THE COST OF REGULATION TO SMALL BUSINESS

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT, AND GOVERNMENT PROGRAMS

AND

SUBCOMMITTEE ON REGULATORY REFORM AND PAPERWORK REDUCTION

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THE COST OF REGULATION TO SMALL BUSINESS

THURSDAY, JUNE 6, 2002

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT, AND SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT, AND GOVERNMENT PROGRAMS, COMMITTEE ON SMALL BUSINESS,

Washington, DC.

The joint Subcommittees met, pursuant to call, at 2:00 p.m., in room 2360, Rayburn House Office Building, Hon. Mike Pence (chairman of the subcommittee) presiding.

Chairman PENCE. This hearing of the Subcommittee on Regulatory Reform and Oversight of the Committee on Small Business is convened.

Our hearing today addresses the cost of regulation to the small business community. Countless efforts to reform and reign in the regulatory state have met with increasing resistance from the government bureaucracy. In 2000, the Code of Federal Regulations required over 74,000 pages to record every executive agency rule and, if laid down next to each other, the volumes would literally extend 19 feet in length. From 1991 to 2000, the Code of Federal Regulations increased by 28 percent and showed no signs of stopping in 2000 when 4,699 rules were codified.

Last year a report put out by the Small Business Administration's Office of Advocacy calculated the cost of regulations to our economy at $843 billion per year, or $8,164 for every household. That number rivals our massive Federal budget this year. Even more troubling than that were statistics gathered on the impact of these regulations to small businesses. Small businesses face a regulatory burden that is 60 percent higher per employee than large businesses. Dr. Crain and Dr. Hopkins estimate in their report that the average small business is burdened with almost $7,000 per employee in regulatory compliance costs. The worst offender in the Federal Government when it comes to disproportionate costs to small businesses is the Environmental Protection Agency. Fully half of the estimated regulatory burden for small businesses identified in the report comes from environmental regulation.

One of the most powerful weapons in our arsenal dedicated to beating back the regulatory state is the Regulatory Flexibility Act; and often our chief warrior in this battle is the Office of Information and Regulatory Affairs, or OIRA, in the President's Office of Management and Budget. It is OIRA's mission to hold agencies accountable to the laws that Congress has passed and the executive

orders of the President when it comes to performing appropriate analysis and rulemakings.

We are very pleased to have Dr. John Graham, the Administrator of OIRA, with us today to testify to his progress in restoring the proper role of his office in the Federal regulatory process. Dr. Graham will also be discussing the Draft Report to Congress on the Costs and Benefits of Federal Regulations which his office is statutorily required to prepare. Both subcommittees have taken note of your reviews of existing regulations to improve their net benefits, and we look forward to your continued progress on reducing the cost of regulations that are currently on the books.

We are also very fortunate and honored to be joined by former Congressman David McIntosh, my predecessor in the Second Congressional District of Indiana. I can say without question that there are very few Members of this Chamber who could rival his knowledge of regulatory issues or his integrity or who have committed themselves and so much of their time and energy and intellect to this issue. Clearly, your days as chairman of the National Economic Growth, Natural Resources and Regulatory Affairs Subcommittee and your work leading the Competitiveness Council in the first Bush administration speak to the weight with which your testimony is held by both of these subcommittees.

We are anxious to hear your thoughts on how the regulatory reform initiatives which you helped put in place are working and how we can be doing a better job still. Your outside perspective is especially appreciated since it has allowed me to follow you in representing the second district in the great State of Indiana.

On a personal note, it is delightful to see you on that side of the desk, though I am daily reminded how many people wish you were still on this side.

In a time when our economy relies so greatly on small businesses to keep our country moving, we cannot afford to stifle that progress by continuing to pile on costly regulations that disadvantage these groups. Half of our national workforce is employed by small businesses and two-thirds to three-quarters of net new jobs are created in the small business sector. Now is the time to do everything in our power to limit the reach of the regulatory state and lower the cost of regulation to small businesses.

We very much look forward to your testimony and to that of our second panel.

We will now have an opening statement from the chairman of the Subcommittee on Workforce, Empowerment and Government Programs who is co chairing and co hosting this Subcommittee joint hearing, Mr. DeMint.

Chairman DEMINT. Thank you, Chairman Pence. It is good to have you folks here. David, it is great to have you back.

