no multi-generation assets to reflect long-term discount rates and the real returns to all assets—including government bonds—are risky due to inflation and default risk (Gollier & Hammitt, 2014). Furthermore, recent empirical work analyzing U.S. government bonds demonstrates that they are positively correlated over time; this empirical work has estimated several declining discount rate schedules that the IWG can use (Cropper et al., 2014; 2014; Arrow et al., 2013; Arrow et al., 2014; Jouini and Napp, 2014; Freeman et al. 2015).

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<sup>6</sup> This argument was first developed in Weitzman (1998) and Weitzman (2001).

<sup>7</sup> See, e.g., Gollier (2009).

<sup>8</sup> The Ramsey discount rate equation for the social discount rate is  $r = \delta + \eta * g$  where  $r$  is the social discount rate,  $\delta$  is the pure rate of time preference,  $\eta$  is the aversion to inter-generational inequality, and  $g$  is the growth rate of per capita consumption. For the original development, see, Ramsey, F. P. (1928). A Mathematical Theory of Saving. *The Economic Journal*, 38(152).

<sup>9</sup> Higher growth rates lead to higher discounting of the future in the Ramsey model because growth will make future generations wealthier. If marginal utility of consumption declines in consumption, then, one should more heavily discount consumption gains by wealthier generations. Thus, if growth rates decline over time, then the rate at which the future is discounted should also decline. See, e.g., Arrow et al. (2014) at 148. It is standard in IAMs to assume that the growth rate of consumption will fall over time. See, e.g., Nordhaus (2017) at 1519, "Growth in global per capita output over the 1980–2015 period was 2.2% per year. Growth in global per capita output from 2015 to 2050 is projected at 2.1% per year, whereas that to 2100 is projected at 1.9% per year." Similarly, Hope (2011) at 22 assumes that growth will decline. For instance, in the U.S., growth is 1.9% per year in 2008 and declines to 1.7% per year by 2040. Using data provided by Dr. David Anthoff (one of the founders of FUND), FUND assumes that the global growth rate was 1.8% per year from 1980–2015 period, 1.4% per year from 2015 to 2050 and 2015 to 2100, and then dropping to 1.0% from 2100 to 2200 and then 0.7% from 2200 to 2300.

Currently when evaluating projects, the U.S. government applies the descriptive approach using constant rates of 3% and 7% based on the private rates of return on consumer savings and capital investments. As discussed previously, applying a capital discount rate to climate change costs and benefits is inappropriate (Newell, 2017). Instead, analysis should focus on the uncertainty underlying the future consumption discount rate (Newell, 2017). Past U.S. government analyses (IWG, 2010; IWG, 2013; IWG, 2016) modeled three consumption discount rates reflecting this uncertainty. If the U.S. government correctly returns its focus on multiple consumption discount rates, then the expected net present value argument given above implies that a declining discount rate is the appropriate way to perform discounting. As an alternative, given that the Ramsey discount rate approach is the appropriate methodology in intergenerational settings, the U.S. government could use a fixed, low discount rate as an approximation of the Ramsey equation following the recommendation of Marten et al. (2015); see our discussion on Martin et al. 2015). This is roughly IWG (2010)’s goal for using the constant 2.5% discount rate.

If the normative approach to discounting is used in the future (i.e., the current approach of IAMs), economists have demonstrated that an extended Ramsey rule<sup>10</sup> implies a declining discount rate when (1) the growth rate of per capita consumption is stochastic,<sup>11</sup> and (2) consumption shocks are positively correlated over time (or their mean or variances are uncertain) (Arrow et al., 2013; Arrow et al., 2014; Gollier & Hammitt, 2014; Cropper et al., 2014).<sup>12</sup> While a constant adjustment downwards (known as the precautionary effect<sup>13</sup>) can be theoretically correct when growth rates are independent and identically distributed (Cropper et al., 2014), empirical evidence supports the two above assumptions for the United States, thus implying a declining discount rate (Cropper et al., 2014; Arrow et al., 2014; IPCC, 2014).<sup>14</sup> We should further expect this positive correlation to strengthen over time due to the negative impact of climate change on consumption, as climate change causes an uncertain permanent reduction in consumption (Gollier, 2009).<sup>15</sup>

Several papers have estimated declining discount rate schedules for specific values of the pure rate of time preference and elasticity of marginal utility of consumption (e.g., Arrow et al., 2014), though recent work demonstrates that the precautionary effect increases and discount rates decrease further when

