

Institute for
Policy Integrity

NEW YORK UNIVERSITY SCHOOL OF LAW

March 23, 2020

VIA ELECTRONIC SUBMISSION

Dr. Thomas Armitage
Designated Federal Officer, EPA Science Advisory Board (1400R)
U.S. Environmental Protection Agency
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Re: Notification of Two Public Teleconferences of the Chartered Science Advisory Board,
FRL-10006-35-OA—Comments on Review of the Oil and Gas NSPS

The Institute for Policy Integrity (“Policy Integrity”) at New York University School of Law¹ submits the following comments to the Environmental Protection Agency (“EPA”) Chartered Science Advisory Board (“SAB”). These comments concern SAB’s review of the scientific and technical basis for the proposed rule entitled Oil and Natural Gas Sector: Emission Standards for New, Reconstructed and Modified Sources Review (“Proposed Rule”).

Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy. Policy Integrity evaluated the Proposed Rule and submitted two sets of public comments to EPA on November 25, 2019, detailing our findings (see the attached comments to EPA, which are hereby incorporated). Our comments address the following deficiencies in EPA’s regulatory impact analysis (“RIA”), which we wish to bring to the Board’s attention’s as well.

First, EPA’s cost-benefit analysis for the Proposed Rule fails to offer any estimate of the costs of forgone volatile organic compound (“VOC”) reductions. In the RIA, EPA stated that the agency will release a project “by the end of 2019” that reviews the suitability of reduced-form modeling techniques like benefit-per-ton approaches for estimating air quality benefits.² SAB should encourage EPA to release the findings of its project, if EPA has not yet done so.³ EPA should

¹ This document does not purport to present New York University School of Law’s views, if any.

² See EPA, REGULATORY IMPACT ANALYSIS FOR THE PROPOSED OIL AND NATURAL GAS SECTOR: EMISSION STANDARDS FOR NEW, RECONSTRUCTED, AND MODIFIED SOURCES REVIEW, at 3-2 to 3-3 (2019).

³ In the Proposed Rule, EPA provides a link that the agency states will house the final report and associated documentation “[u]pon completion and publication of the final report.” EPA, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, 84 Fed. Reg. 50,244, 50,279 (proposed Sept. 24, 2019) (to be codified at 40 C.F.R. pt. 60) [hereinafter Proposed Rule]. The link contains a report authored by consultants and published on October 31, 2019. See *epa-kpc/RFMEVAL*, GITHUB, [https://github.com/epa-](https://github.com/epa-epa-kpc/RFMEVAL)

further use these findings and existing research on the valuation of VOC emission reductions to estimate the Proposed Rule's forgone benefits.

Second, EPA does not adequately consider the Proposed Rule's implications for methane emissions from existing sources in the Crude Oil and Natural Gas source category. If methane standards for new sources are repealed, the agency will lose authority to establish emission guidelines for methane from existing sources in any segment of the source category.⁴ EPA's claim that forgoing federal regulation of existing sources will not affect those sources' emissions is unsupported by the evidence before the agency. Contrary to the agency's claims, market forces do not provide sufficient incentives for methane capture, and state regulatory programs for existing sources are not comparably stringent to federal regulation. Furthermore, exempting existing sources from regulation gives their owners an incentive to operate for a longer period of time, in order to avoid the cost of complying with standards applicable to new or modified sources.

Third, EPA arbitrarily limited the timespan of its analysis, in contravention of best economic practices. EPA claimed it could not project costs or benefits more than seven years into the future—far shorter than even the 10-year period that EPA examined when it finalized the original oil and gas standards in 2016, let alone the 30-year time period more typically recommended for regulatory impact analysis in order to capture all the important effects likely to result from a rule. The problem with EPA's limited timespan is that the proposed deregulation's annual cost savings will decrease over time while the forgone benefits will increase over time. Consequently, over a longer time period, the sign of the cost-benefit calculation could easily flip, revealing the Proposed Rule to be net costly.

Finally, EPA's revised valuation of the social cost of methane severely undervalues the Proposed Rule's significant climate costs. EPA's attempt to limit its valuation to domestic-only climate effects not only excludes a host of significant effects that matter to the United States, including spillover effects and reciprocal actions, but also relies on methodologies and models that cannot possibly calculate an accurate domestic-only value. EPA's application of a 7% discount rate is also out of step with the consensus in the scientific and economic literature about best practices for valuing inter-generational effects. And EPA violates prescribed best practices for dealing with uncertainty, failing to run sensitivity analyses about how different assumptions about catastrophic climate damages would change its cost-benefit analysis.

We strongly urge SAB to consider the above comments and attached materials as part of its review of the repeal of the targeted Oil and Gas New Source Performance Standards.

Respectfully,

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[kpc/REMEVAL](#) (last visited Mar. 23, 2020). If EPA wants to endorse the results, it should do so explicitly, explain why it is endorsing the results, explain how they apply to VOCs, and how they apply to this rule. EPA has failed to do any of the above.

⁴ See Proposed Rule, 84 Fed. Reg. at 50,271.

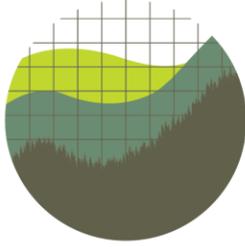
Attachments:

Comments of the Institute for Policy Integrity at New York University School of Law to EPA on Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, EPA-HQ-OAR-2017-0757 (Nov. 25, 2019)

Comments of the Environmental Defense Fund, Institute for Policy Integrity at New York University School of Law, Montana Environmental Information Center, Natural Resources Defense Council, Sierra Club, and Union of Concerned Scientists to EPA on Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, EPA-HQ-OAR-2017-0757 (Nov. 25, 2019)

ATTACHMENT A

Comments of the Institute for Policy Integrity at New York University School of Law to EPA on Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, EPA-HQ-OAR-2017-0757 (Nov. 25, 2019)



Institute for
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NEW YORK UNIVERSITY SCHOOL OF LAW

November 25, 2019

VIA ELECTRONIC SUBMISSION

Environmental Protection Agency

Attn: Ms. Amy Hambrick, Sector Policies and Programs Division (E143-05), Office of Air Quality Planning and Standards

Re: Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, 84 Fed. Reg. 50,244 (Proposed Sept. 24, 2019)

Docket ID: EPA-HQ-OAR-2017-0757

The Institute for Policy Integrity (“Policy Integrity”) at New York University School of Law¹ respectfully submits the following comments to the Environmental Protection Agency (“EPA” or the “agency”) regarding its proposed revisions to New Source Performance Standards (“NSPS”) for methane and volatile organic compound (“VOC”) emissions from the oil and gas sector (“Proposed Rule”). Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decision-making through advocacy and scholarship in the fields of administrative law, economics, and public policy.

Our comments focus on EPA’s flawed legal and economic justifications for the Proposed Rule. Specifically, we note the following:

- EPA does not provide a reasoned explanation for narrowing the scope of the Crude Oil and Natural Gas source category.
- EPA fails to consider the regulatory alternative of creating a new source category for the transmission and storage segment of the crude oil and natural gas industry.
- EPA’s proposed interpretation of Clean Air Act section 111(b) to require pollutant-specific significant contribution findings (“SCFs”) is neither statutorily required nor reasonable.
- EPA’s cost-benefit analysis for the Proposed Rule dramatically underestimates the health and environmental costs of forgone methane reductions and unreasonably fails to offer any estimate of the costs of forgone VOC reductions.
- EPA cannot reasonably interpret Section 111(d) to prohibit the regulation of methane emissions from existing sources.
- EPA does not adequately consider the Proposed Rule’s implications for emissions from existing sources in the Crude Oil and Natural Gas source category.

¹ This document does not purport to present New York University School of Law’s views, if any.

Background

EPA proposes to rescind or revise New Source Performance Standards (“NSPS”) issued in 2012 and 2016 for VOC and methane emissions from sources within the Crude Oil and Natural Gas source category.² In 2012, EPA established NSPS for VOC emissions from certain sources in the oil and natural gas sector (“2012 Rule”).³ Then, in 2016, EPA promulgated methane NSPS for the sources covered by the 2012 Rule, as well as both methane *and* VOC NSPS for additional sources in the oil and natural gas sector that were not included in the 2012 Rule (“2016 Rule”).⁴

Under its primary proposal, EPA would rescind both the methane and VOC NSPS for sources within the transmission and storage segment of the oil and natural gas sector.⁵ The primary proposal would also eliminate methane NSPS, but not VOC NSPS, for sources in the production and processing segments of the sector.⁶ Alternatively, EPA proposes to remove all methane NSPS applicable to oil and natural gas sources, but not to remove any sources from the source category.⁷ Additionally, EPA solicits comment on whether the agency should, in future rulemakings, interpret Clean Air Act (“CAA”) section 111 to require that EPA make a significant contribution finding for each new pollutant it regulates from an already listed source category.⁸

I. EPA fails to provide a reasoned explanation for narrowing the scope of the Crude Oil and Natural Gas source category

EPA argues that the 2012 and 2016 NSPS must be repealed for sources in the transmission and storage segment of the oil and gas industry because that segment is not part of the Crude Oil and Natural Gas source category,⁹ as established in the 1979 Priority Source Category List (“1979 Listing”).¹⁰ This argument is unavailing for two reasons. First, in the 2012 and 2016 rules, EPA reasonably concluded that the 1979 Listing *was* broad enough to encompass the transmission and storage segment.¹¹ Second, even if the original listing was not broad enough to encompass that

² EPA, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, 84 Fed. Reg. 50,244 (proposed Sept. 24, 2019) (to be codified at 40 C.F.R. pt. 60) [hereinafter Proposed Rule].

³ EPA, Oil and Natural Gas Sector: New Source Performance Standards and National Emission Standards for Hazardous Air Pollutants, 77 Fed. Reg. 49,490, 49,493 (Aug. 16, 2012) [hereinafter 2012 Final Rule].

⁴ See EPA, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources, 81 Fed. Reg. 35,824, 35,825 (June 3, 2016) [hereinafter 2016 Final Rule].

⁵ See Proposed Rule, 84 Fed. Reg. at 50,258.

⁶ See *id.* at 50,254.

⁷ See *id.* at 50,244.

⁸ See *id.* at 50,261.

⁹ See *id.* at 50,255.

¹⁰ EPA, Priority List and Additional Categories, 44 Fed. Reg. 49,222 (Aug. 21, 1979) [hereinafter 1979 Listing]. The 1979 Priority List identified source categories and ranked the priority by which EPA should issue New Source Performance Standards.

¹¹ See 2012 Final Rule, 77 Fed. Reg. at 49,493, 49,514; 2016 Final Rule, 81 Fed. Reg. at 35,832-33; see also EPA, Oil and Natural Gas Sector: New Source Performance Standards and National Emission Standards for Hazardous Air Pollutants Review, 76 Fed. Reg. 52,738, 52,745 (proposed Aug. 23, 2011) [hereinafter 2011 Proposed Rule] (“We . . . believe that the currently listed Oil and Natural Gas source category covers all operations in this industry (i.e., production, processing, transmission, storage and distribution).”).

segment, EPA had statutory discretion to amend the original listing, which it properly exercised in the 2016 Rule.

A. *EPA reasonably concluded that the 1979 Crude Oil and Natural Gas source category listing was sufficiently broad to include the transmission and storage segment*

In the Proposed Rule, EPA argues that the 2012 and 2016 rules improperly interpreted the 1979 Listing as encompassing the sources in the transmission and storage segment of the oil and gas industry, because the 1979 Listing “gave no indication that a source category [that is] ostensibly focused on ‘production’ also included those sources associated with post-production operations such as transmission and storage.”¹² But the 2012 and 2016 rules’ conclusion that the 1979 Listing was sufficiently expansive to encompass the transmission and storage segment was entirely reasonable given that (1) the category’s name was deliberately expansive, and (2) EPA in 1979 considered but ultimately declined to create a separate category for certain sources in the transmission and storage segment.

First, the name of the source category in the final 1979 Listing was deliberately expansive. While a draft list in a 1978 technical document (“1978 TD”) included the source category as “Crude Oil and Natural Gas Production Plants,”¹³ the 1979 Listing named the final source category as “Crude Oil and Natural Gas Production.”¹⁴ This change was consistent with EPA’s stated intent to create category listings that encompassed entire industries rather than mere facility types. For example, when revising the final listings for the non-metallic mineral processing industry, EPA aggregated nine subcategories because EPA planned “to study [the] industry at one time, since many of the processes and control techniques are similar.”¹⁵ EPA’s choice to drop the word “plant” from the Oil and Natural Gas Production source category similarly suggests that EPA envisioned an industry-wide source category that expanded beyond any particular set of facilities.

Second, the omission in the 1979 Listing of a source in the transmission and storage segment that had been included in the 1978 TD suggests that this source was incorporated into the Crude Oil and Natural Gas Production source category. EPA studied Stationary Pipeline Compressor Engines, which are found in the transmission and storage segment, as a potential independent source category in the 1978 TD.¹⁶ However, this source was not listed as a major or minor source in the 1979 Listing.¹⁷

In the Proposed Rule, EPA agrees that the absence of the Stationary Pipeline Compressor Engines category from the 1979 Listing indicates that the source was aggregated and included

¹² Proposed Rule, 84 Fed. Reg. at 50,255.

¹³ EPA, PRIORITIES FOR NSPS UNDER CLEAN AIR ACT AMENDMENTS OF 1977, EPA-450/3-78-019, at 34 (1978), available at <http://nepis.epa.gov/Exe/ZyPDF.cgi?Dockey=91010FMP.PDF> [hereinafter 1978 TD].

¹⁴ 1979 Listing, 44 Fed. Reg. at 49,226.

¹⁵ *Id.* at 49,223.

¹⁶ See 1978 TD at 33.

¹⁷ See 1979 Listing, 44 Fed. Reg. at 49,222-26.

within a different listing,¹⁸ but the agency argues that the source was included in the Stationary Internal Combustion Engines listing.¹⁹ However, EPA supports this proposition only by citing to a 2008 rule, which was promulgated three decades after the initial listing and does not expressly include stationary pipeline compressor engines within the Stationary Internal Combustion Engines source category.²⁰

B. *Alternatively, EPA provided a reasoned explanation in 2016 for revising the Crude Oil and Natural Gas source category to include the transmission and storage segment*

Even if the 1979 Listing could not reasonably be read as already encompassing the transmission and storage segment, EPA has broad discretion under Section 111 to expand source category listings. In the 2016 Rule, EPA made the findings necessary to support such an expansion.

In the 2016 Rule, EPA concluded that it was reasonable to include the transmission and storage segment within the Natural Gas and Crude Oil Production source category. The 2016 Rule described the “operations at production, processing, transmission and storage facilities” as a “sequence of functions that are interrelated and necessary for getting the recovered gas ready for distribution.”²¹ EPA emphasized how growth in one segment leads to growth in subsequent segments and how increases in natural gas production can require additional storage.²² Finally, EPA identified technologies in the transmission and storage segment, including storage vessels, pneumatic pumps, and compressors, that are used throughout the industry.²³

Despite the overlap in technology, EPA now argues that the transmission and storage segment cannot be included in the Crude Oil and Natural Gas source category, because the gas composition and operations in that segment are too different from those in the production and processing segments.²⁴ But these differences are of no statutory significance—that is, nothing in the text of Section 111 precludes EPA from regulating sources in the production, processing, and transmission and storage segments of the oil and gas industry as a single category merely because the composition of natural gas changes as it travels through these different segments.

EPA further argues that the 2016 Rule was not a permissible expansion of the Crude Oil and Natural Gas source category because EPA did not, in that rulemaking, make an independent

¹⁸ See Proposed Rule, 84 Fed. Reg. at 50,256 (“EPA was distinguishing between oil and natural gas production plants and natural gas processing on the one hand, and stationary pipeline compressor engines on the other, and . . . it intended to promulgate separate standards for HC and SO₂ emissions from those two source categories.”).

¹⁹ See *id.* at 50,256 n.46.

²⁰ See EPA, Standards of Performance for Stationary Spark Ignition Internal Combustion Engines and National Emission Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines, 73 Fed. Reg. 3,568, 3,569 (Jan. 18, 2008). EPA cites to a page stating that “[c]ategories and entities potentially regulated by this action” include “[a]ny manufacturer that produces or any industry using a stationary internal combustion engine as defined in the final rule.” *Id.* at 3,568-69. The preamble contains a list of “[e]xamples of regulated entities” that includes “[n]atural gas transmission.” *Id.* at 3,569. However, the preamble indicates that readers should “examine the applicability criteria of the final rule” to determine whether a specific engine is regulated by the rule and contains no explicit reference to stationary pipeline compressor engines. *Id.*

²¹ 2016 Final Rule, 81 Fed. Reg. at 35,832.

²² See *id.*

²³ See *id.*

²⁴ See Proposed Rule, 84 Fed. Reg. at 50,258.

Significant Contribution Finding (“SCF”) for the transmission and storage segment, considered separately from the rest of the Crude Oil and Natural Gas source category.²⁵ But nothing in the text of Section 111 requires such a finding. Section 111(b)(1)(A) requires that a source category be listed if “in [the EPA Administrator’s] judgment it causes, or contributes significantly to, air pollution which may reasonably be anticipated to endanger public health or welfare.”²⁶ It further grants the Administrator authority to “from time to time . . . revise” the listed categories.²⁷ Nothing in the statutory text or relevant case law suggests that EPA must, before revising a source category in a way that expands its scope, find that the newly regulated portion of the category, considered alone, “contributes significantly” to air pollution that may reasonably be anticipated to endanger public health and welfare. Put another way, nothing in the statute indicates that Congress intended for it to be any more difficult for EPA to *add* sources to a category than to include those sources in the category in the first instance. Thus, EPA’s obligation when revising a source category is only to conclude that the entire category, as revised, can still be deemed to contribute significantly to pollution that endangers public health or welfare. EPA reasonably reached such a conclusion in the 2016 Rule.²⁸

II. EPA fails to consider the regulatory alternative of creating an independent source category for the transmission and storage segment

Executive Order 12,866 requires agencies to “assess all costs and benefits of available regulatory alternatives” and then select the alternative that “maximize[s] net benefits.”²⁹ However, EPA failed to consider the reasonable alternative of creating a new source category for the transmission and storage segment of the oil and gas sector. Because EPA “fail[ed] to consider . . . alternatives,” much less “explain why such alternatives were not chosen,” finalizing the Proposed Rule would be arbitrary and capricious.³⁰

EPA seeks to rescind portions of the 2012 and 2016 rules on the theory that sources in the transmission and storage segment were not covered by the 1979 Listing for the Crude Oil and Natural Gas source category and that EPA did not and could not properly expand the 1979 Listing to encompass such sources. As discussed in the prior section, neither of these arguments is valid. Even if they were, however, the appropriate response would not be to leave sources in the transmission and storage segment entirely unregulated, as EPA proposes, but instead to create an independent source category for the transmission and storage segment and repromulgate the 2012 and 2016 NSPS under that new source category.