I appreciate the opportunity in helping to convene this joint hearing to look at the cost of regulations on small businesses and entrepreneurs. As a former small businessman myself and a consultant to a number of other businesses, I am very aware of the extraordinary burden of excessive Federal regulations. At a recent field hearing in Spartansburg, I heard from a number of constituents in business who are struggling to comply with regulations, and it is clear that the burden is more cumbersome on smaller

firms who do not have the resources to deal with it. This is very ironic that we do this, as Chairman Pence says, as most of the net new jobs are coming from these firms that we are smothering in regulations.

It is vitally important that we pay close attention to the personal as well as the macroeconomic cost of regulations and other strictures that government unnecessarily places on small business owners. We on this Committee need to be an advocate for clearing the way for entrepreneurs to be free to run their businesses and not spend all of their time jumping through bureaucratic hoops.

I am pleased to note that the regulations issued under President Bush are down in number, although they still remain very high. The 2001 Federal Register contains only 64,431 pages, more than a 13 percent decline. I am concerned that the unelected are doing the bulk of lawmaking here in D.C. While unaccountable regulatory agencies issued 4,132 rules last year, Congress passed only 108 bills.

The five most active rule-producing agencies—the Department of Transportation, Treasury, Interior and Commerce, and the Environmental Protection Agency—account for 48 percent of all rules under consideration.

I want to thank the witnesses again who are participating in the hearing. I appreciate the work that has been done on the papers entitled "The Impact of Regulations on Small Firms" and the "Draft Report to Congress on the Costs and Benefits of Federal Regulations." I look forward to hearing about both of these.

Thank you very much. I yield back, Mr. Chairman.

Chairman PENCE. Thank you, Chairman DeMint.

The Chair will entertain opening statements from any colleagues who join us along the way.

Both of these witnesses on our first panel are very veteran on Capitol Hill, but allow me to ask your forbearance in respecting the 5-minute time limit, knowing that the entirety of your prepared statement will most certainly be added to the record if you are unable to get through all of it, but we will also make the practice of hearing from both of our witnesses before the panel is presented with questions by either chairmen or any other members who join us in the course of the hearing.

Our first witness in this hearing on the cost of regulations to small business is Dr. John Graham, who is the Administrator of OIRA, the Office of Information and Regulatory Affairs, in the President's Office of Management and Budget; and Dr. Graham is recognized for 5 minutes.

STATEMENT OF THE HONORABLE JOHN D. GRAHAM, PH.D., ADMINISTRATOR, OIRA, OFFICE OF MANAGEMENT AND BUDGET

Mr. GRAHAM. Thank you very much, Mr. Chairman—both chairmen, actually, for the two subcommittees hosting the hearing this afternoon.

Since this is my first opportunity to testify before you, I thought I should say a few words about my background. I was born and raised in Pittsburgh, Pennsylvania, a very proud Steelers fan. Perhaps more importantly for the subject of this hearing, I was raised

during a period where that city experienced substantial deindustrialization for a variety of reasons, and I saw the impacts of the lack of business growth and job growth as I was growing up as a young child in Pittsburgh.

From there, I went to Wake Forest University and Duke University and then back to Pittsburgh for my Ph.D. at Carnegie-Mellon University. For the last 17 years, I have been on the faculty at the Harvard School of Public Health where I founded and ran the Harvard Center for Risk Analysis.

For the topic of the hearing today, the impact of regulation on small business, I will start with an anecdote about the education of John Graham with regard to what regulation does to small businesses.

My first opportunity to testify before a congressional hearing was on the Senate side in 1990 on a bill—on one of the early bills to amend the Clean Air Act that ultimately led to the 1990 amendments to the Clean Air Act. After I gave my testimony, I stayed and listened to a second panel. There were several witnesses from large Fortune 500 companies testifying in favor of multi-billion dollar regulatory programs under the Clean Air Act.

That evening I went to dinner with a colleague of mine, Dr. Bob Crandall at the Brookings Institution, and asked him to explain to me what I thought was the surprising testimony of these Fortune 500 companies. I said, is this a case of progressive businesses trying to clean up the environment? Bob has a good cynical mind, and he reminded me that you have to keep in mind that these large corporations, when we get into regulatory issues, oftentimes see regulation as an opportunity to raise capital costs for participants in an industry and to create entry barriers for new companies into those businesses. So, oftentimes, we have to understand that regulatory issues are not an issue of business versus other interests in society; they are oftentimes big business versus little business as part of the problem.