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<sup>10</sup> If the future growth of consumption is uncertainty with mean  $\mu$  and variance  $\sigma^2$ , an extended Ramsey equation  $r = \delta + \eta * \mu - 0.5\eta^2\sigma^2$  applies where  $r$  is the social discount rate,  $\delta$  is the pure rate of time preference,  $\eta$  is the aversion to inter-generational inequality, and  $g$  is the growth rate of per capita consumption. Gollier (2012, Chapter 3) shows that we can rewrite the extended discount rate as  $r = \delta + \eta * g - 0.5\eta(\eta + 1)\sigma^2$  where  $g$  is the growth rate of expected consumption and  $\eta + 1$  is prudence.

<sup>11</sup> The IWG assumption of five possible socio-economic scenarios implies an uncertain growth path.

<sup>12</sup> The intuition of this result requires us to recognize that the social planner is prudent in these models (i.e., saves more when faces riskier income). When there is a positive correlation between growth rates in per capita consumption, the representative agent faces more cumulative risk over time with respect to the “duration of the time spent in the bad state.” (Gollier et al., 2008). In other words, “the existence of a positive correlation in the changes in consumption tends to magnify the long-term risk compared to short-term risks. This induces the prudent representative agent to purchase more zero-coupon bonds with a long maturity, thereby reducing the equilibrium long-term rate.” (Gollier, 2007). Mathematically, the intuition is that under prudence, the third term in the extended Ramsey equation (*see* footnote 323) is negative, and a “positive [first-degree stochastic] correlation in changes in consumption raises the riskiness of consumption at date T, without changing its expected value. Under prudence, this reduces the interest rate associated to maturity T” (Gollier et al., 2007) by “increasing the strength of the precautionary effect” in the extended Ramsey equation (Arrow et al., 2014; Cropper et al., 2014).

<sup>13</sup> The precautionary effect measures aversion to future “wiggles” in consumption (i.e., preference for consumption smoothing) (Traeger, 2014).

<sup>14</sup> Essentially, the precautionary effect increases over time when shocks to the growth rate are positively correlated, implying that future societies require higher returns to face the additional uncertainty (Cropper et al., 2014; Arrow et al., 2014; IPCC, 2014).

<sup>15</sup> Due to the deep uncertainty characterizing future climate damages, some analysts argue that the stochastic processes underlying the long-run consumption growth path cannot be econometrically estimated (Weitzman, 2007; Gollier, 2012). In other words, economic damages, and thus future economic growth, are ambiguous. Agents must then form subjectivity probabilities, which may be better interpreted as a belief (Cropper et al., 2014). Again, theory shows that ambiguity leads to a declining discount rate schedule by Jensen’s inequality (Cropper et al., 2014).

catastrophic economic risks (such as the Great Depression and the 2008 housing crisis) are modeled (Gollier & Hammitt, 2014; Arrow et al., 2014). It should be noted that this decline in discount rates due to uncertainty in the global growth path is in addition to that resulting from a declining central growth path over time (Nordhaus, 2014; Marten, 2015).<sup>16</sup>

Additionally, a related literature has developed over the last decade demonstrating that normative uncertainty (i.e., heterogeneity) over the pure rate of time preference ( $\delta$ )—a measure of impatience—also leads to a declining social discount rate (Arrow et al., 2014; Cropper et al., 2014; Freeman and Groom, 2016). Despite individuals differing in their pure rate of time preference (Gollier and Zeckhauser, 2005), an equilibrium (consumption) discount exists in the economy. In the context of IAMs, modelers aggregate social preferences (often measured using surveyed experts) by calibrating the preferences of a representative agent to this equilibrium (Millner and Heal, 2015; Freeman and Groom, 2016). The literature generally finds a declining social discount rate due to a declining collective pure rate of time preference (Gollier and Zeckhauser, 2005; Jouini et al., 2010; Jouini and Napp, 2014; Freeman and Groom, 2016).<sup>17</sup> The heterogeneity of preferences and the uncertainty surrounding economic growth hold simultaneously (Jouini et al., 2010; Jouini and Napp, 2014), leading to potentially two sources of declining discount rates in the normative context.