Using information from the 2012 and 2016 rules, along with analysis from the Proposed Rule, EPA could make an SCF for the transmission and storage segment to create an independent

²⁵ *See id.* at 50,257.

²⁶ Clean Air Act § 111(b)(1)(A), 42 U.S.C. § 7411(b)(1)(A).

²⁷ *Id.*

²⁸ *See* 2016 Final Rule, 81 Fed. Reg. at 35,833 (“[T]here is ample evidence that this source category as a whole (oil and natural gas production, processing, transmission, and storage) contributes significantly to air pollution that may reasonably be anticipated to endanger public health and welfare.”).

²⁹ Exec. Order No. 12,866 § 1(a), 58 Fed. Reg. 51,735, 51,735 (Oct. 4, 1993).

³⁰ *Int’l Ladies’ Garment Workers’ Union v. Donovan*, 722 F.2d 795, 815 (D.C. Cir. 1983). *See also* *Motor Vehicle Mfr. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 51 (1983) (finding it unreasonable for NHTSA to not consider an air-bag only alternative when rescinding an airbag and automatic seatbelt regulation).

source category. The Proposed Rule estimates that removing NSPS from the transmission and storage segment will increase methane emissions by 370,000 short tons, VOC emissions by 10,000 tons, and hazardous air pollutants (“HAP”) emissions by 300 tons between 2019 and 2025.³¹ The health and welfare costs of the forgone methane reductions would, according to the 2016 Rule, be worth \$690 million for the reductions forgone in 2025 alone (using a 3-percent discount rate).³² Given the volume of emissions emitted by the segment and the magnitude of the associated health and environmental costs, it is entirely reasonable to conclude that the transmission and storage segment, considered alone, significantly contributes to pollution that endangers public health and welfare. EPA states in the Proposed Rule that emissions are lower in the transmission and storage segment than in other segments of the oil and gas sector,³³ but the fact that transmission and storage emissions are smaller in relative terms does not render them insignificant in absolute terms.

III. EPA’s proposed interpretation of Section 111(b) to require pollutant-specific SCFs is neither statutorily required nor reasonable

EPA requests comment on whether it should change its interpretation of Section 111 regarding what, if any, findings the agency must make before regulating additional pollutants from a source category already subject to NSPS.³⁴ EPA asks whether requiring a pollutant-specific SCF would be a reasonable interpretation of the statute.³⁵ Because EPA’s proposed interpretation is entirely unsupported by the statutory text, EPA could not reasonably adopt it.

The plain text of CAA does not require EPA to make a new SCF prior to issuing standards for a new pollutant from an already listed source category. Section 111(b)(1)(A) directs EPA to list a source category if it “causes, or contributes significantly to, air pollution which may reasonably be anticipated to endanger public health or welfare.”³⁶ Section 111(b)(1)(B) then instructs the agency to “establish[] Federal standards of performance for new sources within such category” and to periodically “review and, if appropriate, revise such standards.”³⁷ While Section 111(b)(1)(B) provides detailed instructions for how EPA should go about setting these performance standards, it gives absolutely no indication that EPA must make an SCF for each pollutant covered by the standards. Nor does it suggest that EPA must make such a finding if it revises the standards to include an additional pollutant. In other words, the trigger for establishing performance standards under Section 111 is a finding that the category significantly

³¹ See Proposed Rule, 84 Fed. Reg. at 50,278; EPA, REGULATORY IMPACT ANALYSIS FOR THE PROPOSED OIL AND NATURAL GAS SECTOR: EMISSION STANDARDS FOR NEW, RECONSTRUCTED, AND MODIFIED SOURCES REVIEW, at 1-9 (2019) [hereinafter PROPOSED RULE RIA].

³² See 2016 Final Rule, 81 Fed. Reg. at 35,827; EPA, REGULATORY IMPACT ANALYSIS OF THE FINAL OIL AND NATURAL GAS SECTOR: EMISSION STANDARDS FOR NEW, RECONSTRUCTED, AND MODIFIED SOURCES, at 4-1 (2016), available at https://www3.epa.gov/tneacas1/docs/ria/oilgas_ria_nsps_final_2016-05.pdf [hereinafter 2016 FINAL RULE RIA].

³³ See Proposed Rule, 84 Fed. Reg. at 50,258. EPA claims that VOC emissions are lower in the transmission and storage segment than in other segments.

³⁴ See *id.* at 50,262-63.

³⁵ See *id.*

³⁶ Clean Air Act § 111(b)(1)(A), 42 U.S.C. § 7411(b)(1)(A).

³⁷ § 7411(b)(1)(B).

contributes to *some* type of dangerous air pollution, not a series of findings that the category significantly contributes to *every* type of pollution addressed by the performance standards.

EPA cites legislative history that it claims supports a reading of Section 111(b) as requiring a pollutant-specific SCF.³⁸ But the cited documents are ambiguous at best,³⁹ and, in any event, while legislative history can explain an undefined term or reveal a drafting error, it cannot justify the enforcement of “a principle . . . that has no statutory reference point.”⁴⁰ Accordingly, EPA cannot reasonably read Section 111(b)(1)(B) to require a pollutant-specific SCF.

IV. EPA’s cost-benefit analysis for the Proposed Rule is seriously flawed

For the reasons discussed above, EPA cannot reasonably claim that it is legally *obligated* to repeal any of the NSPS from the 2012 and 2016 rules. As a result, finalizing the Proposed Rule would be a purely discretionary action. But repealing NSPS for the oil and natural gas sector would not be a reasonable exercise of the agency’s discretion, because, among other reasons, the repeal’s costs (in the form of health and environmental harms associated with forgone pollution reductions) outweigh its benefits (in the form of avoided compliance expenditures).

Indeed, EPA’s own cost-benefit analysis shows that the Proposed Rule is net costly with respect to reciprocating compressors and pneumatic controllers.⁴¹ Furthermore, the Proposed Rule as a whole would appear net costly were it not for serious errors and omissions in EPA’s calculations. Finalizing the Proposed Rule in reliance on that misleading analysis would be arbitrary and capricious.

Executive Order 12,866 requires agencies to assess the costs and benefits of any significant regulatory action.⁴² This assessment must be based “on the best reasonably obtainable scientific, technical, economic, and other information,” and should include quantifiable measures “to the fullest extent that [they] can be usefully estimated.”⁴³ Long-standing guidance on regulatory analysis from the Office of Management and Budget (“OMB”) similarly advises that “[s]ound quantitative estimates of benefits and costs, where feasible, are preferable to qualitative descriptions.”⁴⁴ Because some effects are “too difficult to quantify or monetize given current data and methods,” however, agencies must also “carry out a careful evaluation of non-quantified benefits and costs.”⁴⁵

³⁸ See Proposed Rule, 84 Fed. Reg. at 50,264-65.

³⁹ For example, the Conference Report from the 1977 CAA Amendments states that, pursuant to Section 111(b), the Administrator “could regulate any air pollutant from those sources, the emissions of which ‘in his judgment cause or contribute to air pollution which may reasonably be anticipated to endanger public health or welfare.’” H.R. Rep. No. 95-564, at 183 (1977). This summary can easily be read to suggest that EPA may regulate any air pollutant from a source category so long as the agency has already concluded that the category “cause[s] or contribute[s]” to *some* type of air pollution that endangers public health or welfare.

⁴⁰ Shannon v. United States, 512 U.S. 573, 583 (1994).

⁴¹ See PROPOSED RULE RIA, at 2-15 to 2-19.

⁴² See Exec. Order No. 12,866 § 6(a)(3)(B). EPA has concluded that the Proposed Rule is a significant regulatory action for the purposes of Executive Order 12,866. See Proposed Rule, 84 Fed. Reg. at 50,279.

⁴³ Exec. Order No. 12,866 §§ 1(a), (b)(7).

⁴⁴ OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR A-4, at 26 (2003), *available at* <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A4/a-4.pdf> [hereinafter CIRCULAR A-4].

⁴⁵ *Id.* at 26-27.

Separate from the requirements of Executive Order 12,866, courts have held that “when an agency decides to rely on a cost-benefit analysis as part of its rulemaking, a serious flaw undermining that analysis can render the rule unreasonable”⁴⁶ and sustain the regulation as arbitrary and capricious under the statutory requirements of the APA.⁴⁷ The Supreme Court has interpreted the APA to require agency decisions to be “based on consideration of the relevant factors,”⁴⁸ and costs have long been considered “a centrally relevant factor” in regulatory decision-making.⁴⁹ Such costs have been defined to comprise “more than the expense of complying with regulations[,] any disadvantage could be termed a cost,” and include “harms that regulation might do to human health or the environment.”⁵⁰

Here, EPA fails to adequately consider several significant costs of the Proposed Rule. First, EPA significantly underestimates the cost of forgone methane reductions by using what it calls a domestic estimate for the social cost of methane instead of a global estimate. Second, EPA unreasonably fails to monetize the health and environmental impacts of VOC emissions, even though it has presented such information in the past. Third, EPA fails to properly classify the Proposed Rule as an “economically significant” regulatory action and to conduct the detailed cost-benefit analysis required as a result of such designation.

A. EPA’s interim estimate of the social cost of methane is economically unsound

EPA significantly understates the cost of forgone methane reductions by excluding damage from climate impacts occurring outside U.S. borders. For further discussion of this issue, see Policy Integrity’s separate comments on the social cost of methane, filed jointly with several other organizations.⁵¹

B. EPA unreasonably fails to monetize the health and environmental impacts of VOC emission increases

As discussed above, Circular A-4 advises agencies to monetize negative effects on health and welfare “[t]o the extent possible.”⁵² Even when there is uncertainty about the magnitude of a regulatory effect, such uncertainty does not justify assigning no weight to that effect in the agency’s cost-benefit analysis.⁵³ In the Proposed Rule, however, EPA does just that with respect to the health and welfare impacts of VOC emission reductions projected to occur under the 2012

⁴⁶ Nat’l Ass’n of Home Builders v. EPA, 682 F.3d 1032, 1040 (D.C. Cir. 2012); *see also* Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (arbitrary and capricious standard requires agency to “examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made”) (internal quotation marks omitted).

⁴⁷ *See* Administrative Procedure Act § 706(2)(A), 5 U.S.C. § 706(2)(A) (2018).

⁴⁸ *State Farm*, 463 U.S. at 42.

⁴⁹ *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015).

⁵⁰ *Id.*

⁵¹ Policy Integrity et al., *Flawed Monetization of Forgone Benefits in the Proposed Rule, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review* (Nov. 25, 2019).

⁵² CIRCULAR A-4, at 19.

⁵³ *See* Ctr. for Biological Diversity v. Nat’l Highway Traffic Safety Admin., 538 F.3d 1172, 1192, 1200 (9th Cir. 2008) (finding agency reasoning arbitrary and capricious where agency argued that benefits of carbon dioxide reductions were “too uncertain to support their explicit valuation and inclusion” in a regulatory cost-benefit analysis).

and 2016 rules but forgone under the Proposed Rule. While there may be “a range of values” for these forgone benefits, the value “is certainly not zero.”⁵⁴

In the Proposed Rule, EPA recognizes the existence of forgone benefits of VOC emission reductions and expects that VOC emissions resulting from the Proposed Rule “will degrade air quality and are likely to adversely affect health and welfare associated with exposure to ozone, PM_{2.5}, and HAP.”⁵⁵ However, EPA claims that the agency is “unable to quantify these effects at this time,” citing “difficulties in modeling” and lack of available data.⁵⁶ Consequently, EPA does not monetize the forgone benefits of VOC emission reductions. Instead, EPA provides a qualitative analysis of the effects of the anticipated increased VOC emissions as precursors to both ozone and PM_{2.5}.⁵⁷

But EPA *has* provided information on how to monetize the value of VOC reductions in its past regulations of the oil and gas sector. In the 2016 RIA, EPA stated that the VOC benefit-per-ton estimates were not appropriate for calculating that rule’s monetized benefits,⁵⁸ and EPA repeats this conclusion in the Proposed Rule’s RIA.⁵⁹ However, the RIA for the 2016 Rule still presented a range of epidemiology studies estimating the value of reducing a ton of VOC in 2012 dollars: \$300 to \$7,500.⁶⁰ EPA also provided an illustrative breakeven analysis to determine that a proposed regulatory option for the 2016 Rule would be cost-benefit justified if the agency valued VOC emission reductions at \$460 per ton in 2020 and \$160 per ton in 2025, well within the range of the studies presented.⁶¹ EPA provides none of this information in the present rulemaking. In the Proposed Rule’s RIA, EPA explains only that the agency will release a project “by the end of 2019” that reviews the suitability of modeling techniques like benefit-per-ton approaches for estimating air quality benefits.⁶² EPA provides no initial findings from this review on appropriate methods for estimating VOC emission reduction benefits nor does the agency explain why it released the Proposed Rule before completing its analysis of appropriate modeling techniques.

Circular A-4 directs agencies to “present any relevant quantitative information” for unquantified effects.⁶³ Because EPA has heeded this requirement in past rulemakings, the agency’s refusal to present any quantitative value for VOC emission reductions that will be forgone as a result of the Proposed Rule is arbitrary and capricious.⁶⁴

⁵⁴ *Id.* at 1200.

⁵⁵ Proposed Rule, 84 Fed. Reg. at 50,279.

⁵⁶ PROPOSED RULE RIA, at 3-2 to 3-3.

⁵⁷ *See id.* at 3-15 to 3-19.

⁵⁸ *See* 2016 FINAL RULE RIA, at 4-22.

⁵⁹ *See* PROPOSED RULE RIA, at 3-2 to 3-3.

⁶⁰ *See* 2016 FINAL RULE RIA, at 4-22.

⁶¹ *See id.* at 5-3 to 5-4.

⁶² *See* PROPOSED RULE RIA, at 3-2 to 3-3.

⁶³ CIRCULAR A-4, at 27.

⁶⁴ *See* *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (vacating rule where agency “failed adequately to quantify the certain costs or to explain why those costs could not be quantified”).

C. EPA fails to properly classify the Proposed Rule as an “economically significant” regulatory action

According to EPA, the Proposed Rule is a “significant” action, but not an “economically significant” action.⁶⁵ EPA’s unreasonable use of a domestic social cost of methane figure and failure to quantify the forgone benefits of VOC reductions underestimates the Proposed Rule’s economic impact. With correct analysis, the Proposed Rule should be classified as an economically significant action and, as such, be accompanied by a more rigorous cost-benefit analysis.

Under Executive Order 12,866, a regulation is “economically significant” if it is expected to “have an annual effect on the economy of \$100 million or more.”⁶⁶ As OMB has explained, this “\$100 million threshold applies to the impact of the proposed or final regulation in any one year, and it includes benefits, costs, or transfers.”⁶⁷ In 2025, the Proposed Rule estimates that methane emissions will increase by 69,000 short tons per year and that VOC emissions will increase between 860 and 1,900 short tons per year.⁶⁸ Using the Interagency Working Group’s 2016 estimate for the social cost of methane and a 3% discount rate, the methane emissions in 2025 will result in costs of \$106 million in 2018 dollars.⁶⁹ On that basis alone, the Proposed Rule qualifies as economically significant.

Under Executive Order 12,866, agencies have a higher burden with respect to cost-benefit analysis of economically significant rules. An agency proposing an economically significant action must provide “[a]n assessment, including the underlying analysis, of costs anticipated from the regulatory action . . . together with, to the extent feasible, a quantification of those costs.”⁷⁰ The agency must also prepare “[a]n assessment, including the underlying analysis, of benefits anticipated from the regulatory action . . . together with, to the extent feasible, a quantification of those benefits.”⁷¹ Finally, the agency must include “[a]n assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives . . . and an explanation why the planned regulatory action is preferable to the identified potential alternatives.”⁷² As discussed above, the analysis accompanying the Proposed Rule does not satisfy these requirements.

⁶⁵ See Proposed Rule, 84 Fed. Reg. at 50,279.

⁶⁶ Exec. Order No. 12,866 § 3(f).

⁶⁷ OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, REGULATORY IMPACT ANALYSIS: FREQUENTLY ASKED QUESTIONS 1 (2011), *available at* https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/assets/OMB/circulars/a004/a-4_FAQ.pdf.

⁶⁸ See PROPOSED RULE RIA, at 1-9.

⁶⁹ See 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 (2016). President Trump disbanded the Interagency Working Group (IWG) in 2017, *see* Exec. Order No. 13,783 § 5(b), 82 Fed. Reg. 16,093 (Mar. 28, 2017), but the IWG figure still represents the best available estimate of the social cost of methane.

⁷⁰ Exec. Order No. 12,866 § 6(C)(ii).

⁷¹ § 6(C)(i).

⁷² § 6(C)(iii).

With that said, EPA's responsibility to correct the aforementioned flaws in its RIA is not contingent on the Proposed Rule's classification as economically significant. The analysis provided by the agency is below the standards required even for a significant rule.

V. EPA cannot reasonably interpret Section 111(d) to prohibit the regulation of methane from existing sources

EPA solicits comment on whether methane's status as an ozone precursor prohibits the application of Section 111(d) to regulate existing sources.⁷³ Because methane is not regulated as a precursor to ozone under Section 108 and EPA regulations exclude methane from the definition of volatile organic compounds, EPA cannot reasonably interpret Section 111(d) to prohibit the regulation of methane from existing sources.

Pursuant to Section 111(d), EPA must regulate existing sources' emissions of any "air pollutant" for which the agency has established *new* source performance standards under Section 111(b) *and* which is not already regulated as a criteria pollutant under CAA Section 108 or hazardous air pollutant under CAA Section 112.⁷⁴ In turn, Section 302(g) of the Clean Air Act defines "air pollutant" as including "any precursors to the formation of any air pollutant, to the extent the Administrator has identified such precursor . . . for the particular purpose for which the term 'air pollutant' is used."⁷⁵ Under a reasonable construction of this text, EPA has "identified" a precursor "for the particular purpose" of the criteria or hazardous air pollutant programs only if the agency's regulations under those programs actually encompass emissions of the relevant precursor. In other words, if EPA has not taken any steps under the criteria-pollutant program to limit emissions of a given criteria-pollutant particular precursor, it cannot reasonably argue that it is barred from regulating that precursor under Section 111(d).

Although ozone is an air pollutant for which air quality criteria have been issued under Section 108(a), EPA has not "identified" methane as a precursor that must be controlled under that section. Although the agency regulates volatile organic compounds as ozone precursors, its regulations governing implementation plans expressly exclude methane from the regulatory definition of "volatile organic compounds" due to methane's "negligible photochemical reactivity."⁷⁶ As a result, state implementation plans for achieving ambient ozone standards are not expected to address methane emissions.⁷⁷ In sum, EPA does not regulate methane as a

⁷³ See Proposed Rule, 84 Fed. Reg. at 50,269.