That leads to the key finding of the Crain/Hopkins Report commissioned by the Small Business Administration. Firms with less than 20 employees face 60 percent larger regulatory burdens per employee than firms with greater than 500 employees. So I think it is important to realize that regulation for—particularly for larger companies, in certain circumstances they see that as a competitive advantage relative to small companies.

There is, I think, an important piece of missing information in my written testimony. While we have information on the cost side of regulation by size of business, we have not yet been able to collect information on the benefits of regulation by size of business. In order to have a much more concrete handle on what the overall impact of regulation is, it would be useful to have that information on benefits as well as costs.

I also wanted to make a point about the Unified Regulatory Agenda of the Federal Government, which was released last month. It lays out the pipeline of regulations expected over the next year in the Federal Government. As the so-called regulatory czar of the Federal Government, I would like to believe that we are in control of all of this activity but, in all candor, that is a little difficult to do.

There are some interesting pieces of information from this agenda. First of all, the Agenda lists economically significant rules that cost the economy more than $100 million. The agencies that have most of those in the pipeline are one, EPA; two, HHS; three, U.S. Department of Agriculture; four, transportation; and five, the FCC.

However, there is a separate piece of information in this agenda about rules in the pipeline that will have impacts on small businesses. I think it is a very interesting list, because it has a slightly different flavor to it. The top five agencies are the FCC, HHS, Commerce, Transportation, and SEC. If you take the independent agencies out, FCC and SEC, then you add USDA and EPA. I think an important thing to keep in mind there is the executive order we operate under at OIRA does not currently have authority for regulatory review over these independent agencies.

With regard to collaboration in terms of small business issues, we have recently signed a memorandum of understanding with the Advocacy Office at the Small Business Administration Tom Sullivan and I will be working together to try to coordinate our evaluation of rules for small business impact. To make a long story short, we have committed that, on our end of the bargain, we will look carefully at any regulation with an impact on small business, and if they have not adequately taken into account the impact on small business, we will return that rule to the agency for reconsideration.

I have a more extensive set of remarks in my written testimony, but I hope I have kept within the time limit. Thank you.

Chairman PENCE. Well, you have. Thank you, Dr. Graham, for those insightful remarks; and we look forward to—both chairs look forward to dialoguing with you about the issues that were raised. We will enter your entire prepared statement into the record, without objection.

[Mr. Graham's statement may be found in the appendix.]

Chairman PENCE. Our second witness is a former Member of the House of Representatives.

Congressman David McIntosh is a partner at Mayer, Brown, Rowe and Maw. He served in this institution from 1995 to 2001, where he chaired the National Economic Growth, Natural Resources, and Regulatory Affairs Subcommittee of the Government Reform and Oversight Committee. As I mentioned earlier, he was the Executive Director of Vice President Dan Quayle's Council on Competitiveness.

While a Member of Congress, he authored many signature pieces of legislation, including, most notably, the Congressional Review Act, which became law and was deployed even by this Congress in its early days to address concerns Members of the House and Senate had over onerous regulations in the area of ergonomics. He has left an enormous footprint on this institution in the area of regulatory reform in particular, and we are honored to have him here.

The gentleman from Indiana is recognized for 5 minutes.

STATEMENT OF THE HONORABLE DAVID McINTOSH, FORMER MEMBER OF CONGRESS, PARTNER MAYER, BROWN, ROWE & MAW, MUNCIE, INDIANA

Mr. MCINTOSH. Thank you, Mr. Chairman. Thank you both, Chairman DeMint and Chairman Pence. It is an honor to be here sitting in this seat before you.

I would say, Mr. Pence, there are four members of the McIntosh family that are indeed glad that we have traded places; and I want to commend you on the great job you are doing and urge you to continue.

It is also an honor to be here with the OIRA administrator, Dr. Graham; and I would second his initial insight about the tension between big business and small business. In fact, over and over again, it has come to my attention that that is what is behind many of the regulatory initiatives.

In fact, when I worked with Vice President Quayle, a well-intended lobbyist from one of the Nation's large businesses came in and said, we like what you are doing in cutting back on unnecessary regulation, but do not forget there are some regulations that are good. And I said, which ones do you have in mind? He said, well, there are some that we like because our competitors cannot quite comply with them yet. A moment of candor, and it gave me a great insight into what perhaps some of the motivation was behind different programs.