### *Declining Rates are Actionable and Time-Consistent*

There are multiple declining discount rate schedules from which the U.S. government can choose, of which several are provided in Arrow et al. (2014) and Cropper et al. (2014). One possible declining interest rate schedule for consideration by the IWG is the one proposed by Weitzman (2001).<sup>18</sup> It is derived from a broad survey of top economists in context of climate change, and explicitly incorporates arguments around interest rate uncertainty.<sup>19</sup> Other declining discount rate schedules include Newell and Pizer (2003); Groom et al. (2007); Freeman et al. (2015). Many leading economists support the United States government adopting a declining discount rate schedule (Arrow et al., 2014; Cropper et al., 2014). Moreover, the United States would not be alone in using a declining discount rate. It is standard practice for the United Kingdom and French governments, among others (Gollier & Hammitt, 2014; Cropper et al., 2014). The U.K. schedule explicitly subtracts out an estimated time preference.<sup>20</sup> France's schedule is roughly similar to the United Kingdom's. Importantly, all of these discount rate schedules yield lower present values than the constant 2.5% discount rate employed by IWG (2010), suggesting that even the lowest discount rate evaluated by the IWG is too high.<sup>21</sup> The consensus of leading economists is that a

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<sup>16</sup> A common assumption in IAMs is that global growth will slow over time leading to a declining discount rate schedule over time; see footnote 7. Uncertainty over future consumption growth and heterogeneous preferences (discussed below) would lead to a more rapid decline in the social discount rate.

<sup>17</sup> The intuition for declining discount rates due to heterogeneous pure rates of time preference is laid out in Gollier and Zeckhauser (2005). In equilibrium, the least patient individuals trade future consumption to the most patient individuals for current consumption, subject to the relative value of their tolerance for consumption fluctuations. Thus, while public policies in the near term mostly impact the most impatient individuals (i.e., the individuals with the most consumption in the near term), long-run public policies in the distant future are mostly going to impact the most patient individuals (i.e., the individuals with the most consumption in the long-run).

<sup>18</sup> Weitzman (2001)'s schedule is as follows: 4% for 1-5 years; 3% for 6-25 years; 2% for 26-75 years; 1% for 76-300 years; and 0% for 300+ years.

<sup>19</sup> Freeman and Groom (2014) demonstrate that this schedule only holds if the heterogeneous responses to the survey were due to differing ethical interpretations of the corresponding discount rate question. A recent survey by Drupp et al. (2015) – which includes Freeman and Groom as co-authors – supports the Weitzman (2001) assumption.

<sup>20</sup> The U.K. declining discount rate schedule that subtracts out a time preference value is as follows (Lowe, 2008): 3.00% for 0-30 years; 2.57% for 31-75 years; 2.14% for 76-125 years; 1.71% for 126-200 years; 1.29% for 201-300 years; and 0.86% for 301+ years.

<sup>21</sup> Using the IWG's 2010 SCC model, Johnson and Hope (2012) find that the U.K. and Weitzman schedules yield SCCs of \$55 and \$175 per ton of CO<sub>2</sub>, respectively, compared to \$35 at a 2.5% discount rate. Because the 2.5% discount rate was included by the IWG (2010) to proxy for a declining discount rate, this result indicates that constant discount rate equivalents may be insufficient to address declining discount rates.



declining discount rate schedule should be used, harmonious with the approach of other countries like the United Kingdom. Adopting such a schedule would likely increase the SCC substantially from the administration's 3% estimate, potentially up to two to three fold (Arrow et al., 2013; Arrow et al., 2014; Freeman et al., 2015).

A declining discount rate motivated by discount rate or growth rate uncertainty avoids the time inconsistency problem that can arise if a declining pure rate of time preference ( $\delta$ ) is used. *Circular A-4* cautions that “[u]sing the same discount rate across generations has the advantage of preventing time-inconsistency problems.”<sup>22</sup> A time inconsistent decision is one where a decision maker changes his or her plan over time, solely because time has passed. For instance, consider a decision maker choosing whether to make an investment that involves an up-front payment followed by future benefits. A time consistent decision maker would invest in the project if it had a positive net-present value, and that decision would be the same whether it was made 10 years before investment or 1 year before investment. A time inconsistent decision maker might change his or her mind as the date of the investment arrived, despite no new information becoming available. Consider a decision maker who has a declining pure rate of time preference ( $\delta$ ) trying to decide whether to invest in a project that has large up-front costs followed by future benefits. Ten years prior to the date of investment, the decision maker will believe that this project is a relatively unattractive investment because both the benefits and costs would be discounted at a low rate. Closer to the date of investment, however, the costs would be relatively highly discounted, possibly leading to a reversal of the individual's decision. Again, the discount rate schedule is time consistent as long as  $\delta$  is constant.