⁷⁴ See Clean Air Act § 111(d)(1)(A), 42 U.S.C. § 7411(d)(1)(A); see also EPA, Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units, 80 Fed. Reg. 64,662, 64,701 (Oct. 23, 2015) (explaining that Section 111(d) applies to "certain existing sources of air pollutants that were not otherwise regulated as criteria pollutants or hazardous air pollutants").

⁷⁵ § 7602(g).

⁷⁶ 40 C.F.R. § 51.100(s)(1); see also EPA, Air Quality: Revision to Definition of Volatile Organic Compounds—Exclusion of 16 Compounds, 62 Fed. Reg. 44,900 (Aug. 25, 1997) (final rule revising definition of VOC for purposes of preparing implementation plans to exclude methane and other compounds); Proposed Rule, 84 Fed. Reg. at 50,269 n.86 (stating that "EPA has excluded methane and some related pollutants from the definition of VOC").

⁷⁷ See 40 C.F.R. § 51.100(s)(1).

precursor to ozone under Section 108 and disclaims its authority to do so pursuant to existing VOC regulations.

Because EPA does not regulate methane as a precursor to a criteria-pollutant under the criteria-pollutant program, it would be unreasonable for EPA to classify methane as a criteria-pollutant precursor that cannot be regulated in existing sources under Section 111(d). EPA characterizes Section 111(d) as serving a “gap-filling” role.⁷⁸ Regulating emissions in existing sources of precursors left unregulated by Section 108 and 112 properly fulfills this gap-filling purpose.

VI. EPA does not adequately consider the Proposed Rule’s implications for emissions from existing sources in the oil and gas category

In the Proposed Rule, EPA argues that, unlike methane, VOCs do not qualify as the type of air pollutant that, if subject to a standard of performance for new sources, would trigger the application of Section 111(d), which would also require the regulation of emissions from existing sources.⁷⁹ But if methane standards for new sources are repealed, EPA recognizes that the agency would lose authority to establish emission guidelines for methane for existing sources in any segment of the Crude Oil and Natural Gas source category under Section 111(d).⁸⁰ This loss of authority is an important consequence of the Proposed Rule to which EPA gives inadequate consideration.

Instead of addressing the consequences of its proposal, EPA falsely claims that “lack of regulation of existing sources under CAA section 111(d) will not mean a substantial amount of lost emission reductions.”⁸¹ EPA argues that market forces already provide sufficient incentive for existing sources to reduce their emissions; that many existing sources will retire or become subject to regulation under Section 111(b) after modification or reconstruction; and that state regulatory programs will fill in the gaps left between federal standards.⁸² EPA states that these forces will, collectively, achieve comparable methane emission reductions to performance standards, but this assertion is unsupported by the evidence before the agency.

A. Contrary to EPA’s claims, market forces alone do not provide a sufficient incentive for methane capture at existing sources

EPA claims that operators have market incentives to reduce emissions of methane because rational actors in the economic system will collect the natural gas and sell it.⁸³ Specifically, the Proposed Rule states that because methane is an “important commodity,” operators have an incentive to “maximize the capture of natural gas” to prevent the “loss of valuable product to the

⁷⁸ Proposed Rule, 84 Fed. Reg. at 50,272.

⁷⁹ *See id.*

⁸⁰ *See id.* at 50,271 (“The EPA recognizes that by rescinding the applicability of the NSPS, issued under CAA section 111(b), to methane emissions for the sources in the Crude Oil and Natural Gas Production source category that are currently covered by the NSPS, existing sources of the same type in the source category will not be subject to regulation under CAA section 111(d).”).

⁸¹ *Id.*

⁸² *See id.*

⁸³ *See id.* at 50,274.

atmosphere.”⁸⁴ However, EPA fails to account for the negative externalities of methane emissions that the market fails to adequately internalize.

A negative externality occurs when the manufacture or consumption of a good imposes uncompensated costs on a third party to the transaction. Because neither the buyer nor seller of the good is forced to take this cost into account, the good will be consumed at a higher-than-optimal level.⁸⁵ OMB has long recognized that environmental harms like air pollution are a “classic case of externality”—and a justification for promulgating regulation.⁸⁶ Executive Order 12,866 similarly recognizes that regulation is necessary to correct “material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people.”⁸⁷

In the case of methane and VOCs, leaks from oil and gas operations generate both private costs (in the form of forgone sales revenue from the loss of gas to the atmosphere) and external costs (in the form of methane’s contribution to climate change, and the health and environmental harms associated with VOC emissions). Private operators have an incentive to take the private cost into account, but not the external costs. Thus, they will not invest in leak prevention at an optimal level.

EPA promulgated the 2016 Rule, which the Proposed Rule seeks to rescind, to decrease the negative externalities of methane emissions from *new* sources in the oil and gas sector. EPA recognized that “all else held equal, the quantity of oil and natural gas produced in a competitive market will not be at the socially optimal level” without proper regulation of emissions.⁸⁸ This is just as true for existing sources as for the new sources covered by the 2016 Rule. Thus, in the absence of regulation, neither methane nor VOC emissions from existing sources will be adequately controlled.

B. EPA’s argument that many existing sources will be folded into the NSPS for new and modified sources fails to account for the perverse incentives created by grandfathering

EPA believes that many existing sources will be folded into the NSPS for new and modified sources as they can be reasonably expected to go through “modifications.”⁸⁹ However, the Proposed Rule fails to consider how divergent standards for modified versus existing facilities create perverse incentives for current operators.

Legal and economic scholars have long recognized that stringently regulating new sources of pollution while exempting existing sources—a regulatory practice commonly known as “grandfathering”—can perversely encourage those existing sources to stay in operation longer than they otherwise would and lead to adverse environmental consequences.⁹⁰ Indeed, EPA’s

⁸⁴ *Id.*

⁸⁵ See EPA, GUIDELINES FOR PREPARING ECONOMIC ANALYSES, at A-5 to A-6 (2010), available at <https://www.epa.gov/sites/production/files/2017-08/documents/ee-0568-50.pdf>.

⁸⁶ CIRCULAR A-4, at 4.

⁸⁷ Exec. Order No. 12,866 § 1(a).

⁸⁸ 2016 FINAL RULE RIA, at 1-3.

⁸⁹ Proposed Rule, 84 Fed. Reg. at 50,271, 50,273.

⁹⁰ See Richard L. Revesz & Jack Lienke, STRUGGLING FOR AIR: POWER PLANTS AND THE “WAR ON COAL” 30-35 (2016); see also Richard L. Revesz & Allison L. Westfahl Kong, *Regulatory Change and Optimal Transition Relief*,

own Guidelines for Preparing Economic Analyses warn that “grandfathering” existing sources by exempting them from more stringent regulatory requirements creates “a bias against constructing new facilities and investing in new pollution control technology or production processes.”⁹¹ Consequently, grandfathered older facilities, which have higher emission rates and larger negative impacts on public health and the environment, “tend to remain active longer than they would if the same emissions standard applied to all polluters.”⁹²

Under the Proposed Rule, EPA leaves NSPS for VOCs in place for new and modified sources in the production and processing segments but denies itself the ability to set equivalent standards for existing sources. Therefore, existing sources will have an incentive to remain operational longer than they otherwise would have, leading to prolonged adverse environmental consequences. EPA’s argument that existing sources will inevitably become subject to NSPS ignores this pernicious effect.

C. EPA’s conclusion that state regulatory programs will regulate existing sources is unreasonable given that current state programs are not comparably stringent

EPA concludes that state regulatory programs will regulate methane emissions from existing sources and minimize the environmental impact of EPA removing its authority to regulate methane emissions under Section 111(d).⁹³ However, state programs do not cover the same sources as the NSPS, are not present in all states, and are unlikely to regulate at an optimal level.

EPA admits that “not all of these states [with oil and natural gas regulations] cover all emission sources covered by the NSPS OOOO and OOOOa.”⁹⁴ The following chart shows the sources covered by regulations of oil and natural gas sector methane emissions:

105 NW. U. L. REV. 1581 (2011); Jonathan Remy Nash & Richard L. Revesz, *Grandfathering and Environmental Regulation: The Law and Economics of New Source Review*, 101 NW. U. L. REV. 1677 (2007).

⁹¹ EPA, GUIDELINES FOR PREPARING ECONOMIC ANALYSES, at 4-3 (2010), available at <https://www.epa.gov/sites/production/files/2017-08/documents/ee-0568-50.pdf>.

⁹² *Id.* See also Victor B. Flatt & Kim Diana Connolly, ‘Grandfathered’ Air Pollution Sources and Pollution Control: *New Source Review Under the Clean Air Act 3* (Ctr. for Progressive Regulation, White Paper No. 504, Mar. 2005), available at http://www.progressivereform.org/articles/NSR_504.pdf (“[M]any of these “grandfathered” plants are operating far beyond the lifetimes originally envisioned... [and] continue to contribute to dangerous pollution levels in all regions, and they put a high burden on health and clean economic growth years after they were expected to close.”). For more information, see RICHARD L. REVESZ & JACK LIENKE, STRUGGLING FOR AIR: POWER PLANTS AND THE “WAR ON COAL” 30-35 (2016); Richard L. Revesz & Allison L. Westfahl Kong, *Regulatory Change and Optimal Transition Relief*, 105 NW. U. L. REV. 1581 (2011); Jonathan Remy Nash & Richard L. Revesz, *Grandfathering and Environmental Regulation: The Law and Economics of New Source Review*, 101 NW. U. L. REV. 1677 (2007).

⁹³ See Proposed Rule, 84 Fed. Reg. at 50,274.

⁹⁴ *Id.* at 50,277.

*Comparison of State Oil and Natural Gas Regulations*⁹⁵

Source	CA	CO	MT	ND	NM	OH	PA	TX	UT	WY
Storage Vessels	X	X	X	X	X	X	X	X	X	X
Reciprocating Compressors	X	X				X	X			
Centrifugal Compressors	X	X				X	X			
Pneumatic Controllars	X	X				X	X		X	X
Pneumatic Pumps	X	X				X	X			X
Equipment Leaks at Natural Gas Processing Plants	X	X					X	X		
Fugitive Emissions at Well Sites	X	X	X	X	X	X	X	X	X	X
Fugitive Emissions at Compressor Stations	X	X				X	X			X
Methane Standards	X	X					X			
Transmission and Storage Segment	X	X				X	X			X

EPA does not differentiate between which states' regulations cover existing versus new source categories, merely noting that states may define existing and new sources differently.⁹⁶ EPA also does not explicitly state whether its chart includes all state regulations of methane emissions, but, if so, two of the top-five states for gas production⁹⁷ and one of the five leading states for crude oil production⁹⁸ lack state-level regulations for methane emissions in the oil and natural gas

⁹⁵ Table adapted from the Proposed Rule, 84 Fed. Reg. at 50,277.

⁹⁶ See Proposed Rule, 84 Fed. Reg. at 50,277 n.102.

⁹⁷ See *Which States Consume and Produce the Most Natural Gas?*, U.S. ENERGY INFO. ADMIN., <https://www.eia.gov/tools/faqs/faq.php?id=46&t=8> (last visited Nov. 11, 2019). The chart summarizes regulations in Ohio, Pennsylvania, and Texas, but it does not include regulations for Louisiana or Oklahoma. The Proposed Rule explains that Oklahoma merely incorporates NSPS OOOO and OOOOa by reference into state rules. See Proposed Rule, 84 Fed. Reg. at 50,277.

⁹⁸ See *Crude Oil Production*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbbldp_a.htm (last visited Nov. 11, 2019). The chart summarizes regulations in Colorado, New Mexico, North Dakota, and Texas, but it does not include regulations for Oklahoma. The Proposed Rule explains that Oklahoma merely incorporates NSPS OOOO and OOOOa by reference into state rules. See Proposed Rule, 84 Fed. Reg. at 50,277.

sector. EPA seeks comment on other state-level practices. However, given these significant gaps in EPA’s information regarding state-level regulations and the limited scope of the state regulations that EPA has identified, it is unreasonable for EPA to conclude that they would adequately fill the role of federal regulations for existing sources.

Economic logic also cautions against an assumption that states will regulate methane emissions at the same level of stringency as the federal government. Because greenhouse gases are global pollutants, states can enjoy the benefits of having oil and natural gas industry within their borders, such as jobs and tax revenue, without bearing the full environmental cost of that activity.⁹⁹ Because the negative effects are not wholly felt within the emitting jurisdiction, “the state has a significant incentive to under-regulate methane-producing activities.”¹⁰⁰ Therefore, it is unreasonable for EPA to conclude that states have adequate incentives to regulate emissions to the socially optimal level.

Overall, given (1) EPA’s own findings in 2016 that market incentives are not sufficient to reduce methane emissions to the socially optimal level, (2) the perverse incentives created by grandfathering, and (3) the insufficiency of state regulations, EPA cannot reasonably conclude that federal regulation of existing sources in the oil and gas sector is unnecessary.

Respectfully,

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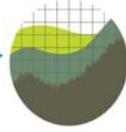
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⁹⁹ See *Constitutional Considerations: States vs. Federal Environmental Policy Implementation: Hearing Before the Subcomm. on Env’t and the Econ.*, 113th Cong. 3 (2014) (statement of Richard Revesz, Lawrence King Professor of Law, New York University School of Law).

¹⁰⁰ *Id.* at 5.

ATTACHMENT B

Comments of the Environmental Defense Fund, Institute for Policy Integrity at New York University School of Law, Montana Environmental Information Center, Natural Resources Defense Council, Sierra Club, and Union of Concerned Scientists to EPA on Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review, EPA-HQ-OAR-2017-0757 (Nov. 25, 2019)



Institute for
Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW



Union of
Concerned
Scientists

November 25, 2019

To: Environmental Protection Agency, via regulations.gov

Docket ID: EPA-HQ-OAR-2017-0757

Subject: Flawed Monetization of Forgone Benefits in the Proposed Rule, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review

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

The following comments focus on the failure of the Environmental Protection Agency (“EPA”) to adequately monetize and evaluate the forgone benefits of its proposed rule, Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources Review (“proposed deregulation”), which proposes to deregulate crucial controls on emissions from the oil and gas sector.¹

EPA forecasts that the proposed deregulation will lead to the emission of at least 350,000 additional metric tons of methane from new sources in just the next seven years alone, along with increases in emissions of volatile organic compounds, hazardous air pollutants, ozone, and fine particulate matter.² EPA justifies these substantial emissions increases by asserting that the rule will yield cost savings to industry that outweigh its climate costs.³ But this is the complete opposite of what EPA found just three years ago when it finalized the emissions standards that are now being repealed (“2016 Rule”); there, EPA found that the resulting decreases in methane emissions alone would benefit society far more than the amount of industry’s costs to comply with the rule.⁴ This reversal is primarily attributable to a change in EPA’s methodology that drastically—and inappropriately—reduces the agency’s estimate of the social cost of methane emissions.

In fact, by decreasing the social cost of methane by more than 85%,⁵ EPA has now disregarded significant climate and public-health costs that the agency properly accounted for in the 2016 Rule. As detailed below, the agency’s revised estimate of the social cost of methane is completely inconsistent with the best

¹ 84 Fed. Reg. 50,244 (Sept. 24, 2019).

² EPA, Regulatory Impact Analysis for the Proposed Oil and Natural Gas Sector: Emissions Standards for New, Reconstructed, and Modified Sources Review 3-6 (Aug. 2019) [hereinafter “RIA”] (projecting emissions increases in methane, volatile organic compounds, and hazardous air pollutants from the proposed deregulation); *see also id.* at 3-1 (recognizing that the 2016 Rule would result in “climate and ozone benefits from methane reductions, ozone and fine particulate matter (PM2.5) health benefits from VOC reductions, and health benefits from ancillary HAP emission reduction.”).

³ *Id.* at 1-12.

⁴ 81 Fed. Reg. 35,823, 35,828 (June 3, 2016) (finding quantified net benefits to be \$170 million per year in 2025, with many important climate, health, and environmental benefits not quantified or monetized).

⁵ Compare RIA at 3-10 (\$180 social cost of methane in 2020, in 2016\$ and discounted at 3 percent) with EPA, Regulatory Impact Analysis of the Final Oil and Natural Gas Sector: Emission Standards for New, Reconstructed, and Modified Sources 4-16 (May 2016) (hereinafter “2016 RIA”) (\$1,300 social cost of methane in 2020, in 2012\$ and discounted at 3 percent).

available science, best practices for economic analysis, and legal standards for rational decisionmaking. Had the agency properly accounted for the social costs of methane emissions to appropriately account for the full forgone benefits using the best available science and economics—as it did in the 2016 Rule—it would have recognized that the proposed deregulation causes far more harm than good, and is therefore not a rational exercise of the agency’s discretion.

These comments make the following main arguments about how EPA failed to appropriately value the social cost of methane and other forgone benefits:

- EPA arbitrarily limits the timespan for its analysis and so fails to capture all important costs and benefits. A longer timespan would confirm that the 2016 Rule remains massively cost-benefit justified.
- EPA arbitrarily attempts to limit its valuation of the social cost of methane to domestic-only effects. Not only is a global perspective required under principles of rational decisionmaking, but the methodology and models that EPA uses cannot calculate an accurate domestic-only value.
- EPA arbitrarily discounts future climate effects at a 7% discount rate in addition to a 3% rate. Applying a 7% discount rate to inter-generational 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 methane at the 95th percentile). By failing to run such sensitivity analyses, EPA overlooks how different (and more plausible) assumptions would change its cost-benefit calculation.
- EPA uses “interim values” of the social cost of methane that advance its predetermined goal of a lower social cost of methane. Any update to the Interagency Working Group’s 2016 estimates must fully engage with all the most up-to-date literature and with all the recommendations issued by the National Academies of Sciences.
- EPA fails to appropriately value unquantified foregone benefits to climate and public health.

These critical failings completely undercut, and reverse the outcome of, the cost-benefit assessment that accompanies the proposed deregulation, and underscores that the proposal is arbitrary and capricious.

1. EPA Arbitrarily Limits the Timespan of Its Analysis

EPA’s analysis is flawed right off the bat because it only assesses the regulatory impact of the proposed deregulation through 2025—an unreasonably short timeframe that not only conflicts with the agency’s normal practice but also works to limit the rule’s projected long-term costs.

