Oral Comments on Discount Rate in EPA Guidelines for Preparing Economic Analyses

I’d like to thank the SAB panel for your hard work during this very rapid review process. I’d like to quickly refer the panel again to Policy Integrity’s past written comments on issues like how climate change blurs any traditional lines between domestic and international standing, with many so-called global impacts actually having direct implications for U.S. welfare, and on the potential employment benefits of not just compliance with environmental regulations but also of health improvements from regulation. I’ll focus my comments this morning on discounting.

The panel’s draft report recommends using an upper-end discount rate for intergenerational benefits and costs. This would be a break from the EPA’s Guidelines’ longstanding recommendation to focus on the consumption rate for regulations with long time horizons, and from the National Academy of Science’s recent similar recommendation to [quote] “choose parameters . . . consistent with consumption rates of interest.” In a 2017 RFF post, Richard Newell warned against when [quote] “adherence to the letter of OMB’s simplified discounting approach yields results that are inconsistent with and ungrounded from good economics.”

Recent literature, including from Li & Pizer, as well as economist surveys, and including work done in the decade since the Interagency Working Group chose 5% as its very top discount rate for the social cost of carbon, all point toward even lower discount rates for long-term planning and intergenerational effects.

There are also many reasons why the current estimates of the social opportunity cost of capital, rather than being stable, are overestimated. The Council of Economic Advisers recommended in 2017 that the current estimates should likely be lower because they do not account for upward biases from unpriced externalities, market power rents, differences between private and social risk, among other considerations. The current EPA Guidelines cite to literature showing the social opportunity cost of capital could be as low as 4.5%. And of course, uncertainty over the discount rate tends to point toward using a lower rate over time, as shown by Weitzman and others, as does uncertainty over the magnitude of any crowding out of investment versus consumption, and uncertainty over the magnitude of the shadow price of capital, as shown by Li & Pizer. This is before considering any of the ethical implication of applying a higher rate to intergenerational effects.

I’ll refer you to our written comments for more details on all these points. But to offer a path forward: Policy Integrity would encourage the panel to move its recommendation on developing a declining discount rate schedule up out of the “future considerations” tier and into key recommendations, as a declining discount rate schedule both is actionable now and would resolve some of the apparent disagreement here about what do with intergenerational effects.