So, John, I would wholeheartedly agree with you and keep that perspective.

What I would like to do today is focus on a couple of main points in my testimony, and then perhaps others can be explored in response to your questions.

First, the Crain/Hopkins study I think is alarming in that it shows that the costs are so high, $800 billion, that the disproportionate impact on small businesses, a 50 percent higher cost per employee, which effectively means every day when they are deciding do I add another employee to my business, they realize that it is going to cost them on the order of $8,000. It is an inhibitor for job growth and for recovery in our economy. I think it is alarming and something that everyone in the administration and in Congress should take to heart.

Looking at SBREFA and the way it has been functioning, there are many good things in there in terms of furthering the emphasis on cost-benefit and looking at the impact on small business, but there are a few ways in which I think this Congress could try to strengthen that act, and I wanted to particularly draw your attention to those.

One of them is that the 605(b) certification process seems to be greatly abused, where an agency does not have to go through a review of what the costs are to small business if they certify that the regulation will not significantly impact the small business. I would suggest that Congress look at a mechanism, perhaps similar to what it has set up in the Paperwork Reduction Act, where a central office has to sign off on that certification, perhaps OIRA, perhaps the SBA chief counsel, before that certification can allow them to escape the requirements for doing an impact analysis.

The second point is that the regulations should clearly apply to standards that are not directly administered by an agency but set the standard for regulations at the State level. You think of the ozone and particulate standards that EPA issued a few years ago. They claim they did not have to do a small business impact, even though it would cost hundreds of millions of dollars to small businesses, because, ultimately, all it did was set a standard that then 50 State governments had to implement in their clean air regulations. So by extending the application of SBREFA to those type of regulations, I think you would do a great service.

The third is to more explicitly include an estimate of cost in the impact analysis. There I think OIRA has a tremendous definition of what costs and benefits should be included in their analysis, extend those definitions statutorily into what should be done by the agencies to make it clear that they have to identify cost as they do their analysis.

Then, finally, one of the things that I think would be helpful is to direct the courts to give deference to the Small Business Administration in determining cases on how SBREFA should be applied to the agencies. Normally you have, under the Chevron decision, a great deal of deference to the agency that administers a program, but in this case, because the Small Business Administration does not actually administer the regulatory program, their view of what is required under SBREFA is not granted that type of judicial deference. You have a very good set of people there in the Small Business Administration who are familiar with the type of problems that different regulatory programs cause and direct the courts to give them that deference.

The other parts of my testimony I would be delighted to talk with you about in question and answers, and I do appreciate you holding this hearing so that you can raise the standard for people in government and outside of government. Thank you.

Chairman PENCE. Thank you. We will enter the balance of your prepared remarks in the record for this hearing without objection.

[Mr. McIntosh's statement may be found in the appendix.]

Chairman PENCE. I want to defer to Chairman DeMint, since I gave the first opening statement, if he wants to begin the questioning.

Chairman DEMINT. That is the kind of thing I guess that is politically good to talk about, and ever since I have been here we talk about the regulations and the cost, particularly on small businesses. I have had a lot of hearings myself. I, frankly, would like to know from you two if you had one suggestion as far as what we could do, not just as a part of this Committee, because this Committee needs the help of a number of others and the leadership to actually make some things happen, but what would you suggest we do to begin to make a dent in what is obviously a bad situation for our economy and our global competitiveness and the encouragement of entrepreneurism and innovation? I am just looking for a few little things I can sink my teeth into and maybe actually try to get something done. So I will start with you, Dr. Graham.

Mr. GRAHAM. Well, let me start on the analytic side of the case for reform of regulation to protect small business. I think there has been, for a number of years, a good analytic case of the substantial

costs of regulation on the small business community and the disproportionate nature of that cost. My own opinion is that the weakness in the analytic case is that we do not have the parallel body of information on the benefits side.

The reason why that is important is that many people who believe that sometimes regulation is necessary fear that if we were to take away regulatory protections, it could either harm the consumer, the worker, or the environment or so forth. Until we get a good analytic foundation—like we have provided on the cost side of the ledger—on the benefit side of the ledger, we are always going to be vulnerable to people speculating about what is going to happen if you remove these regulations. I think that there should be no one in either party or of any ideology that should be against a good collective and a good objective body of information of what we really know about the benefits of these regulations that disproportionately impact small businesses.