The reason for this short timeframe, according to EPA, is that while “it would be desirable to analyze impacts beyond 2025,” it has “chosen not to, largely because of . . . limited information on how practices, equipment, and emissions at new facilities change as they age or may be shut down.”⁶ In other words, EPA claims it cannot make any reasonable projections about costs or benefits more than 7 years into the future. That assertion is implausible. For example, when EPA published the 2016 Rule, it had no trouble

⁶ RIA at 2-7.

forecasting reasonable estimates of costs and benefits at least 10 years into the future.⁷ A typical EPA regulatory analysis often includes reasonable estimates of costs and benefits for at least 30 years.⁸

The problem with EPA's limited timespan is that the proposed deregulation's alleged annual cost savings will decrease over time, while the forgone benefits will increase over time. EPA's own numbers show this to be true. While these comments in no way endorse EPA's calculations of the proposed deregulation's annual cost savings or forgone emissions totals, even using EPA's own figures, the undiscounted cost savings per ton of methane emitted decreases throughout the agency's 2019-2025 timespan.⁹ Those decreases occur even without the agency having fully considered how technological development and learning would have changed compliance costs over time. Indeed, EPA admits that "the current analysis does not include potential fugitive emissions controls utilizing remote sensing technologies currently under development."¹⁰ By failing to acknowledge that the compliance costs for the 2016 Rule would likely have decreased over time, such that the projected annual cost savings from this deregulatory proposal would also decrease over time, EPA has arbitrarily contradicted the guidance on best practices for analysis from the Office of Management and Budget's *Circular A-4*.¹¹

Meanwhile, even as the undiscounted cost savings per ton of emissions will continue to drop each year, forgone benefits per ton of emissions will increase each year. First, the undiscounted value of natural gas recovered will likely increase in the future, as evidenced by EPA's own assumptions for conducting its analysis. Specifically, EPA forecasts (based on AEO estimates) that the cost of natural gas will be just \$3.09/Mcf in 2019, which increases to \$3.70 by 2025, and continues to increase to \$4.09 by 2040. Consequently, the annual undiscounted value of natural gas recovered not only increases over the course of EPA's limited analysis, but also would have continued to increase had EPA expanded its timespan.

Even more importantly, the undiscounted value of forgone climate benefits per ton of methane will increase each year. Once emitted, greenhouse gases linger in the atmosphere, building up the concentration of radiative-forcing pollution and affecting the climate in cumulative, non-linear ways.¹² As physical and economic systems become increasingly stressed by climate change, each marginal additional ton of emissions has a greater, non-linear impact. The climate damages generated by a given amount of greenhouse pollution is therefore a function not just of the pollution's total volume but also the year of emission, and with every passing year an additional ton of emissions inflicts greater damage.¹³ As EPA's own numbers show, the central estimate for climate damages per ton of emissions is \$1,345 per metric ton

⁷ See 2016 RIA at 4-5 (projecting impacts in the year 2025). Note that, in that 2015 analysis, EPA did not necessarily need to analyze impacts further than 10 years into the future, because EPA determined that the standards would deliver net benefits in each year of implementation. In that case, a longer timespan for analysis would have only strengthened the net benefits calculation for the proposed rule. For this proposed deregulation, in contrast, a longer timespan for analysis would have reversed the sign of the cost-benefit calculation.

⁸ See OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT OMB CIRCULAR A-4, REGULATORY ANALYSIS 34 (2003) (citing a typical EPA rule as calculating cost and benefit streams for 30 years).

⁹ Compare RIA at 2-10 (increased methane emissions by year) with *id.* at 2-13 (annualized cost savings without forgone revenue by year). EPA lists annualized cost savings at \$15 million in 2019, \$18 million in 2020, \$21 million in 2021, \$24 million in 2022, \$26 million in 2023, \$29 million in 2024, and \$32 million in 2025. *Id.* at 2-13. Meanwhile, forgone methane emissions reductions are 31,000 metric tons in 2019, 37,000 metric tons in 2020, 44,000 metric tons in 2021, 50,000 metric tons in 2022, 56,000 metric tons in 2023, 62,000 metric tons in 2024, and 69,000 metric tons in 2025. *Id.* at 2-10. That means that cost savings per ton were \$483 in 2019, but drop to \$463 in 2025.

¹⁰ *Id.* at 2-7.

¹¹ OMB, Circular A-4 at 37 (instructing agencies to make its estimates of costs and benefits "based on credible changes in technology over time" as well as "learning").

¹² Carbon dioxide also has cumulative effects on ocean acidification, in addition to cumulative radiative-forcing effects.

¹³ Interagency Working Group on the Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis 28 (2010), available at <https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/for-agencies/Social-Cost-of-Carbon-for-RIA.pdf> (explaining that the social cost of greenhouse gas estimates grow over time).

of methane for year 2019 emissions, but grows to \$2,079 per metric ton of methane for year 2035 emissions.¹⁴

Additionally, a chief reason that EPA's annual estimates of cost savings seem to increase every year over the time period of analysis is that EPA's estimate of "total affected sources" continues to increase over the entire time period. For example, the 4,900 sources that EPA assumes will be affected in the year 2025 includes every affected source from all previous years.¹⁵ In other words, EPA does not estimate that any affected sources will have retired during its analysis period. Of course, the projected constant rate of growth in the total number of covered sources cannot continue indefinitely into the future; at some point, covered sources will retire or be replaced. Yet by failing to apply any reasonable assumptions about the rate of retirement of covered sources, either during the time period of analysis or in the future, EPA has skewed the results of its cost-benefit analysis. Once the number of total covered sources levels off, estimates of annual cost savings should level off as well. While estimates of annual forgone emissions reductions may also level off, because the damages per emissions continues to increase over time,¹⁶ annual forgone climate benefits will continue to increase in the future, in a way that alleged cost savings will not. Over an adequate time period of analysis, that difference could change the cost-benefit calculation.

OMB's *Circular A-4* requires agencies' regulatory analyses to "cover a period long enough to encompass all the important benefits and costs likely to result from the rule."¹⁷ Given that, over time, the proposed deregulation's annual cost savings will decrease, while its annual forgone benefits will increase, seven years is simply too short of a timespan to cover all the important effects likely to result from the proposal. Indeed, even using EPA's own numbers (which, again, these comments do not endorse), a longer timespan for analysis could flip the sign of the cost-benefit calculation, showing the proposed deregulation to be net costly.¹⁸ As such, the proposed deregulation's economic analysis is misleading and arbitrary, and the economic justification for the proposal crumbles under scrutiny.

Moreover, even within the artificially short seven-year period of analysis, a full accounting of costs and benefits would show that the proposed deregulation is not cost-benefit justified. EPA has manipulated its assessment of both costs and benefits. The remainder of these comments focuses on EPA's flawed calculation and presentation of the social cost of methane, as well as its insufficient treatment of unquantified forgone benefits. Had EPA properly accounted for the full forgone benefits of the proposed deregulation, even an analysis of just years 2019-2025 would show that the proposed deregulation is net costly every year.

2. EPA's Revised Valuation of the Social Cost of Methane Severely—and Arbitrarily—Undervalues the Proposed Deregulation's Significant Climate Costs

Standards of rationality require attention to and consistent treatment of important factors. To the extent that EPA seeks to justify its proposed deregulation by comparing cost savings to forgone benefits, EPA's estimates of forgone benefits overlook a host of important factors like climate spillovers, international

¹⁴ See the "SCHH4" tab of the "Benefits and Tables" spreadsheet. The figures cited here are for the global social cost of methane calculated at the 3% discount rate, which, as these comments explain, is the appropriate figure to use as a central estimate. But the annual increase in damages is true for all of the social cost of methane metrics, including for the domestic-only calculations.

¹⁵ RIA at 2-8, table 2-2 note 2 ("Total affected sources include the accumulation of sources over time. These include sources that are newly affected in each year plus the affected sources from previous years.")

¹⁶ Interagency Working Group on the Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis 28 (2010), *available at* <https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/for-agencies/Social-Cost-of-Carbon-for-RIA.pdf> (explaining that the social cost of greenhouse gas estimates grow over time).

¹⁷ OMB, *Circular A-4*, at 15.

¹⁸ Using a discount rate of 3 percent, the proposed deregulation is only net beneficial by \$8.4 million in annualized value under the EPA's own estimates, a small enough number to potentially flip the cost-benefit justification as costs decrease and benefits increase over time. See RIA at 1-12.

reciprocity, extraterritorial interests, intergenerational equity, uncertainty over long-term growth, uncertainty over catastrophic outcomes, risk aversion, option value, and unquantified effects to climate and health. Executive Order 13,783 does not, and cannot, change EPA’s legal obligations to appropriately weigh forgone benefits. Moreover, Executive Order 13,783’s disbanding of the Interagency Working Group (“IWG”) does nothing to change the fact that the IWG’s 2016 estimates of the social cost of methane reflect the best available data and methods. As such, EPA should use the Interagency Working Group’s estimates when assessing the climate costs of the proposed deregulation, just like it did when it issued the 2016 Rule.

A. EPA Must Monetize the Full Social Cost of Methane, Using the Best Available Data and Methodologies

The Administrative Procedure Act requires the EPA to use the best available data and methodologies to account for the social cost of greenhouse gases, including methane. 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 methane reflect the best available data and methods.

Standards of Rationality Requires Attention to and Consistent Treatment of Important Factors

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.¹⁹

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.”²⁰

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.²¹ In *Center for Biological Diversity v. National Highway Traffic Safety Administration*, 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.”²² Specifically, it was arbitrary to “assign[] no value to *the most significant benefit* of more stringent [vehicle fuel efficiency] standards: reduction in carbon emissions.”²³ When an agency bases a

¹⁹ *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.’”).

²⁰ *Id.*

²¹ 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.

²² 538 F.3d 1172, 1203 (9th Cir. 2008).

²³ *Id.* at 1199.

rulemaking on cost-benefit analysis, it is arbitrary to “put a thumb on the scale by undervaluing the benefits and overvaluing the costs.”²⁴

More recently, 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.”²⁵ 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.”²⁶

Two federal district courts have also found the failure to use the social cost of carbon in NEPA analyses to be arbitrary and capricious when—like EPA’s regulatory analysis here—those same analyses also quantified economic benefits. In *High Country Conservation Advocates v. Forest Service*, the U.S. District Court for the District 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 “social cost of carbon protocol.”²⁷ In *Montana Environmental Information Center v. Office of Surface Mining*, the U.S. District Court for the District of Montana followed the lead set by *High Country* and likewise held an environmental assessment to be arbitrary and capricious because it quantified the benefits of action while failing to use the social cost of carbon to quantify the costs.²⁸

In short, agencies must monetize important greenhouse gas effects when their decisions are grounded in cost-benefit analysis.²⁹

A Recent Executive Order Encourages Continued Monetization of the Social Cost of Greenhouse Gases

Executive Orders 12,866 and 13,563 remain in effect³⁰ and continue to require agencies to weigh the costs and benefits of significant regulatory actions. In particular, Executive Order 12,866 requires agencies to “select those approaches that maximize net benefits (including potential economic, *environmental*, *public health* and safety, and *other advantages*; distributive impacts; and equity), unless a statute requires another regulatory approach.”³¹ For significant regulatory actions, agencies must quantify costs and benefits to the fullest extent feasible.³² The Interagency Working Group on the Social Cost of Greenhouse Gases was specifically organized to develop a single, harmonized value for all agencies to use in their regulatory impact analyses under Executive Order 12,866.³³

President Trump’s Executive Order 13,783, issued March 28, 2017, officially disbanded the Interagency Working Group on the Social Cost of Greenhouse Gases (IWG) and withdrew the technical support

²⁴ *Id.* at 1198.

²⁵ 832 F.3d 654, 677 (7th Cir. 2016).

²⁶ *Id.* at 679.

²⁷ 52 F. Supp. 3d 1174, 1191 (D. Colo. 2014) (emphasis original).

²⁸ 274 F. Supp. 3d 1074, 1094–99 (D. Mont. 2017) (also holding that it was arbitrary to imply that there would be zero effects from greenhouse gas emissions).

²⁹ 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.

³⁰ See Exec. Order No. 13,777 § 2 (Feb. 24, 2017) (continuing to cite the policies required under Executive Orders 12,866 and 13,563).

³¹ Exec. Order 12,866 § 1(a) (Oct. 4, 1993).

³² *Id.* § 6(a)(3)(C)(i).

³³ Interagency Working Group on Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis (2010). Though note the IWG’s estimates are applicable in a wider range of contexts, including environmental impact statements. See, e.g., *High Country*, 52 F. Supp. 3d at 1190; *Montana Environmental*, 274 F. Supp. 3d at 1095.

documents that underpinned their range of estimates.³⁴ 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.”³⁵ Consequently, while EPA and other federal agencies no longer have technical guidance directing them to exclusively rely on the IWG’s estimates to monetize climate effects, by no means does the new Executive Order imply that agencies should not monetize important effects in their regulatory analyses or environmental impact statements. In fact, Circular A-4 instructs agencies to monetize costs and benefits whenever feasible.³⁶

The 2017 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.³⁷ The new 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.

As explained throughout these comments, the IWG’s estimates of the social cost of greenhouse gases are, in fact, already consistent with the Circular A-4 and represent the best existing estimates of the lower bound of the range for the social cost of greenhouse gases. Therefore, the IWG estimates or those of a similar or higher value³⁸ should be used in regulatory analyses and environmental impact statements.

B. EPA Must Rely on a Global Estimate of the Social Cost of Methane

EPA claims that Circular A-4 requires a “domestic perspective in our central analysis”³⁹ and therefore buries any discussion of global climate damages in an appendix to a supplemental memorandum. EPA is wrong. Not only is it inconsistent with Circular A-4, best economic practices, and statutory requirements 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—including EPA’s approach—are unreliable, incomplete, and inconsistent with Circular A-4. EPA’s domestic-only estimate inappropriately relies on models never 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 Global Estimate of Climate Damages Is Required by the Clean Air Act*⁴⁰

Section 111 of the Clean Air Act charges EPA with protecting public health and welfare,⁴¹ where “welfare” is defined to include “effects on . . . weather . . . and climate.”⁴² When interpreting similar

³⁴ Exec. Order. No. 13,783 § 5(b), 82 Fed. Reg. 16,093 (Mar. 28, 2017).

³⁵ *Id.* § 5(c).

³⁶ OMB, Circular A-4 at 27 (“You should monetize quantitative estimates whenever possible.”).

³⁷ 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).

³⁸ 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).

³⁹ RIA at 3-9; see also *id.* at A-8.

⁴⁰ This subsection draws from Howard & Schwartz, *supra* note 30, which contains additional discussion of how Section 115 of the Clean Air Act, which explicitly requires the United States to take a global perspective on the effects of its greenhouse gas emissions, interacts with Section 111.

⁴¹ 42 U.S.C. § 7411(b)(1)(A).

⁴² 42 U.S.C. § 7602(h); *Massachusetts v. EPA*, 549 U.S. 497, 506 (2007).

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.”⁴³ 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.”⁴⁴

To assess the necessary protections of public welfare under Section 111 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. As explained below, continued use of 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.

Standards of Rational Decisionmaking, As Articulated in Case Law and Executive Guidance, Require Consideration of Global Climate Damages

As noted above, the Administrative Procedure Act, as interpreted by the Supreme Court in *State Farm*, requires agencies to consider all “important aspect[s] of the problem” and articulate a rational connection between the facts and the choice made.⁴⁵ Both case law and executive guidance interpreting this requirement counsel strongly in favor of considering internationally-connected climate costs in administrative rulemaking.

With regard to case law, as noted above, two courts of appeals have already applied arbitrary and capricious review to support the use of a global social cost of carbon in setting regulatory standards. In *Center for Biological Diversity v. NHTSA*, the U.S. Court of Appeals for the Ninth Circuit not only held that it was arbitrary not to monetize the greenhouse gas benefits of vehicle efficiency standards, but also approvingly cited a partial consensus among experts around an estimate of “\$50 per ton of carbon (or \$13.60 per ton CO₂),”⁴⁶ which, in the year 2006 when the rule was issued, would have been consistent with estimates of a global social cost of carbon.⁴⁷ More recently, in *Zero Zone v. Department of Energy*, the Court of Appeals for the Seventh Circuit found, in response to petitioners’ challenge that the agency’s consideration of the global social cost of carbon was arbitrary, that the agency had acted reasonably in considering the global climate effects.⁴⁸

Since at least 2010, including some recent agency actions under the Trump administration,⁴⁹ federal agencies have based their regulatory decision and NEPA reviews on global estimates of the social cost of

⁴³ *Massachusetts*, 549 U.S. at 531 (emphasis added).

⁴⁴ *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).

⁴⁵ 5 U.S.C. § 706; *see Motor Vehicle Manufacturers Assoc. v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 41-42 (1983) (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”).

⁴⁶ 538 F.3d at 1199, 1201.

⁴⁷ *See Average Fuel Economy Standards, Passenger Cars and Light Trucks; Model Years 2011-2015*, 73 Fed. Reg. 24,352, 24,414 (May 2, 2008) (the National Highway Traffic Safety Administration estimated that \$14 per ton of carbon dioxide approximated global benefits).

⁴⁸ 832 F.3d at 679.

⁴⁹ *See, e.g., Dep’t of Energy, Energy Conservation Program: Energy Conservation Standards for Walk-In Cooler and Freezer Refrigeration Systems*, 82 Fed. Reg. 31,808, 31,812 (July 10, 2017) (“DOE maintains that consideration of global benefits is appropriate because of the global nature of the climate change problem.”); U.S. Dep’t of Interior, Bureau of Ocean Energy

greenhouse gases. Though agencies often also disclosed a “highly speculative” range that tried to capture exclusively U.S. climate costs, emphasis on a global value has been recognized as more accurate given the science and economics of climate change, as more consistent with best economic practices, and as crucial to advancing U.S. strategic goals.⁵⁰

Opponents of climate regulation have long challenged the global number in court and other forums, and often attempted to use Circular A-4 as support.⁵¹ 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.”⁵² Importantly, despite this language and such challenges, the U.S. Court of Appeals for the Seventh Circuit had no trouble concluding that a global focus for the social cost of greenhouse gases was reasonable:

[The industry petitioners] next contend that [the Department of Energy] arbitrarily considered the global benefits to the environment but only considered the national costs. They emphasize that the [statute] only concerns “national energy and water conservation.” In the New Standards Rule, DOE did not let this submission go unanswered. It explained that climate change “involves a global externality,” meaning that carbon released in the United States affects the climate of the entire world. According to DOE, national energy conservation has global effects, and, therefore, those global effects are an appropriate consideration when looking at a national policy. Further, AHRI and Zero Zone point to no global costs that should have been considered alongside these benefits. Therefore, DOE acted reasonably when it compared global benefits to national costs.⁵³

Circular A-4’s reference to effects “beyond the borders” 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 complexity*** of the regulatory issues and the sensitivity of the benefit and cost estimates to the key assumptions.⁵⁴

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,”⁵⁵ suggesting that in some circumstances it is appropriate

Mgmt., Draft Envtl. Impact Statement: Liberty Development Project at 3-129, 4-246 (Aug. 2017) (BOEM, Liberty Development Project), available at <https://cdxnodengn.epa.gov/cdx-enepa-II/public/action/eis/details?eisId=236901> (calling the global social cost of carbon estimates developed in 2016 by the Interagency Working Group “a useful measure” and applying them to analyze the consequences of offshore oil and gas drilling).