The arguments provided here for using a declining consumption discount rate are not subject to this time inconsistency critique. First, time inconsistency occurs if the decision maker has a declining pure rate of time preference, not due to a decreasing discount rate term structure.<sup>23</sup> Second, uncertainty about growth or the discount rate avoids time inconsistency because uncertainty is only resolved in the future, after investment decisions have already been made. As the NAS (2017) notes, “One objection frequently made to the use of a declining discount rate is that it may lead to problems of time inconsistency.... This apparent inconsistency is not in fact inconsistent.... At present, no one knows what the distribution of future growth rates... will be; it may be different or the same as the distribution in 2015. Even if it turns out to be the same as the distribution in 2015, that realization is new information that was not available in 2015.”<sup>24</sup>

We should note that time-inconsistency is not a reason to ignore heterogeneity (i.e., normative uncertainty) over the pure rate of time preference ( $\delta$ ). If the efficient declining discount rate schedule is time-inconsistent, the appropriate solution is to select the best time-consistent policy. Millner and Heal (2014) do just this by demonstrating that a voting procedure – whereby the median voter determines the collective preference – is: (1) time consistent, (2) welfare enhancing relative to the non-commitment, time-inconsistent approach, and (3) preferred by a majority of agents relative to all other time-consistent plans. Due to the right skewed distribution of the pure rate of time preference and the social discount rate as shown in all previous surveys (Weitzman, 2001; Drupp et al., 2015; Howard and Sylvan, 2015), the median is less than the mean social discount rate (and pure rate of time preference); the mean social discount rate is what holds in the very short-run under various aggregation methods, such as Weitzman (2001) and Freeman and Groom (2015). Combining an uncertain growth rate and heterogeneous

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<sup>22</sup> *Circular A-4* at 35.

<sup>23</sup> Gollier (2012) states “It is often suggested in the literature that economic agents are time inconsistent if the term structure of the discount rate is decreasing. This is not the case. What is crucial for time consistency is the constancy of the rate of impatience, which is a cornerstone of the classic analysis presented in this book. We have seen that this assumption is compatible with a declining monetary discount rate.”

<sup>24</sup> National Academies of Sciences, Engineering, and Medicine, *Valuing Climate Damages: Updating Estimation of the Social Cost of Carbon Dioxide* 182 (2017).

preference together implies a declining discount rate starting at a lower value in the short-run. In addition to the reasons discussed earlier in the comments, this is another reason to exclude a discount rate as high as 7%.

*There is an economic consensus on the appropriateness of employing a consumption discount rate (and the inappropriateness of a capital discount rate) in the context of climate change*

There is a strong consensus among economists that it is theoretically correct to use consumption discount rates in the intergenerational setting of climate change, such as in the calculation of the SCC. Similarly, there is a strong consensus that a capital discount rate is inappropriate according to “good economics” (Newell, 2017).<sup>25</sup> This consensus holds across panels of experts on the social cost of carbon (NAS, 2017); surveys of experts on climate change and discount rates (Weitzman, 2001; Drupp et al., 2015; Howard and Sylvan, 2015; and Pindyck, 2016); the three most commonly cited IAMs employed in calculating the federal SCC; and the government’s own analysis (IWG, 2010; CEA, 2017). For more analysis of this issue, see the discussion in the main body our Comments on the inappropriateness of using a discount rate premised on the return to capital in intergenerational settings.

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<sup>25</sup> The former co-chair of the National Academy of Sciences’ Committee on Assessing Approaches to Updating the Social Cost of Carbon – Richard Newell (2017) – states that “[t]hrough the addition of an estimate calculated using a 7 percent discount rate is consistent with past regulatory guidance under OMB Circular A-4, there are good reasons to think that such a high discount rate is inappropriate for use in estimating the SCC...It is clearly inappropriate, therefore, to use such modeling results with OMB’s 7 percent discount rate, which is intended to represent the historical before-tax return on private capital...This is a case where unconsidered adherence to the letter of OMB’s simplified discounting approach yields results that are inconsistent with and ungrounded from good economics.”



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