Mr. MCINTOSH. Let me add to that something that Dr. Graham worked on prior to coming to government. Risk assessment should be a key part of that benefit analysis, because it lets you in many ways prioritize which type of regulations give you, in the terms of health rather than cost, the greatest benefit, something we tried to do when I was in Congress but were unable to because of the political configuration of the Senate in the Clinton administration. That is a large project but one well worth fighting, because essentially what it does is it directs this whole regulatory apparatus towards maximizing the benefits out of it. They focus on those things that are most risky to people. Believe it or not, that is not what the government does currently, time after time.

I guess if there were a statutory provision that I would recommend that focus be put on in terms of SBREFA, I think it would be that certification process where you have a mandatory check off by that centralized agency. The Paperwork Reduction Act is probably the most successful of all of the different congressionally created or administratively created review processes, because the form is invalid if the agency does not comply with it. Dr. Graham administers that program in OIRA.

Taking a look at it from a larger scheme, there are two notions that I did not mention in my testimony but I think are important to start the dialogue on. One is finding a way to have more accountability by elected officials for regulatory decisions.

The Congressional Review Act was a start in that direction, but one way conceptually to really make that effective is to change the presumption. The presumption in the Congressional Review Act is, if Congress does nothing, the regulation goes into effect. If you flip that and say until Congress ratifies the decision by the agency, and you would obviously have to limit it to major regulations or significant impact regulations, that would change the whole dynamic.

Now, having sat in your seats, there is a lot of consequences that go with that, and there will be a lot of your colleagues who are perhaps happy not to have that type of accountability. There is a record created if they vote yes or no on a clean air regulation. But I think in our democratic system that type of accountability will lead to a better product by the Federal Government.

The second large conceptual issue that I would love to see people work on is taking a look at the enforcement side and asking ourselves, what has happened in the last 100 years as we moved from an administrative state that did not have these regulatory bodies into a regulatory state for much of the Federal programs? Specifically, what has happened to the procedural protections in the Bill of Rights when those rules and regulations are enforced?

It would be my premise that many of those protections have gone by the wayside. You still technically have the right to have your day in court and the fifth amendment, the seventh amendment, all of the different protections that go with that, but the reality is the enforcement of most of these programs is done by injunction, it is done by failure to give approval for a new product, it is administered through processes and remedies that the government has that are extrajudicial.

One thing Congress should look at is, how do we apply those Bill of Rights or the concepts in the Bill of Rights to provide protection to the innocent citizen or small businessman or company when they are up against the leviathan of big government implementing these regulatory programs? It would protect against the petty bureaucrat who has a lot of power and very little control and oversight, but it would also, I think, force the government to do a better job in selecting how they enforce these regulations in the same way we feel that the Bill of Rights helps ultimately law enforcement do a better job of focusing in on its efforts to apprehend criminals.

So those are two large conceptual areas that much work would need to be done to lay the groundwork to support those. But if you are of interest in those, I would be delighted to further work with you on them.

Chairman DEMINT. I hope to follow up, and I thank you.

I yield back, Mr. Chairman.

Chairman PENCE. Dr. Graham, first, a very specific question that has to do with the status of the executive order that the President promised on March 19 of this year. What is the status of that order from the perspective of your office?

Mr. GRAHAM. Well, I can tell you what I know about the status of it. The executive order process involves first the Executive Office of the President getting comfortable with a first draft and then sharing that with the agencies for interagency review. Then we come back and try to resolve any issues that are involved. So that is the three-step process.

We are launched now into the second step where there is a draft, and it is undergoing interagency review. There will be comments taken, and then there will be a final piece put together.

But you can be assured that there are people working hard on that, and we are definitely committed to an executive order that in particular will strengthen the ability of the Advocacy Office at the Small Business Administration to do their work and assure that agencies comply with the Reg Flex Act.

Chairman PENCE. Well, let me say from the standpoint of this Subcommittee it would be our hope and, frankly, our expectation that the executive order have the strongest possible language to give the OIRA and SBA's Office of Advocacy the tools they need to ensure that agencies comply with the Reg Flex Act; and that, if

that was not the case, that you might be able to carry back to the deliberations that certainly this Subcommittee and perhaps Mr. DeMint's Subcommittee and maybe the full Small Business Committee would likely have a hearing on that issue, if not more.