⁵⁰ See generally Howard & Schwartz, *supra* note 30.

⁵¹ 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*, case 15-1363, D.C. Cir. (filed February 19, 2016) (challenging EPA’s use of the global social cost of carbon).

⁵² Circular A-4 at 15; see also RIA at 3-9, 3-14 (quoting Circular A-4 at 15). 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, as discussed further below.

⁵³ *Zero Zone*, 832 F.3d at 679.

⁵⁴ Circular A-4 at 3.

⁵⁵ *Id.* at 38 (counting international transfers as costs and benefits “as long as the analysis is conducted from the United States perspective”).

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.⁵⁶

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.⁵⁷ 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.⁵⁸

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 continue to do so.⁵⁹ 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.⁶⁰ 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.⁶¹ For the United States to now depart from this collaborative dynamic by reverting to a domestic-only estimate would undermine the country’s long-term 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” estimate of the domestic-only effects of climate change. In particular, the Department of Energy always includes a chapter on a domestic-only value of carbon emissions in the economic analyses supporting its energy efficiency standards; EPA has also often disclosed similar estimates.⁶² Such an approach is consistent with Circular A-4’s suggestion that agencies should usually disclose domestic effects separately from global effects. However, as we have discussed, reliance on a domestic-only methodology would be

⁵⁶ See Howard & Schwartz, *supra* note 30, at 268-69.

⁵⁷ 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.”).

⁵⁸ 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>

⁵⁹ See Robert Axelrod, *The Evolution of Cooperation* 10-11 (1984) (on repeated prisoner’s dilemma games).

⁶⁰ See Howard & Schwartz, *supra* note 30, at Appendix B.

⁶¹ 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).

⁶² Howard & Schwartz, *supra* note 30, at 220-21.

inconsistent with both the inherent nature of climate change and the standards of Circular A-4. Consequently, under Circular A-4, EPA should have estimated, and used in its primary analysis, the global social cost of methane.

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), attached. 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.”⁶³

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 estimates. 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. Indeed, EPA admits that its focus on climate effects “inside the U.S. borders” will not capture all the effects that “acru[e] to U.S. citizens”⁶⁴—but then fails to do anything to remedy that significant discrepancy. 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 cost of methane 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.⁶⁵ 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.⁶⁶ 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.

⁶³ Richard Revesz, Kenneth Arrow et al., *The Social Cost of Carbon: A Global Imperative*, 11 *REVIEW OF ENVTL. ECON. & POLICY* 172 (2017).

⁶⁴ RIA at A-1 n.71 (“Note that inside the U.S. borders is not the same as accruing to U.S. citizens.”).

⁶⁵ 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).

⁶⁶ See Freeman & Guzman, *supra* note 65, at 1563-93.

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.⁶⁷ A recent economic study explored how heat stress-induced reductions in productivity worldwide will ripple through the interconnected global supply network.⁶⁸ 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.⁶⁹

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.⁷⁰ 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.⁷¹ Besides threats to U.S. military installations and operations at home and abroad from flooding, storms, extreme heat, and wildfires,⁷² climate change is also a “source[] of conflict around the world” requiring U.S. response, according to a Department of Defense report issued earlier this year.⁷³ 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.”⁷⁴ As an example of the climate-security-migration nexus, prolonged drought in Syria likely exacerbated the social and

⁶⁷ See Charles Arthur, *Thailand’s Devastating Floods Are Hitting PC Hard Drive Supplies*, THE GUARDIAN (Oct. 25, 2011).

⁶⁸ Leonie Wenz & Anders Levermann, *Enhanced Economic Connectivity to Foster Heat Stress-Related Losses*, SCIENCE ADVANCES (June 10, 2016).

⁶⁹ 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).

⁷⁰ 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).

⁷¹ See CNA Military Advisory Board, *National Security and the Accelerating Risks of Climate Change* (2014).

⁷² 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).

⁷³ 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.

⁷⁴ 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.”)

political tensions that erupted into an ongoing civil war,⁷⁵ which has triggered an international migration and humanitarian crisis.⁷⁶

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.⁷⁷ 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.

EPA even recognizes in its regulatory impact analysis that the failure to “model all relevant regional interactions—e.g., how climate change impacts in other regions of the world could affect the United States, through pathways such as global migration, economic destabilization, and political destabilization”—represents a major challenge to estimating a domestic-only social cost of methane.⁷⁸ EPA also notes that the National Academies of Sciences concluded that it “is important to consider what constitutes a domestic impact in the case of a global pollutant that could have international implications that impact the United States.”⁷⁹ Yet after acknowledging the serious deficiencies in its own domestic-only estimate, EPA fails to address these shortcomings and account for spillovers in any meaningful way. EPA therefore arbitrarily ignores an important factor.

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.”⁸⁰ 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 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.⁸¹ This impact can be incredibly significant: According to one study, by 2030, direct U.S. benefits from global climate policies already in effect could

⁷⁵ 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).

⁷⁶ See, e.g., *Ending Syria War Key to Migrant Crisis, Says U.S. General*, BBC.COM (Sept. 14, 2015).

⁷⁷ See Robert E. Kopp & Bryan K. Mignone, *Circumspection, Reciprocity, and Optimal Carbon Prices*, 120 CLIMATE CHANGE 831, 833 (2013).

⁷⁸ RIA at 3-14.

⁷⁹ *Id.* (internal quotation marks omitted).

⁸⁰ Circular A-4 at 26.

⁸¹ Howard & Schwartz, *supra* note 30, at 232-37 (citing acknowledgement of this phenomenon by both the Bush administration and the Obama administration).

reach over \$2 trillion.⁸² Any attempt to estimate a domestic-only value of the social cost of greenhouse gases must include such indirect effects from reciprocal foreign actions.⁸³

EPA again recognizes this shortcoming in its own domestic-only value, noting that the National Academies of Sciences recommended that a “thorough[] estimati[on]” of the social cost of methane “consider the potential implications of climate impacts on, and actions by, other countries, which also have impacts on the United States.”⁸⁴ Once again, however, EPA fails to address this serious deficiency and account for reciprocity in any meaningful way. EPA therefore arbitrarily ignores another important cost of methane emissions resulting from the proposed deregulation.

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 methane, contrary to Circular A-4’s explicit instructions, EPA “significantly understate[s] the ... costs” of the proposed deregulation.⁸⁵ 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.”⁸⁶ 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 EPA’s valuation of the social cost of methane 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,⁸⁷ including significant U.S. ownership interests in foreign businesses, properties, and other assets, as well as consumption abroad including tourism,⁸⁸ and even the 8.7 million Americans living abroad.⁸⁹ Notably, EPA admits that its estimates of cost savings from the proposed deregulation do not distinguish between foreign and domestic ownership of affected firms, and so “some of the cost savings accruing to entities outside U.S. borders is captured in the compliance cost savings” calculated by EPA.⁹⁰ EPA never attempts, nor should it, to separate out cost effects to foreign interests and relegate such effects to an appendix; yet EPA arbitrarily treats U.S. financial interests in global forgone climate benefits differently.

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

⁸² 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>.

⁸³ 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.

⁸⁴ RIA at 3-14.

⁸⁵ Circular A-4 at 22.

⁸⁶ *Id.*

⁸⁷ 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).

⁸⁸ “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>.

⁸⁹ 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.

⁹⁰ RIA at 3-14.

“effects of activities carried on both within and outside the Antarctic Treaty area on the Antarctic environment.”⁹¹ 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.⁹² Though the methodologies for calculating existence value remain controversial,⁹³ 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.⁹⁴ 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.⁹⁵

No Current Methodology for Estimating a “Domestic-Only” Value Is Consistent with Practices for Reasoned Decisionmaking

OMB, the National Academies of Sciences, 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.⁹⁶ 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.⁹⁷

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.⁹⁸ 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

⁹¹ Madrid Protocol on Environmental Protection to the Antarctic Treaty (1991), http://www.ats.aq/documents/recatt/Att006_e.pdf

⁹² RICHARD REVESZ & MICHAEL LIVERMORE, *RETAKING RATIONALITY* 121 (2008).

⁹³ *Id.* at 129.

⁹⁴ See Arden Rowell, *Foreign Impacts and Climate Change*, 39 HARV. ENV'T'L. L. REV. 371 (2015); Dana, *supra* note 88 (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).

⁹⁵ Datablog, *A History of CO₂ 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).

⁹⁶ Interagency Working Group on Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis 11 (2010) (emphasis added).

⁹⁷ *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”).

⁹⁸ 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>.

costs and benefits that matter to U.S. citizens.⁹⁹ 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.”¹⁰⁰ GDP therefore does not reflect significant U.S. ownership interests in foreign businesses, properties, and other assets, as well as consumption abroad including tourism,¹⁰¹ or even the 8 million Americans living abroad.¹⁰²

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.¹⁰³ However, not only has GNI fallen out of favor as a metric used in international economic policy,¹⁰⁴ 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.¹⁰⁵ 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.¹⁰⁶

As a result, in 2015, OMB concluded, along with several other agencies, that “good methodologies for estimating domestic damages do not currently exist.”¹⁰⁷ Similarly, the NAS recently concluded that current IAMs cannot accurately estimate the domestic social cost of greenhouse gases, and that estimates based on U.S. share of global GDP would be likewise insufficient.¹⁰⁸ 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.”¹⁰⁹ 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.

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

⁹⁹ 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).

¹⁰⁰ 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).

¹⁰¹ “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 89.

¹⁰² 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.

¹⁰³ *GNI, Atlas Method (Current US\$)*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GNP.ATLS.CD>.

¹⁰⁴ *Id.*

¹⁰⁵ 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).

¹⁰⁶ 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).”).

¹⁰⁷ 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].

¹⁰⁸ 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].

¹⁰⁹ William Nordhaus, *Revisiting the Social Cost of Carbon*, 114 PNAS 1518, 1522 (2017).

estimates. Specifically, 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. 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 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 methane 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 methane. For example, the models make simplifying assumptions about the extent of heterogeneity in crucial parameters like relative prices and discount rates.¹¹⁰ The models also simplify or ignore completely global spillovers from trade, migration, and other sources.¹¹¹ 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, as detailed below. 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.¹¹² Global estimates will also generally be more accurate than domestic estimates because aggregation of multiple values reduces the error of the overall estimate.¹¹³

An examination of the individual models used by the agency to calculate the domestic social cost of methane—PAGE 2009, FUND 3.8, and DICE 2010¹¹⁴—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.”¹¹⁵ 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.¹¹⁶

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,¹¹⁷ 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 agency incorporates—completely disregards significant damage categories. When Congress instructed EPA to “protect and enhance the quality of the Nation’s air resources so as to promote the public health and welfare and the productive capacity of its population,” it surely did not intend for EPA to limit its assessment of all U.S. interests and public welfare based on the length of our coastline, ignoring massive

¹¹⁰ Christian Gollier & James K. Hammitt, *The Long-Run Discount Rate Controversy*, 6 ANNU. REV. RESOUR. ECON. 273–295 (2014) at 287-289.

¹¹¹ See generally Howard & Schwartz, *supra* note 30.

¹¹² 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.

¹¹³ See, e.g. SIDNEY I RESNICK, A PROBABILITY PATH (2013) at 203.

¹¹⁴ RIA at A-1.

¹¹⁵ Interagency Working Group, Technical Support Document: Technical Update of the Social Cost of Carbon for Regulatory Impact Analysis 17 (2016)

¹¹⁶ 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>.

¹¹⁷ Solomon Hsiang et al., *Economic Damage from Climate Change in the United States*, 356 SCIENCE 1362–69 (2017).

climate and public-health costs not directly related to coastal flooding. Yet, in relying on PAGE’s approach to calculating regional impacts, that is precisely what EPA has done.

The other two models on which EPA based its domestic estimates 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 [relative] to GDP.”¹¹⁸ 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.¹¹⁹ 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.¹²⁰ 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.¹²¹ 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.”¹²² These statements reinforce the conclusion of OMB that “good methodologies for estimating domestic damages do not currently exist.”¹²³ EPA’s inaccurate and arbitrary methodological shortcuts in estimating a domestic-only social cost of methane are exemplified by the application of a 10% domestic share to the DICE results. That percentage is based on one set of estimates of regional shares for the social cost of carbon. EPA admits that transferring this share estimate to the social cost of methane results in an underestimate, because regional shares are highly correlated with output and U.S. share of global output is higher during the shorter lifespan of methane compared to during the longer lifespan of carbon dioxide.¹²⁴ Yet EPA makes no effort to adjust its estimate to reflect the shorter lifespan of methane, remaining content to let stand a severe underestimate of forgone climate benefits.

In conclusion, EPA’s estimation of the domestic-only social cost of methane 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.¹²⁵

¹¹⁸ DAVID ANTHOFF & RICHARD S. J. TOL, *THE CLIMATE FRAMEWORK FOR UNCERTAINTY, NEGOTIATION, AND DISTRIBUTION (FUND)*, TECHNICAL DESCRIPTION, VERSION 3.8 (2014) at 8.

¹¹⁹ *Id.* at 10.

¹²⁰ 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).

¹²¹ F. C. Moore et al., *New Science of Climate Change Impacts on Agriculture Implies Higher Social Cost of Carbon*, 1–43 (2017).

¹²² William D Nordhaus, *Revisiting the social cost of carbon*, 114 *PROC. NATL. ACAD. SCI. U. S. A.* 1518–1523 (2017) at 1522.

¹²³ OMB 2015 Response to Comments, *supra* note 108.

¹²⁴ RIA at A-2.

¹²⁵ *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.

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

In addition to its failure to account for significant domestic costs, EPA also treats costs and benefits inconsistently by counting considerable benefits that will accrue to foreign residents from the proposed deregulation. While we do not endorse EPA's benefits estimates, the agency has unlawfully "put a thumb on the scale" by counting certain purported foreign benefits while ignoring foreign costs.¹²⁶

EPA admits that some portion of the proposed action's costs savings will "accru[e] to entities outside U.S. borders."¹²⁷ EPA tries to downplay these effects to foreign entities by qualifying its admission "to the extent that affected firms have some foreign ownership."¹²⁸ EPA never attempts to separate out cost effects to foreign interests or to relegate such effects to an appendix. Yet a significant portion of cost savings will ultimately accrue to foreign owners and foreign customers of U.S. firms. 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.

A significant portion of the proposed action's cost savings will accrue 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. For example, Anadarko Petroleum Corporation—a member of the American Petroleum Institute that has been active in API's petition for reconsideration of these emission standards¹²⁹—is a public company. Based on its recent 13F filings, major institutional investors include foreign government pension plans, foreign central banks, and foreign-based investment banks and funds (such as the central bank of Switzerland and Sumitomo Mitsui Trust Holdings Inc. of Japan).¹³⁰ Norway's Government Pension Fund holds nearly \$238 million worth of Anadarko stock and \$60 million in Anadarko bonds as of December 2017.¹³¹ Of course, many of those foreign-based investment banks and funds will have U.S. investors, but U.S.-based funds that invest heavily in Anadarko, like BlackRock, will similarly have foreign investors. Economy-wide, between 20-30% of U.S. stocks and 35% of U.S. corporate debt are held by foreigners,¹³² with significant foreign direct investment in U.S. mining and fossil fuel extraction, in U.S. utilities, and in U.S. manufacturing.¹³³ A significant portion of the regulatory effects passing through Anadarko and other 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 oil and gas trade in global markets. 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 tries to confuse the matter by claiming that its original economic analysis of the 2016 emission standards did not "quantitatively project the full impact . . . on international trade and the location of

¹²⁶ *Ctr. for Biological Diversity*, 538 F.3d at 1198.

¹²⁷ RIA at 3-14.

¹²⁸ *Id.*

¹²⁹ See API Well Site Data Memo, available at <https://www.regulations.gov/document?D=EPA-HQ-OAR-2017-0483-0072> (listing Anadarko as a participant in calls on the petition for reconsideration); see also <https://www.api.org/membership/members> (listing Anadarko as a member in API).

¹³⁰ See, e.g., <https://www.nasdaq.com/symbol/apc/institutional-holdings?page=3>.

¹³¹ <https://www.nbim.no/en/the-fund/holdings/holdings-as-at-31.12.2017/?fullsize=true>.

¹³² 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>.

¹³³ 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 (see exhibit 19: market value of foreign holdings of U.S. securities, by industry, as of June 30, 2016).

production.”¹³⁴ In fact, EPA’s original analysis did use NEMS to “estimate . . . changes in international trade of crude oil and natural gas,”¹³⁵ and found only minor impacts on production (0-0.03%) and possibly no estimated change to global commodity prices.¹³⁶ Regardless, even if EPA could not, due to data limitations, conduct a full quantitative assessment of international trade effects in the original emissions standards in no way excuses EPA now, in its proposed deregulation, from ignoring readily quantifiable effects that will result due to climate change damages that happen to occur outside U.S. borders.

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.

C. 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 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. EPA now proposes to give equal consideration to estimates calculated at a 7% discount rate, alleging that this is required by Circular A-4.¹³⁷ EPA is wrong.

Not only does use of a 7% discount rate violate EPA’s statutorily required consideration of impacts on future generations, but 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.”¹³⁸ While Circular A-4 tells agencies generally to use a 7% discount rate in addition to lower rates for typical rules,¹³⁹ 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.

EPA’s Statutory Authority Requires Protecting the Needs of Future Generations, And a 7% Discount Rate Ignores Those Future Needs

Section 111 of the Clean Air Act requires EPA to regulate a source category that “causes, or contributes significantly to, air pollution which may reasonably be anticipated to endanger public health or welfare.”¹⁴⁰ The Clean Air Act explicitly defines “welfare” to include “effects on . . . climate.”¹⁴¹ The terms “endanger” and “reasonably anticipate” are not defined, but their plain dictionary definitions

¹³⁴ RIA at 3-14.

¹³⁵ 2016 RIA at 6-1.

¹³⁶ 2016 RIA at 6-7 (noting that “the bulk of the rule’s [energy market] impacts are expected to be in the continental U.S.”); *id.* at 6-8 (finding likely change to range from 0% to 0.03%) In addition, if there were any international trade effects resulting from the 2016 Rule some would be distributional in nature, and transfers between the United States and other nations do not count as costs or benefit per Circular A-4 if the analysis is conducted from the global perspective. Circular A-4 at 38.

¹³⁷ RIA at 3-9.

¹³⁸ OMB 2015 Response to Comments, *supra* note 108, at 36 (emphasis added).

¹³⁹ 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.”).

¹⁴⁰ 42 U.S.C. § 7411(b)(1)(A).

¹⁴¹ 42 U.S.C. § 7602(h).

include a temporal element, and legislative history confirms that this language was chosen deliberately to ensure that harms need not be imminent before EPA must act.

In the 1970 Clean Air Act amendments, EPA’s authority to regulate air pollution dangers was substantially strengthened, and Congress was motivated partly by the desire to protect future generations. For example, Senator Randolph (Chair of the Environment and Public Works Committee) spoke specifically about Section 111’s new provisions on performance standards for stationary sources,¹⁴² stating that “[t]he implementation of the policies that are contained in this measure will test the determination in this country to achieve a livable environment, not only for ourselves *but for future generations*.”¹⁴³ More generally, Senator Muskie—a subcommittee chair who was instrumental in passing the Clean Air Act—explained the amendments were designed to “*deal with the long-term aspects* as well as the short term,”¹⁴⁴ and minority leader Senator Scott spoke specifically about the legislation’s importance for protecting future generations from climate change: “Unless this outpouring of contaminants is controlled, scientists tell us we may very well experience *irreversible atmospheric and climatic changes* capable of producing a snowballing adverse effect to the health and safety of our citizens. . . . *To guarantee that future generations of Americans can live without fear* of the destruction of the very air they breathe, I urge immediate passage.”¹⁴⁵ When he signed the Clean Air Act Amendments of 1970 into law, President Nixon pronounced that “1970 will be known as the year of the beginning, in which we really began to move on the problems of *clean air* and clean water and open spaces *for the future generations of America*.”¹⁴⁶

The U.S. Court of Appeals for the District of Columbia Circuit confirmed the future-looking nature of EPA’s authority when it ruled, in *Ethyl Corp v. EPA*, that the word “endanger” in the Clean Air Act made that statute “precautionary,” and EPA need not wait for certain evidence of imminent harm before acting to prevent dangerous pollution.¹⁴⁷ Years later, that same Court of Appeals also upheld EPA’s 2009 endangerment finding on greenhouse gas emissions from motor vehicles under Section 202. The endangerment finding spoke of the need to protect future generations in its very first sentence,¹⁴⁸ and the D.C. Circuit upheld the finding as based on “evidence of current and future effects.”¹⁴⁹ Responding to industry petitioners who questioned the judgment on the grounds that there was “too much uncertainty” in the evidence, the Court recalled that the Act was meant to be “precautionary in nature” and warned that “[a]waiting certainty will often allow for only reactive, not preventive, regulation.” The Court concluded that the language “may reasonably be anticipated to endanger” required “a precautionary, forward-looking scientific judgment.”¹⁵⁰

In summary, the Clean Air Act’s use of the phrase “may reasonably be anticipated to endanger public health or welfare” requires EPA to consider the effects of climate change to future generations. Applying a 7% discount rate to the social cost of greenhouse gases means that, after a generation or two, future climate damages are insignificant. The use of such a rate thus effectively ignores the needs of future

¹⁴² See Clean Air Act Amendments of 1970 Legislative History vol. 1, p. 144.

¹⁴³ *Id.* at 145 (emphasis added).

¹⁴⁴ *Id.* at 144 (emphasis added).

¹⁴⁵ *Id.* at 349 (emphasis added).

¹⁴⁶ *Id.* at 106; President’s Remarks upon Signing the Clean Air Amendments of 1970 Into Law, Dec. 31, 1970, available at <https://babel.hathitrust.org/cgi/pt?id=mdp.39015077941642;view=lup;seq=245> (continuing, “We can look back and say, in the Roosevelt room on the last day of 1970, we signed a historic piece of legislation that put us far down the road toward a goal that Theodore Roosevelt, 70 years ago, spoke eloquently about, a goal of clean air, clean water, and open spaces for the future generations of America.”).

¹⁴⁷ 541 F.2d 1, 13 (D.C. Cir. 1976).

¹⁴⁸ Proposed Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 18886-01 (2009).

¹⁴⁹ *Coal. for Responsible Regulation, Inc. v. E.P.A.*, 684 F.3d 102, 121–22 (D.C. Cir. 2012), *aff’d in part, rev’d in part sub nom. Util. Air Regulatory Grp. v. E.P.A.*, 134 S. Ct. 2427 (2014), and amended sub nom. *Coal. for Responsible Regulation, Inc. v. Env’tl. Prot. Agency*, 606 F. App’x 6 (D.C. Cir. 2015).

¹⁵⁰ *Id.* (internal quotation marks omitted).

generations. Doing so would arbitrarily fail to consider an important statutory factor that Congress wrote into the Clean Air Act requirements.

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.”¹⁵¹ As such, analysis must be “based on the best reasonably obtainable scientific, technical, and economic information available,”¹⁵² and agencies must “[u]se sound and defensible values or procedures to monetize benefits and costs, and ensure that key analytical assumptions are defensible.”¹⁵³ 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.”¹⁵⁴ 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.”¹⁵⁵ 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,¹⁵⁶ a 7% rate is inappropriate.

In 2013, OMB called for public comments on the social cost of greenhouse gases. In its 2015 Response to Comment document,¹⁵⁷ 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

¹⁵¹ Circular A-4 at 3.

¹⁵² *Id.* at 17.

¹⁵³ *Id.* at 27 (emphasis added).

¹⁵⁴ *Id.* at 3.

¹⁵⁵ *Id.* at 33.

¹⁵⁶ 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 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.”).

¹⁵⁷ Note that this document was not withdrawn by Executive Order 13,783.

services—it is appropriate to use the consumption rate of interest to reflect how private individuals trade-off current and future consumption.¹⁵⁸

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.”¹⁵⁹ The NAS also explained that a consumption rate of interest is the appropriate basis for a discount rate for climate effects.¹⁶⁰ There is also strong consensus through the economic literature that a capital discount rate like 7% is inappropriate for climate change.¹⁶¹ 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.¹⁶² By contrast, greenhouse gas emissions generate 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.”¹⁶³

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.¹⁶⁴ 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*.”¹⁶⁵ The National Academies of Sciences makes the same point about discount rates and uncertainty.¹⁶⁶ In fact, as discussed more below and in the

¹⁵⁸ OMB 2015 Response to Comments, *supra* note 108, at 22.

¹⁵⁹ 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. 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).

¹⁶⁰ NAS Second Report, *supra* note 109, 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).

¹⁶¹ 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).

¹⁶² Circular A-4 at 34. See also OMB 2015 Response to Comments, *supra* note 108, 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”).

¹⁶³ Circular A-4 at 36.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*; see also CEA Issue Brief, *supra* note 160, 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).”

¹⁶⁶ NAS Second Report, *supra* note 109, at 27.

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**. As demonstrated in EPA's graph of the frequency distribution of social cost of methane estimates, the 7% rate truncates the long right-hand tail of social costs relative to the 3% rate's distribution.¹⁶⁷ 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. This assumption violates EPA's statutory duty to protect the future needs of Americans. At the same time, the 7% distribution also misleadingly exaggerates the possibility of negative estimates of the social cost of greenhouse gases.¹⁶⁸ A negative social cost of methane 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). Again, this assumption is inconsistent with empirical data and contravenes EPA's statutory responsibilities to protect the welfare of future Americans.

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.”¹⁶⁹ 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.¹⁷⁰ 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, warrants serious consideration for a reduction in the discount rates used for benefit-cost analysis.¹⁷¹

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,”¹⁷² which further confirms 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 knowledge¹⁷³—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

¹⁶⁷ RIA at A-6.

¹⁶⁸ 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%.

¹⁶⁹ Circular A-4 at 17.

¹⁷⁰ 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.

¹⁷¹ CEA Issue Brief, *supra* note 160, 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.”).

¹⁷² *Id.* at 1.

¹⁷³ Circular A-4 at 41.

benefits of climate change.¹⁷⁴ 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 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.¹⁷⁵

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.”¹⁷⁶ 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**.¹⁷⁷

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-4.¹⁷⁸

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.¹⁷⁹ As the Council of Economic Advisers explained earlier this year, 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-

¹⁷⁴ 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%.

¹⁷⁵ Circular A-4 at 35-36.

¹⁷⁶ *Id.* at 3.

¹⁷⁷ *Id.* at 42 (emphasis added).

¹⁷⁸ *Id.* at 17.

¹⁷⁹ Circular A-4, at page 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.

term, very low rates dominate due to uncertainty.¹⁸⁰ The National Academies of Sciences’ report also strongly endorses a declining discount rate approach.¹⁸¹ Notably, Marten et al., upon which EPA implicitly relies for developing the methodology for the social cost of methane,¹⁸² also note the “agreement that the use of a constant discount rate over long time horizons with uncertain changes in the consumption per capita growth is not theoretically consistent.”¹⁸³

One possible schedule of declining discount rates was proposed by Weitzman.¹⁸⁴ It is derived from a broad survey of top economists and other climate experts and explicitly incorporates arguments around 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.¹⁸⁵ Another schedule of declining discount rates has been adopted by the United Kingdom.¹⁸⁶

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.”¹⁸⁷ 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

¹⁸⁰ CEA Issue Brief, *supra* note 160, 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.”).

¹⁸¹ NAS Second Report, *supra* note 109, at 166.

¹⁸² We assume that EPA’s starting point for analysis is the IWG’s 2016 technical addendum on the social cost of methane, which in turn relies on Marten et al. IWG, Addendum to Technical Support Document: Application of the Methodology to Estimate the Social Cost of Methane and the Social Cost of Nitrous Oxide (2016) (citing Marten, A.L., Kopits, E.A., Griffiths, C.W., Newbold, S.C., and A. Wolverton. 2015. Incremental CH4 and N2O Mitigation Benefits Consistent with the U.S. Government’s SC-CO2 Estimates. *Climate Policy*. 15(2): 272-298.

¹⁸³ Marten, A.L., Kopits, E.A., Griffiths, C.W., Newbold, S.C., and A. Wolverton. 2015. Incremental CH4 and N2O Mitigation Benefits Consistent with the U.S. Government’s SC-CO2 Estimates. *Climate Policy*. 15(2): 272-298.

¹⁸⁴ 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%

¹⁸⁵ 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).

¹⁸⁶ 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%

¹⁸⁷ NAS Second Report, *supra* note 109, at 78.

evaluation of longer-run geophysical system dynamics, such as sea level change and the carbon cycle.”¹⁸⁸ 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 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.¹⁸⁹

D. EPA’s Estimate for the Social Cost of Methane Arbitrarily Fails to Follow Prescribed Practices for Dealing with Uncertainty

EPA notes that “several important factors” are “incomplete[ly] or inadequate[ly] represent[ed] in the integrated assessment models,” including uncertainty over catastrophic damages and extrapolation of damages to high temperatures.¹⁹⁰ That mere mention of significant uncertainty that could lead to much higher social cost of methane estimates hardly satisfies *Circular A-4*’s requirements for quantitative treatment of uncertainty.¹⁹¹ The IWG highlighted a 95th percentile estimate to address uncertainty over catastrophic damages, tipping points, option value, and risk aversion.¹⁹² EPA should have done the same, but failed to do so. EPA admits that the distributions “have long right tails”¹⁹³ and depicts a range of estimates from the 5th to 95th percentiles,¹⁹⁴ but by giving a 5th percentile estimate equal standing with the 95th percentile estimate, EPA obscures the significance of low-probability, high-catastrophe outcomes. Under sensitivity analyses that treated such low-probability, high-catastrophe outcomes seriously, even with EPA’s incorrect choices of discount rate and domestic-only perspective, the sign of net benefits for the proposed deregulation would have shifted from positive to sharply negative. By failing to give serious treatment to such sensitivity analyses, EPA overlooks how different (and more plausible) assumptions would change its cost-benefit calculation.

Uncertainty in general, as well as uncertainty over the discount rate in particular, are discussed in greater detail in the technical appendices attached to these comments.

Circular A-4’s Prescriptions for Uncertainty

Circular A-4 requires thorough treatment of uncertainty around both values and outcomes,¹⁹⁵ and for especially large or complex matters it recommends a formal probabilistic analysis.¹⁹⁶ Generally, Circular A-4 encourages agencies to disclose the full probability distribution of potential consequences, including both upper and lower bound estimates in addition to central estimates.¹⁹⁷

However, this guidance comes with some caveats. First, this approach to central estimates and the probability distribution “is appropriate as long as society is ‘risk neutral’ with respect to the regulatory

¹⁸⁸ *Id.*

¹⁸⁹ Nat’l Acad. Of Sci., *Assessment of Approaches to Updating the Social Cost of Carbon* 49 (2016), at 32.

¹⁹⁰ RIA at 3-12.

¹⁹¹ Circular A-4 at 18 (“When benefit and cost estimates are uncertain . . . you should report benefit and cost estimates (including benefits of risk reductions) that reflect the full probability distribution of potential consequences.”).

¹⁹² Interagency Working Group on the Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis 4 (2010).

¹⁹³ RIA at A-5.

¹⁹⁴ *Id.* at A-6.

¹⁹⁵ Circular A-4, at 42, requires probability distributions for “values as well for each of the outcomes”; the social cost of greenhouse gases is a value with a probability distribution.

¹⁹⁶ *Id.* at 41.

¹⁹⁷ Circular A-4 at 18, 40; *id.* at 45 (“When you provide only upper and lower bounds (in addition to best estimates), you should, if possible, use the 95 and 5 percent confidence bounds.”).

alternatives.”¹⁹⁸ But if society is risk averse—as is the case with climate change¹⁹⁹—different considerations need to be taken into account. Second, in 2011, the Office of Information and Regulatory Affairs interpreted Circular A-4’s goal as “not to characterize the full range of *possible* outcomes . . . but rather the range of *plausible* outcomes.”²⁰⁰ Agency analysts must exercise judgment. Finally, as with all elements of agencies’ economic analyses, Circular A-4 stresses that regulatory impact analyses “should be credible, objective, realistic, and scientifically balanced.”²⁰¹

Consequently, while it may be appropriate to disclose the full probability distribution of an uncertainty analysis, it is not appropriate under Circular A-4 to give a low-percentile estimate of the social cost of greenhouse gases equal weight in decision-making with the central and upper-percentile estimates. Giving equal attention to a low-percentile estimate is not “credible, objective, realistic, and scientifically balanced,” does not reflect “plausible” scenarios, and would undermine consideration of risk aversion. Instead, a proper and plausible treatment of uncertainty in the context of climate change will support higher estimates of the social cost of greenhouse gases.

A 95th Percentile Value as a Treatment of Uncertainty over Damages

The IWG accounted for uncertainty in numerous rigorous ways. The group modeled the uncertainty over the value of the equilibrium climate sensitivity parameter using the Roe and Baker distribution calibrated to the IPCC reports. Additionally, using well-established analytic tools to capture and reflect uncertainty, including a Monte Carlo simulation to randomly select the equilibrium climate sensitivity parameter and other uncertainty parameters selected by the model developers, the IWG quantitatively modeled the uncertainty underlying how greenhouse gas emissions affect temperature.

To further deal with uncertainty, the IWG recommended to agencies a range of four estimates: three central or mean-average estimates at a 2.5%, 3%, and 5% discount rate respectively, and a 95th percentile value at the 3% discount rate. While the IWG’s technical support documents disclosed fuller probability distributions, these four estimates were chosen by agencies to be the focus for decisionmaking. In particular, application of the 95th percentile value was not part of an effort to show the probability distribution around the 3% discount rate; rather, the 95th percentile value serves as a methodological shortcut to approximate the uncertainties around low-probability but high-damage, catastrophic, or irreversible outcomes that are currently omitted or undercounted in the economic models.

The shape of the distribution of climate risks and damages includes a long tail of lower-probability, high-damage, irreversible outcomes due to “tipping points” in planetary systems, inter-sectoral interactions, and other deep uncertainties. Climate damages are not normally distributed around a central estimate, but rather feature a significant right skew toward catastrophic outcomes. In fact, a 2015 survey of economic experts concludes that catastrophic outcomes are increasingly likely to occur.²⁰² Because the three integrated assessment models that the IWG’s methodology relied on are unable to systematically account for these potential catastrophic outcomes, a 95th percentile value was selected instead to account for such uncertainty. There are no similarly systematic biases pointing in the other direction which might warrant giving weight to a low-percentile estimate.

Additionally, the 95th percentile value addresses the strong possibility of widespread risk aversion with respect to climate change. The integrated assessment models do not reflect that individuals likely have a

¹⁹⁸ *Id.* at 42.

¹⁹⁹ See Interagency Working Group on Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis 11 (2010).

²⁰⁰ Office of Information and Regulatory Affairs, Regulatory Impact Analysis: A Primer 2 (2011). This is best understood as drawing the line at insignificant or scientifically unsupported outcomes. By contrast, the low-probability but catastrophic potential outcomes of climate change are highly significant and the scientific literature demands giving them due attention.

²⁰¹ Circular A-4 at 39.

²⁰² Expert Consensus, *supra* note 175, at 2 (“Experts believe that there is greater than a 20% likelihood that this same climate scenario would lead to a ‘catastrophic’ economic impact (defined as a global GDP loss of 25% or more).”). See also Robert Pindyck, *The Social Cost of Carbon Revisited* (National Bureau of Economic Research, No. w22807, 2016).

higher willingness to pay to reduce low-probability, high-impact damages than they do to reduce the likelihood of higher-probability but lower impact damages with the same expected cost. Beyond individual members of society, governments also have reasons to exercise some degree of risk aversion to irreversible outcomes like climate change.

In short, the 95th percentile estimate attempts to capture risk aversion and uncertainties around lower-probability, high-damage, irreversible outcomes that are currently omitted or undercounted by the models. There is no need to balance out this estimate with a low-percentile value, because the reverse assumptions are not reasonable:

- There is no reason to believe the public or the government will be systematically risk seeking with respect to climate change.²⁰³
- The consequences of overestimating the risk of climate damages (i.e., spending more than we need to on mitigation and adaptation) are not nearly as irreversible as the consequences of underestimating the risk of climate damage (i.e., failing to prevent catastrophic outcomes).
- Though some uncertainties might point in the direction of lower social cost of greenhouse gas values, such as those related to the development of breakthrough adaptation technologies, the models already account for such uncertainties around adaptation; on balance, most uncertainties strongly point toward higher, not lower, social cost of greenhouse gas estimates.²⁰⁴
- There is no empirical basis for any “long tail” of potential benefits that would counteract the potential for extreme harm associated with climate change.

Moreover, even the best existing estimates of the social cost of greenhouse gases are likely underestimated because the models currently omit many significant categories of damages—such as depressed economic growth, pests, pathogens, erosion, air pollution, fire, dwindling energy supply, health costs, political conflict, and ocean acidification—and because of other methodological choices.²⁰⁵ There is little to no support among economic experts to give weight to any estimate lower than the 5% discount rate estimate.²⁰⁶ Rather, even a discount rate at 3% or below likely continues to underestimate the true social cost of greenhouse gases.

The National Academies of Sciences did recommend that the IWG document its full treatment of uncertainty in an appendix and disclose low-probability as well as high-probability estimates of the social

²⁰³ As a 2009 survey revealed, the vast majority of economic experts support the idea that “uncertainty associated with the environmental and economic effects of greenhouse gas emissions increases the value of emission controls, assuming some level of risk-aversion.” See Expert Consensus, *supra* note 175, at 3 (citing 2009 survey).