Let me go specifically to some of your prepared testimony that I looked at last night. In today's remarks, you used the phrase that OIRA is prepared to return any draft rules for agency reconsideration if they have not taken into consideration the impact of a draft rule on small business as required under Reg Flex Act. How do you plan to decide—how does your office, rather, plan to decide if an agency has taken small business into consideration? What is the objective or subjective standard for that reconsideration?

Mr. GRAHAM. Excellent question.

I guess the first point I would make, to be candid, is that the Office of Information and Regulatory Affairs is an organization that has a career staff of about 50 employees, and that compares to on the order of thousands upon thousands of people in the various agencies. We have 4,000 regulations each year—600 of them are significant, 50 to 100 of those are economically significant. So the first point I want to make is that, given all of the considerations that we look at when we review a regulation, while the small business consideration is extremely important, there are a variety of other considerations that are mandated in the executive order. For example, we look at overall cost-benefit on society—and that is why we believe that the role of the Advocacy Office at the Small Business Administration is, in fact, so critical.

Because we do not have the detailed staff understanding of guidelines around what is an adequate analysis for small business, we do not have the experience of dealing with agencies specifically on small business issues that the Advocacy Office has. We will be looking to Mr. Sullivan to give us an objective opinion on each of these rules on whether or not the agency has, in fact, treated the small business issue fairly.

Now what we have pledged to do in the memorandum of understanding is, if Mr. Sullivan's office indicates that there has not been an adequate regulatory flexibility analysis and if we believe that judgment is a reasonable one, then basically we do not need to get to a lot of other issues. My boss, Mitch Daniels, has told me that, at that point, the rule goes right back to the agency.

Chairman PENCE. Okay. One question for Mr. McIntosh. I am very intrigued by some of the proposals that came up in your testimony with Chairman DeMint. But, specifically, in your written testimony you spoke about a new role for OIRA and SBA's Office of Advocacy in agency reg-flex certifications. Can you expand on that, what the impact of that would be and what specifically you were alluding to?

Mr. MCINTOSH. The practical impact would be to take the process that Dr. Graham just described and make it mandatory, that some combination of those two offices would have to grant—and the way they do it in the Paperwork Reduction Act is they give a number that is put on the form that shows it has been cleared by OIRA, but some indication to the world that that impact analysis has been signed off on. Perhaps because of staffing constraints, maybe the Small Business Advocacy Office is the best of the two, or let

the President decide. There are ways, multiple ways Congress could choose to do that.

But essentially what it does is give private rights to the regulated community. If those regulations have not had the impact analysis done adequately, then the regulation would not be enforceable against those small business entities. A powerful tool, because what it does is it dramatically increases the seriousness with which the agencies have to do that review.

One other thing. Data collection that you all could consider along the way would be—my recollection was that GAO did a study in the Clinton administration that was referred to the Subcommittee I chaired on compliance with SBREFA, and you might consider asking GAO to update that study to see—and that, I think, would help Dr. Graham also in identifying if there are some agencies that have a tendency to ignore the requirement for the small business impact.

Chairman PENCE. I am told that Chairman DeMint for this panel did not have any additional questions, so I will maybe offer one generic question to both of our witnesses before we dismiss and go to the next panel. It might have to do with what Congressman McIntosh was just alluding to, and that is the data issue. How do you think we can improve the data that is available on the impact on small businesses that you have? Are there recommendations that these subcommittees could consider and proposals Congress could consider?

I will recognize Dr. Graham first.

Mr. GRAHAM. Well, I cannot give you a comprehensive answer to that question, but I think I can give you a very interesting example of the problem we face with data.

The National Highway Traffic Safety Administration, the organization that regulates car safety and tire safety, is now in a major proposed rulemaking on improving the quality of tires. In their proposed rulemaking, they have apparently determined that there are no small businesses affected by the particular proposed rule dealing with tire safety. We have had both letters and visits from companies—people who are in the tire business, who profess to me that they are executives in small businesses, who look, as far as we can tell, like they are small businesses. Yet we have an official Federal Register notice out there by the Federal agency stating there are no such businesses in the United States of America.

It is fascinating to me to think through the question; how are we going to get agencies at least to the point that they are aware that there are small businesses in some of these industries that they are proposing rather substantial regulations to affect?