²⁰⁴ See Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, *supra* note 39. R. Tol, *The Social Cost of Carbon*, 3 Annual Rev. Res. Econ. 419 (2011) (“[U]ndesirable surprises seem more likely than desirable surprises. Although it is relatively easy to imagine a disaster scenario for climate change—for example, involving massive sea level rise or monsoon failure that could even lead to mass migration and violent conflict—it is not at all easy to imagine that climate change will be a huge boost to human welfare.”).

²⁰⁵ See Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, *supra* note 39; Peter Howard, *Omitted Damages: What’s Missing from the Social Cost of Carbon* (Cost of Carbon Project Report, 2014); Frances C. Moore & Delavane B. Diaz, *Temperature Impacts on Economic Growth Warrant Stringent Mitigation Policy*, 5 NATURE CLIMATE CHANGE 127 (2015) (demonstrating SCC may be biased downward by more than a factor of six by failing to include the climate’s effect on economic growth).

²⁰⁶ The existing estimates based on the 5% discount rate already provides a lower-bound; indeed, if anything the 5% discount rate is already far too conservative as a lower-bound. A recent survey of 365 experts on the economics of climate change found that 90% of experts believe a 3% discount rate or lower is appropriate for climate change; a 5% discount rate falls on the extremely high end of what experts would recommend. Expert Consensus, *supra* note 175, at 21; see also Drupp, M.A., 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%). Only 8% of the experts surveyed believe that the central estimate of the social cost of carbon is below \$40, and 69% of experts believed the value should be at or above the central estimate of \$40. Expert Consensus, *supra* note 175, at 18.

cost of greenhouse gases.²⁰⁷ However, that does not mean it would be appropriate for individual agencies to rely on low-percentile estimates to justify decisions. While disclosing low-percentile estimates as a sensitivity analysis may promote transparency, relying on such an estimate for decisionmaking—in the face of contrary guidance from the best available science and economics on uncertainty and risk—would not be a “credible, objective, realistic, and scientifically balanced” approach to uncertainty.²⁰⁸

By giving only a scant graphical presentation of the 95th percentile value, and by misleadingly placing that value on equal footing with a 5th percentile estimate, EPA has failed to address uncertainties over catastrophic outcomes, tipping points, risk aversion, and option value, and so has violated the prescriptions of Circular A-4. The IWG emphasized the 95th percentile (not the 5th percentile) to address this systematic downward bias in the social cost of greenhouse gases. By giving equal weight to the 5th and 95th percentiles, the EPA is ignoring this systematic bias and failing to consider the accepted logic that climate change is likely to bring with it more bad surprises than good surprises.

Uncertainty over Climate Damages Points Toward a Higher Social Cost of Methane

A technical appendix attached to these comments more fully details how uncertainty on the whole points toward an even higher social cost of methane. The appendix covers such topics as insufficient modeling of catastrophic outcomes (including unlucky states of the world, deep uncertainty over the probability distributions for specific climate parameters, and tipping points), failure to include a risk premium, exclusion of the real option value of preventing irreversible greenhouse gas emissions, and how the social cost of greenhouse gases would increase with improved modeling of uncertainty.

E. EPA Appropriately Gives Equal Weight to the Three Most Peer-Reviewed Models, but Should Use the Updated Models

EPA equally weighted the results of the three most peer-reviewed integrated assessment models in order to balance out the limitations and omissions of any one model.²⁰⁹ In any future applications of the social cost of methane, EPA should continue to rely on the Interagency Working Group’s methodology and use multiple peer-reviewed models. That said, EPA has failed to use the most up-to-date versions of those models, and should use the updated models in future calculations, including in any revised analysis of its proposed suspension.

Agencies Should Continue to Rely on the Interagency Working Group’s Methodology and Estimates

In 2016, IWG published updated central estimates for the social cost of greenhouse gases: \$50 per ton of carbon dioxide, \$1440 per ton of methane, and \$18,000 per ton of nitrous oxide (in 2017 dollars for year 2020 emissions).²¹⁰ Notwithstanding the recent Executive Order disbanding the IWG, the estimates updated by that group in 2016 are still the best estimates of the lower bound of the social cost of greenhouse gases, reflecting current best practices and best scientific and economic literature. Agencies should continue to use estimates of a similar or higher value²¹¹ in their regulatory analyses and environmental impact statements. In particular, when estimating the social cost of greenhouse gases, agencies should use multiple peer-reviewed models, a global estimate of climate damages, and a 3% or lower discount rate for the central estimate.

²⁰⁷ Nat’l Acad. Of Sci., *Assessment of Approaches to Updating the Social Cost of Carbon* 49 (2016) (“[T]he IWG could identify a high percentile (e.g., 90th, 95th) and corresponding low percentile (e.g., 10th, 5th) of the SCC frequency distributions on each graph.”).

²⁰⁸ Circular A-4 at 39.

²⁰⁹ RIA at A-2 (noting that EPA’s social cost estimates “are equally weighted across models”).

²¹⁰ 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 (2016).

²¹¹ See Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, *supra* note 39 (explaining that current estimates omit key damage categories and, therefore, are very likely underestimates).

Any departure from IWG’s most recent estimates would require agencies to engage with the complex integrated assessment models and ensure consistency with the most current scientific and economic literature, which overwhelmingly supports a global estimate based on a 3% or lower discount rate. Indeed, since the IWG’s estimates omit important damage categories and so are best treated as a lower bound, if anything the social cost of greenhouse gas values used by agencies should be even higher.

Agencies Must Not Rely on a Single Model, but Must Use Multiple, Peer-Reviewed Models

Circular A-4 requires agencies to use “the best reasonably obtainable scientific, technical, and economic information available. To achieve this, you should rely on peer-reviewed literature, where available.”²¹²

Since the IWG first issued the federal social cost of carbon protocol in 2010, this methodology has relied on the three most cited, most peer-reviewed integrated assessment models (IAMs). These three IAMs—called DICE (the Dynamic Integrated Model of Climate and the Economy²¹³), FUND (the Climate Framework for Uncertainty, Negotiation, and Distribution²¹⁴), and PAGE (Policy Analysis of the Greenhouse Effect²¹⁵)—draw on the best available scientific and economic data to link physical impacts to the economic damages of each marginal ton of greenhouse gas emissions. As noted previously, each model translates emissions into changes in atmospheric greenhouse gas concentrations, atmospheric concentrations into temperature changes, and temperature changes into economic damages, which can then be adjusted according to a discount rate. These three models have been combined with inputs derived from peer-reviewed literature on climate sensitivity, socio-economic and emissions trajectories, and discount rates. The results of the three models have been given equal weight in federal agencies’ estimates and have been run through statistical techniques like Monte Carlo analysis to account for uncertainty.

In a 2017 report, the National Academies of Sciences recommended future improvements to this methodology. Specifically, over the next five years the NAS recommends unbundling the four essential steps in the IAMs into four separate “modules”: a socio-economic and emissions scenario module, a climate change module, an economic damage module, and a discount rate module.²¹⁶ Unbundling these four steps into separate modules could allow for easier, more transparent updates to each individual component in order to better reflect the best available science and capture the full range of uncertainty in the literature. These four modules could be built from scratch or drawn from the existing IAMs. Either way, the integrated modular framework envisioned by NAS for the future will require significant time and resource commitments from federal agencies.

In the meantime, the NAS has supported the continued near-term use of the existing social cost of greenhouse gas estimates based on the DICE, FUND, and PAGE models, as used by federal agencies to date.²¹⁷ In short, DICE, FUND, and PAGE continue to represent the state-of-the-art models. The Government Accountability Office found in 2014 that the estimates derived from these models and used by federal agencies are consensus-based, rely on peer-reviewed academic literature, disclose relevant limitations, and are designed to incorporate new information via public comments and updated research.²¹⁸ In fact, the social cost of greenhouse gas estimates used in federal regulatory proposals and

²¹² OMB, Circular A-4, at 17.

²¹³ William D. Nordhaus, *Estimates of the social cost of carbon: concepts and results from the DICE-2013R model and alternative approaches*, 1 JOURNAL OF THE ASSOCIATION OF ENVIRONMENTAL AND RESOURCE ECONOMISTS 1 (2014).

²¹⁴ David Anthoff & Richard S.J. Tol, THE CLIMATE FRAMEWORK FOR UNCERTAINTY, NEGOTIATION AND DISTRIBUTION (FUND), TECHNICAL DESCRIPTION, VERSION 3.6 (2012), available at <http://www.fund-model.org/versions>.

²¹⁵ Chris Hope, *The Marginal Impact of CO₂ from PAGE2002: An Integrated Assessment Model Incorporating the IPCC's Five Reasons for Concern*, 6 INTEGRATED ASSESSMENT J. 19 (2006).

²¹⁶ NAS Second Report, *supra* note 109 (recommending an “integrated modular approach”).

²¹⁷ Specifically, NAS concluded that a near-term update was not necessary or appropriate and the current estimates should continue to be used while future improvements are developed over time. Nat’l Acad. Sci., Eng. & Medicine, *Assessment of Approaches to Updating the Social Cost of Carbon: Phase 1 Report on a Near-Term Update* 1 (2016) [hereinafter “NAS, First Report”].

²¹⁸ Gov’t Accountability Office, *Regulatory Impact Analysis: Development of Social Cost of Carbon Estimates* (2014).

EISs have been subject to over 80 distinct public comment periods.²¹⁹ The economics literature confirms that estimates based on these three IAMs remain the best available estimates.²²⁰ In 2016, the U.S. Court of Appeals for the Seventh Circuit held that those estimates are reasonable for agencies to use in cost-benefit analysis.²²¹ And more recently, the District of Montana rejected an agency's Environmental Assessment for failure to incorporate the federal social cost of carbon estimates into its cost-benefit analysis of a proposed mine expansion.²²²

Regardless of Executive Order 13,783's withdrawal of the guidance requiring federal agencies to rely on IWG's technical support documents to estimate the social cost of greenhouse gases, IWG's choice of DICE, FUND, and PAGE, its use of inputs and assumptions, and its statistical analysis still represent the state-of-the-art approach based on the best available, peer-reviewed literature. This approach satisfies Circular A-4's requirements for information quality and transparency. Therefore, in complying with the Executive Order's instructions to ensure that social cost of greenhouse gas estimates are consistent with Circular A-4, agencies will necessarily have to rely on models like DICE, FUND, and PAGE, to use the same or similar inputs and assumptions as the IWG, and to apply statistical analyses like Monte Carlo.

The unavoidable fact is that DICE, FUND, and PAGE are still the dominant, most peer-reviewed models,²²³ and most estimates in the literature continue to rely on those models.²²⁴ Each of these models has been developed over decades of research, and has been subject to rigorous peer review, documented in the published literature. While other models exist, they lack DICE's, FUND's, and PAGE's long history of peer review or exhibit other limitations. For example, the World Bank has created ENVISAGE, which models a more detailed breakdown of market sectors,²²⁵ but unfortunately does not account for non-market impacts and so would omit a large portion of significant climate effects. Models like ENVISAGE are therefore not currently appropriate choices under the criteria of Circular A-4.²²⁶

An approach based on multiple, peer-reviewed models (like DICE, FUND, and PAGE) is more rigorous and more consistent with Circular A-4 than reliance on a single model or estimate. DICE, FUND, and PAGE each include many of the most significant climate effects, use appropriate discount rates and other assumptions, address uncertainty, are based on peer-reviewed data, and are transparent.²²⁷ However, each IAM also has its own limitations and is sensitive to its own assumptions. No model fully captures all the

²¹⁹ Howard & Schwartz, *supra* note 30, at Appendix A.

²²⁰ E.g., Richard G. Newell et al., *Carbon Market Lessons and Global Policy Outlook*, 343 SCIENCE 1316 (2014); Bonnie L. Keeler et al., *The Social Costs of Nitrogen*, 2 SCIENCE ADVANCES e1600219 (2016); Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, *supra* note 39.

²²¹ *Zero Zone*, 832 F.3d at 678–79 (finding that the agency “acted reasonably” in using global estimates of the social cost of carbon, and that the estimates chosen were not arbitrary or capricious).

²²² *Montana Environmental Information Center*, 2017 WL 3480262, at *12-15, 19.

²²³ See Interagency Working Group on the Social Cost of Carbon, Response to Comments: Social Cost of Carbon for Regulatory Impact Analysis 7 (July 2015) (“DICE, FUND, and PAGE are the most widely used and widely cited models in the economic literature that link physical impacts to economic damages for the purposes of estimating the SCC.”), citing Nat'l Acad. Sci., Eng. & Medicine, *Hidden Cost of Energy: Unpriced Consequences of Energy Production and Use* (2010) (“the most widely used impact assessment models”).

²²⁴ R.S. Tol, *The Social Cost of Carbon*, 3 Annual Rev. Res. Econ. 419 (2011); T. Havranek et al., *Selective Reporting and the Social Cost of Carbon*, 51 Energy Econ. 394 (2015).

²²⁵ World Bank, *The Environmental Impact and Sustainability Applied General Equilibrium (ENVISAGE) Model* (2008), available at <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1193838209522/Envisage7b.pdf>.

²²⁶ Similarly, Intertemporal Computable Equilibrium System (ICES) does not account for non-market impacts. See <https://www.cmcc.it/models/ices-intertemporal-computable-equilibrium-system>. Other models include CRED, which is worthy of further study for future use. Frank Ackerman, Elizabeth A. Stanton & Ramón Bueno, *CRED: A New Model of Climate and Development*, 85 ECOLOGICAL ECONOMICS 166 (2013). Accounting for omitted impacts more generally, E.A. Stanton, F. Ackerman, R. Bueno, *Reason, Empathy, and Fair Play: The Climate Policy Gap*, (Stockholm Environment Inst. Working Paper 2012-02), find a doubling of the SCC using the CRED model.

²²⁷ While sensitivity analysis can address parametric uncertainty within a model, using multiple models helps address structural uncertainty.

significant climate effects.²²⁸ By giving weight to multiple models—as the IWG did—agencies can balance out some of these limitations and produce more robust estimates.²²⁹

Finally, while agencies should be careful not to cherry-pick a single estimate from the literature, it is noteworthy that various estimates in the literature are consistent with the numbers derived from a weighted average of DICE, FUND, and PAGE—namely, with a central estimate of about \$40 per ton of carbon dioxide, and a high-percentile estimate of about \$120, for year 2015 emissions (in 2016 dollars, at a 3% discount rate). The latest central estimate from DICE’s developers is \$87 (at a 3% discount rate);²³⁰ from FUND’s developers, \$12;²³¹ and from PAGE’s developers, \$123, with a high-percentile estimate of \$332.²³²

In fact, much of the literature suggests that a central estimate of \$40 per ton is a very conservative underestimate. A 2015 meta-analysis—which sought out estimates besides just those based on DICE, FUND, and PAGE—found a mean estimate of \$83 per ton of carbon dioxide.²³³ Various studies relying on expert elicitation²³⁴ from a large body of climate economists and scientists have found mean estimates of \$50 per ton of carbon dioxide,²³⁵ \$96-\$144 per ton of carbon dioxide,²³⁶ and \$80-\$100 per ton of carbon dioxide.²³⁷ There is a growing consensus in the literature that even the best existing estimates of the social cost of greenhouse gases may severely underestimate the true marginal cost of climate damages.²³⁸ Overall, a central estimate of \$40 per ton of carbon dioxide at a 3% discount rate, with a high-percentile estimate of about \$120 for year 2015 emissions, is consistent with the best available literature; if anything, the best available literature supports considerably higher estimates.²³⁹

Similarly, a comparison of international estimates of the social cost of greenhouse gases suggests that a central estimate of \$40 per ton of carbon dioxide is a very conservative value. Sweden places the long-term valuation of carbon dioxide at \$168 per ton; Germany calculates a “climate cost” of \$167 per ton of carbon dioxide in the year 2030; the United Kingdom’s “shadow price of carbon” has a central value of

²²⁸ See Peter Howard, *Omitted Damages: What’s Missing from the Social Cost of Carbon 5* (Cost of Carbon Project Report, 2014), <http://costofcarbon.org/>.

²²⁹ 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).

²³⁰ William Nordhaus, *Revisiting the Social Cost of Carbon*, *Proc. Nat’l Acad. Sci.* (2017) (estimate a range of \$21 to \$141).

²³¹ D. Anthoff & R. Tol, *The Uncertainty about the Social Cost of Carbon: A Decomposition Analysis Using FUND*, 177 *Climatic Change* 515 (2013).

²³² C. Hope, *The social cost of CO2 from the PAGE09 model*, 39 *Economics* (2011); C. Hope, *Critical issues for the calculation of the social cost of CO2*, 117 *Climatic Change*, 531 (2013).

²³³ S. Nocera et al., *The Economic Impact of Greenhouse Gas Abatement through a Meta-Analysis: Valuation, Consequences and Implications in terms of Transport Policy*, 37 *Transport Policy* 31 (2015).

²³⁴ Circular A-4, at 41, supports use of expert elicitation as a valuable tool to fill gaps in knowledge.

²³⁵ Scott Holladay & Jason Schwartz, *Economists and Climate Change* 43 (Inst. Policy Integrity Brief, 2009 (directly surveying experts about the SCC)).

²³⁶ Expert Consensus, *supra* note 175 (using survey results to calibrate the DICE-2013R damage function).

²³⁷ R. Pindyck, *The Social Cost of Carbon Revisited* (Nat’l Bureau of Econ. Res. No. w22807, 2016) (\$80-\$100 is the trimmed range of estimates at a 4% discount rate; without trimming of outlier responses, the estimate is \$200).

²³⁸ See, e.g., *id.*; Expert Consensus, *supra* note 175. The underestimation results from a variety of factors, including omitted and outdated climate impacts (including ignoring impacts to economic growth and tipping points), simplified utility functions (including ignoring relative prices), and applying constant instead of a declining discount rate. See Howard, *supra* note 229; Revesz et al., *Global Warming: Improve Economic Models of Climate Change*, *supra* note 39; J.C. Van Den Bergh & W.J. Botzen, *A Lower Bound to the Social Cost of CO2 Emissions*, 4 *Nature Climate Change* 253 (2014) (proposing \$125 per metric ton of carbon dioxide in 1995 dollars, or about \$200 in today’s dollars, as the lower bound estimate). See also F.C. Moore & D.B. Diaz, *Temperature Impacts on Economic Growth Warrant Stringent Mitigation Policy*, 5 *Nature Climate Change* 127 (2015) (concluding the SCC may be six times higher after accounting for potential growth impacts of climate change). Accounting for both potential impacts of climate change on economic growth and other omitted impacts, S. Dietz and N. Stern find a two- to seven-fold increase in the SCC. *Endogenous growth, convexity of damage and climate risk: how Nordhaus’ framework supports deep cuts in carbon emissions*. 125 *The Economic Journal* 574 (2015).

²³⁹ Note that the various estimates cited in the paragraph have not all been converted to standard 2017\$, and may not all reflect the same year emissions. Nevertheless, the magnitude of this range suggests that \$40 per ton of year 2015 emissions is a conservative estimate.

\$115 by 2030; Norway’s social cost of carbon is valued at \$104 per ton for year 2030 emissions; and various corporations have adopted internal shadow prices as high as \$80 per ton of carbon dioxide.²⁴⁰

Indeed, a number of our organizations have previously commented on ways in which the IWG’s approach could be improved to more accurately reflect the true social cost of greenhouse gases. For instance, the IWG’s values should incorporate a risk premium, which reflects an additional price that society is willing to pay in order to avoid greater uncertainty about the impacts from climate change. In addition, noted Harvard economist Martin Weitzman has observed that the three IAMs used by the IWG assume a relatively smooth upward slope in economic damages even as the global climate crosses critical tipping points.²⁴¹

An improved social cost of greenhouse gases could reflect modified damage functions that better address tipping points. For these reasons, the IWG’s estimates are very likely to underrepresent the true impact that greenhouse gas emissions have on society, and we strongly encourage further efforts to make those estimates more robust. Nevertheless, the IWG’s approach represents the best and most rigorous effort that the U.S. government has engaged in thus far to realistically estimate the social cost of greenhouse gases. We therefore strongly urge EPA to adopt the IWG’s approach for estimating the social cost of methane, with the understanding that such estimates should be seen as a conservative lower-bound estimate of the true impacts of this pollutant.

EPA Should Use the Most Updated Models

EPA explains it uses DICE 2010, FUND 3.8, and PAGE 2009.²⁴² However, not only is DICE 2010 not considered to be a major update of the DICE model,²⁴³ but two major updates have occurred more recently: DICE-2013R²⁴⁴ and DICE-2016R.²⁴⁵ In using the outdated DICE 2010, EPA has failed to use the “best available science and economics” as required by Executive Order 13,783, and failed to follow the recommendations of the National Academies of Sciences on updating the integrated assessment models.²⁴⁶ Updating from DICE 2010 to the most recent model would increase the social cost of greenhouse gases and enable a Monte Carlo simulation (as in FUND and PAGE) to better specify uncertainty.²⁴⁷

F. EPA Has Cherry-Picked Methodological Revisions to Advance a Predetermined Goal, Without Engaging in a Holistic Update

As detailed above, the EPA’s “interim values” for the social cost of methane were produced from a series of choices that are all methodologically unsound: ignoring the global values and calculating an inaccurate

²⁴⁰ See Howard & Schwartz, *supra* note 30, at Appendix B. All these estimates are in 2016\$.

²⁴¹ Martin L. Weitzman, *On Modeling and Interpreting the Economics of Catastrophic Climate Change*, 91 REV. ECON. STAT. 1–19 (2009) at 15–18.

²⁴² RIA at A-1.

²⁴³ William Nordhaus & Paul Sztorc, DICE 2013R: Introduction and User’s Manual (2013), *available at* http://www.econ.yale.edu/~nordhaus/homepage/homepage/documents/DICE_Manual_100413r1.pdf.

²⁴⁴ William Nordhaus, Estimates of the Social Cost of Carbon: Concepts and Results from the DICE-2013R Model and Alternative Approaches, 1 JOURNAL OF THE ASSOCIATION OF ENVIRONMENTAL AND RESOURCE ECONOMISTS 273–312 (2014).

²⁴⁵ William Nordhaus, Revisiting the Social Cost of Carbon, 114 PROCEEDINGS OF THE NATIONAL ACADEMY OF SCIENCES 1518 (2017).

²⁴⁶ NAS Second Report, *supra* note 109. Note that the Interagency Working Group was incorrect in 2016 in failing to update the DICE model from DICE-2010 to DICE-2013R, which was available at the time. *Cf.* IWG, 2013 Technical Update (updating the models). See also Marten, A.L., Kopits, E.A., Griffiths, C.W., Newbold, S.C., and A. Wolverton. 2015. Incremental CH4 and N2O Mitigation Benefits Consistent with the U.S. Government’s SC-CO2 Estimates. *Climate Policy*. 15(2): 272-298 (anticipating that the models will be continually updated).

²⁴⁷ The update would also increase EPA’s calculation of the domestic-only share from 10% to 15%, see Nordhaus, W. D. (2017). Revisiting the social cost of carbon. *Proceedings of the National Academy of Sciences*, 201609244. But, as explained in these comments, a domestic-only value is the wrong framework and is inaccurate.

and incomplete domestic-only estimate; applying the inappropriate 7% discount rate; and failing to disclose a 95th percentile estimate. What links these select revisions together is a common, predetermined goal: lowering the social cost of methane to support deregulation.

This is an arbitrary approach to updating the social cost of methane. EPA does not engage with any of the most recent literature on damages (see the technical appendix attached to these comments on damage literature), does not update the underlying models (EPA continues to use DICE-2010, even though DICE-2016R has been published), does not move toward a declining discount rate, and does not implement any of the recommendations for improving the social cost of greenhouse gas methodology as articulated by the National Academies of Sciences. EPA notes, but then does nothing about, the National Academies of Sciences' warning that domestic-only numbers fail to account for spillovers and reciprocity.²⁴⁸ EPA notes, but then does nothing about, the Intergovernmental Panel on Climate Change's updated estimates of methane's radiative efficacy.²⁴⁹ EPA has had almost three years since the National Academies of Sciences' January 2017 report was published to incorporate its recommendations into a proper update of the social cost of greenhouse gases; instead, EPA continues to use the same "interim" estimates, with no indication of any process for properly revising the estimates.²⁵⁰ Agencies should pursue a holistic update of the social cost of greenhouse gas methodology, but EPA only seems interested in revisions designed to lower the valuation. As such, EPA's interim values are biased and should not be used in analysis.

The National Academies of Sciences' reports are attached to these comments, so that EPA might review their recommendations for a holistic update to the methodology.

3. EPA Fails to Appropriately Consider the Unquantified Costs of the Proposed Deregulation

In addition to its failure to adequately account for the costs of methane emissions, EPA also fails to adequately address the numerous unquantified costs of the proposed deregulation.

Specifically, EPA recognizes that the proposed deregulation will result in numerous unquantified health impacts, including increases in premature mortality and non-fatal diseases (such as heart attacks, bronchitis, and cardiovascular disease) by increasing emissions in particulate matter and ozone.²⁵¹ Such emissions increases will also produce unquantified climate impacts, such as reduced vegetation and ecosystem effects from exposure to ozone, along with indirect economic costs such as decreased worker productivity and school attendance.²⁵² Moreover, as detailed above, the social cost of methane fails to account for many of the damages associated with an increase in methane emissions, meaning that the increase in methane emissions from the proposed deregulation will also result in significant unquantified costs.²⁵³

Yet EPA only briefly ticks through these unquantified costs of the proposed deregulation, and does not consider their likely scope or magnitude when assessing whether the rule is cost-justified. Instead, EPA simply concludes that the rule is justified because the monetized benefits purportedly outweigh the monetized costs.²⁵⁴ The agency fails to explain why the proposed deregulation's estimated cost savings justify the sum of both the monetized and unmonetized forgone benefits.

²⁴⁸ RIA at 3-14.

²⁴⁹ *Id.* at 3-13.

²⁵⁰ *Id.* at 3-8 ("The SC-CH₄ estimates presented here are *interim* values developed under E.O. 13783 for use in regulatory analyses *until an improved estimate . . . can be developed based on the best available science and economics.*") (emphasis added).

²⁵¹ RIA at 3-3-4.

²⁵² *Id.*

²⁵³ Peter Howard, *Omitted Damages: What's Missing from the Social Cost of Carbon 5* (Cost of Carbon Project Report, 2014), <http://costofcarbon.org/> (describing how greenhouse gas damage estimates omit or poorly quantify numerous damage categories).

²⁵⁴ *See id.* at 1-12 (reporting "net benefits" by subtracting monetized costs from monetized benefits). For all the reasons detailed above, EPA is incorrect that the rule's monetized benefits exceed even its monetized costs.

EPA’s treatment of unquantified costs is insufficient. Circular A-4 requires agencies to not only “identify” non-monetary costs and benefits, but to also “highlight (e.g., with categories or rank ordering) those that [it] believe[s] are most important” and to “evaluate their significance” by quantifying their impact to the extent possible and then qualitatively comparing that impact to other costs and benefits.²⁵⁵ Merely determining that a regulation is justified because monetized benefits exceed monetized costs is insufficient: The Circular cautions that “the most efficient alternative will not necessarily be the one with the largest quantified and monetized net-benefit estimate.”²⁵⁶ Consistent with this guidance, EPA must fully disclose the limitations of its social cost of greenhouse gas estimates and assess the significance of all the unquantified health, climate, and economic costs.

EPA’s list of unquantified costs and cursory reference to “impact categories omitted”²⁵⁷ from the social cost of methane falls well short of this standard. First, EPA must consider the tools that *are* available to monetize the costs of foregone VOC reductions from the oil and gas sector,²⁵⁸ which it has not done. Second, to the extent that there remain costs to the rule that EPA cannot monetize, it must appropriately *weigh* all such non-monetized costs, not merely recognize that they exist without further discussion. This applies both to any unaccounted climate impacts from methane emissions and non-monetized health and productivity costs from particulate matter and ozone emissions. Only then can EPA determine whether all of the proposal’s costs, monetized and non-monetized alike, can be justified by the purported benefits of the proposed deregulation.

Finally, EPA entirely omits any analysis or quantification of expected emissions from existing sources that are affected by the proposed deregulation. Specifically, the repeal of methane regulation would cause EPA to lose authority to establish methane emissions guidelines for existing sources under Section 111(d) of the Clean Air Act, thereby allowing existing sources to emit unregulated pollution and perversely incentivizing existing sources to evade modification for longer than they otherwise would to prevent the triggering of more stringent emissions requirements. By giving existing sources an incentive to remain operational longer than they otherwise would, the proposed deregulation will cause additional adverse environmental consequences. Yet EPA fails to recognize these consequences even in its short summary of the rule’s unquantified effects, entirely failing to recognize this critical consequence of the proposed deregulation.

For these reasons, as well, the economic analysis underlying the proposed deregulation is fundamentally flawed, and any final rulemaking relying on a similar analysis would be arbitrary and capricious.

Sincerely,

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²⁵⁵ Circular A-4 at 2, 27.

²⁵⁶ *Id.* at 2.

²⁵⁷ *Id.* A-5.

²⁵⁸ See Fann et al., *Assessing Human Health PM2.5 and Ozone Impacts from U.S. Oil and Natural Gas Sector Emissions in 2025*, 52 ENV’T L. SCI. & TECH. 8095-103 (2018).

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

Appendices:

- Technical Appendix on Uncertainty
- Technical Appendix on Discounting

Attached Documents:

Council of Econ. Advisers, *Discounting for Public Policy: Theory and Recent Evidence on the Merits of Updating the Discount Rate* (CEA Issue Brief, 2017).

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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.¹ 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.² 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.³ Rather than being a reason not to take action, uncertainty increases the SCC and should lead to more stringent policy to address climate change.⁴

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.⁵ Stochastic uncertainty is persistent randomness in the economic-climate system, including various environmental phenomena such as volcanic eruptions and sun spots.⁶ 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).⁷

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

¹ 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.

² 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).

³ 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.

⁴ See cites *supra* note 3.

⁵ 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).

⁶ 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.

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

⁸ 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.⁹ 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.¹⁰ 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.¹¹ Given the general opinion that bad surprises are likely to outweigh good surprises in the case of climate change,¹² modelers capture deep uncertainty by selecting probability distributions with a fat upper tail which reflects the greater likelihood of extreme events.¹³ 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).¹⁴

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.¹⁵ 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.¹⁶ 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.¹⁷ 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.¹⁸ 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.¹⁹ Accounting fully for these most pressing, and potentially most dramatic, uncertainties in the

⁹ Kopp et al. (2016), *supra* note 8.

¹⁰ *Id.*

¹¹ 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.

¹² 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.

¹³ 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.”

¹⁴ 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.

¹⁵ 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.

¹⁶ *Id.*

¹⁷ *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.

¹⁸ 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 CO2 emission reduction; Kopp et al. (2016) *supra* note 8.

¹⁹ 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 model²⁰ 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.²¹ 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.²² 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 95th 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.²³ 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

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

²⁰ Nordhaus, W. & Sator, 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>

²¹ 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.

²² 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.”

²³ IWG (2010).

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.²⁴ 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.²⁵ 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.²⁶

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.²⁷ 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.²⁸ 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.²⁹ Despite the obvious methodological basis for addressing tipping points, the latest versions of DICE³⁰ and FUND exclude tipping points in their preferred specifications. Research shows that if these models were to correctly account for the full range of climate impacts—including tipping points—the resulting SCC estimates would increase.³¹

²⁴ 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. Explicitly modeling parameter distributions as fat tailed may further increase the SCC.

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

²⁶ 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.

²⁷ 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.

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

²⁹ Kopp et al. (2016) *supra* note 8.

³⁰ 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*.

³¹ 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;

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.³² 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.³³ 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,³⁴ current IAM assumptions,³⁵ 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).³⁶ Designing IAMs to properly account for the risk and ambiguity premiums from uncertain climate damages would increase the resulting SCC values they generate.

Even under the IWG’s current assumption of risk neutrality, the mean SCC from uncertainty propagation excludes the (real) option value of preventing marginal CO₂ emissions.³⁷ Option value reflects the value

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.

³² 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).

³³ 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.

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

³⁵ The developers of each of the three IAMs used by the IWG (2010; 2013; 2016) assume a risk aversion society. Nordhaus and Satorc (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; 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; 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.

³⁶ 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.

³⁷ 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

of future flexibility due to uncertainty and irreversibility; in this case, the irreversibility of CO2 emissions due to their long life in the atmosphere.³⁸ If society exercises the option of emitting an additional unit of CO2 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.”³⁹ 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.⁴⁰ 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.⁴¹ 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),⁴² the stochastic dynamic optimization model must also account 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.

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.*

³⁸ Even if society drastically reduced CO2 emissions, CO2 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.

³⁹ Pindyck (2007), *supra* note 3.

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

⁴¹ 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.

⁴² 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 CO2 in most future states of the world. Alternatively, society is unlikely to regret current abatement levels unless the extremely unlikely scenarios that there is little to no warming and/or damages from climate change.

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.⁴³ 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.⁴⁴

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.⁴⁵ For SDP models, uncertainty tends to strengthen the optimal emissions path relative to the determinist case even without tipping points,⁴⁶ and these results are strengthened under realistic preference assumptions.⁴⁷ Given that there is no counterbalancing tipping abatement cost,⁴⁸ 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 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

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

⁴⁴ 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.

⁴⁵ 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.

⁴⁶ 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.

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

⁴⁸ Pindyck (2007), *supra* note 3.

in the optimal tax by 100%⁴⁹ to 800%⁵⁰ 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.⁵¹ Recent research has shown that accurate estimation of decisions under uncertainty crucially depends on distinguishing between risk and time preferences.⁵² 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.⁵³ 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.⁵⁴ 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.⁵⁵ Current omission of key features of the climate problem under uncertainty (the risk and climate premiums, option value, and fat tailed probability

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

⁵⁰ Cai et al., 2016.

⁵¹ 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.

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

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

⁵⁴ 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.

⁵⁵ 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 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-CH4 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-CH4, 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.”

distributions) and incomplete modeling of tipping points imply that the SCC will further increase with the improved modeling of uncertainty in IAMs.

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 (η) 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%.⁵⁶ However, more recent versions of DICE (DICE-2013R and DICE-2016) update η 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.⁵⁷ 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%,⁵⁸ 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).⁵⁹ 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.⁶⁰ Uncertainty about future discount rates could stem from a number of sources particularly salient in the context of climate change, including uncertainty about 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

⁵⁶ 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.

⁵⁷ 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.

⁵⁸ According to the World Bank, the average global and United States per capita growth rates were 1.7% and 1.9%, respectively.

⁵⁹ 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."

⁶⁰ 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.

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.⁶¹ 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.⁶² 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 rule⁶³ for discounting will lead to a declining discount rate.⁶⁴

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).

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

⁶¹ This argument was first developed in Weitzman (1998) and Weitzman (2001).

⁶² See, e.g., Gollier (2009).

⁶³ The Ramsey discount rate equation for the social discount rate is $r = \delta + \eta * g$ where r is the social discount rate, δ is the pure rate of time preference, η 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).

⁶⁴ 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.

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 rule⁶⁵ implies a declining discount rate when (1) the growth rate of per capita consumption is stochastic,⁶⁶ 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).⁶⁷ While a constant adjustment downwards (known as the precautionary effect⁶⁸) 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).⁶⁹ 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).⁷⁰

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 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).⁷¹

⁶⁵ If the future growth of consumption is uncertainty with mean μ and variance σ^2 , an extended Ramsey equation $r = \delta + \eta * \mu - 0.5\eta^2\sigma^2$ applies where r is the social discount rate, δ is the pure rate of time preference, η 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.

⁶⁶ The IWG assumption of five possible socio-economic scenarios implies an uncertain growth path.

⁶⁷ 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).

⁶⁸ The precautionary effect measures aversion to future “wiggles” in consumption (i.e., preference for consumption smoothing) (Traeger, 2014).

⁶⁹ 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).

⁷⁰ 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).

⁷¹ 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.

Additionally, a related literature has developed over the last decade demonstrating that normative uncertainty (i.e., heterogeneity) over the pure rate of time preference (δ)—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).⁷² 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).⁷³ It is derived from a broad survey of top economists in context of climate change, and explicitly incorporates arguments around interest rate uncertainty.⁷⁴ Other declining discount rate schedule 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.⁷⁵ 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.⁷⁶ The consensus of leading economists is that a 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 (δ) is used. Circular A-4 cautions that “[u]sing the same discount rate across generations has the advantage of preventing time-

⁷² 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).

⁷³ 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.

⁷⁴ 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.

⁷⁵ 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.

⁷⁶ 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 CO₂, 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.

inconsistency problems.”⁷⁷ 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 (δ) 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 δ 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.⁷⁸ 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.”⁷⁹

We should note that time-inconsistency is not a reason to ignore heterogeneity (i.e., normative uncertainty) over the pure rate of time preference (δ). 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 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”

⁷⁷ Circular A-4 at 35.

⁷⁸ 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.”

⁷⁹ National Academies of Sciences, Engineering, and Medicine, Valuing Climate Damages: Updating Estimation of the Social Cost of Carbon Dioxide 182 (2017).

(Newell, 2017).⁸⁰ 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.

⁸⁰ 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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