Now, I think those businesses did submit comments through the public comment process to NHTSA. We are certainly hopeful that they will take seriously their concerns. But obviously we have a data problem when we have agencies declaring that there are no small businesses within a particular industry, when, in fact, we are having visits from businesses who are well aware of these regulations and concerned about them.

Mr. MCINTOSH. Let me mention one other idea that has been worked on in the past and I think would help in the acquisition of data. That would be a move toward a regulatory budget that would

be in the same time frame and the same process to the spending budgets that the agencies put forward, again, with OMB in the same role they are as with the budget, having a lot of insight and control over what the agencies do to make sure they comply with the President's policy directives. There is a lot of work that would need to be done, but the requirement of a budget would then force agencies to provide data about what are the costs and benefits of their various regulatory programs.

Chairman PENCE. On behalf of both subcommittees, allow me to thank this panel for your very thought-provoking commentary. With that, you are dismissed; and we will invite our next panel to take their seat at the table.

Mr. GRAHAM. Thank you to both of you.

Mr. MCINTOSH. Thank you very much.

Chairman PENCE. We will now entertain testimony from the second panel in this hearing on the cost of regulations to small business convened by the Subcommittee on Regulatory Reform and Oversight and the Subcommittee on Workforce, Empowerment, and Government Programs of the Committee on Small Business.

We welcome our new panel. We thank you for your willingness to participate in the process; and, as was mentioned to the previous panel, you will be recognized for 5 minutes. We ask you to respect the light board in front of you and conclude your remarks at the appropriate time. Knowing that all of your prepared remarks will be entered into the full record of this hearing, so you need not feel hurried or rushed but rather might take the minutes that you have to amplify points that might be of particular interest to the two Chairs represented here.

Next, the subcommittees will hear from Dr. Robert Hahn. Dr. Hahn serves as the Director of the AEI-Brookings Joint Center for Regulatory Studies, as well as a research associate at Harvard University. Dr. Hahn has his Ph.D. in economics from the California Institute of Technology and previously served as a senior staff economist in the President's Council of Economic Advisors. He has written extensively on the topic of regulation and is regularly consulted by government agencies for his expertise and acumen.

Dr. Hahn, we are grateful for your participation in this panel and for traveling to this joint hearing. You are recognized for 5 minutes.

STATEMENT OF DR. ROBERT HAHN, DIRECTOR, AEI-BROOKINGS JOINT CENTER FOR REGULATORY STUDIES

Mr. HAHN. Thank you, Chairman Pence and Chairman DeMint. It is a pleasure to be here. I think looking at the impact of regulations on small business is a very important topic, and I think Dr. Graham and former Congressman McIntosh made several points that I would agree with, and I am not going to dwell on them.

My general view of the impact of regulation on small business is related to a quotation I think that was due to Oscar Wilde where he said, "I have been rich and I have been poor and rich is better," and for those reasons, you might imagine why small business sometimes gets the short end of the stick.

One of the issues that you raised, Chairman Pence—and Dr. Graham, who was formerly my colleague at Carnegie-Mellon, I

know is intensely interested in—is how you get better information into this process? I simply want to state for the record that I think the general quality of information is fairly poor in the regulatory process, and the Joint Center has several researchers who did a study that I cite in my testimony, which talks about the fact that many of the regulatory analyses that we reviewed over the last several years did not even seriously consider regulatory alternatives or costs and benefits. So it is hard to make a strong claim that the quality of information that we are getting generally is very good.

What we tried to do in this joint testimony—and I should say that it is joint testimony with my co-director, Bob Litan of the Brookings Institution, who sends his regrets for not being able to be here today—is to develop a set of recommendations that we think would engender bipartisan support. They are probably not as far as we would go individually as economists, but, nonetheless, we recognize or at least we think there is not a very strong sentiment for changing the world radically with respect to regulation and its reform right now. So we think some incremental steps in the direction of reform would be welcome.

We go a little bit further in our comment on the OMB draft report, which I also left on the table over there and would be happy to e-mail to you if you would like to see it.

So let me just briefly turn to the recommendations. We can talk about them, and feel free to stop me if you have questions.

The first one, though it might seem unobjectionable, is not happening as quickly as we might like. That is for the agencies to get the regulatory information out there before the decisions are actually made. Specifically, we say that Congress should require that agencies make each regulatory impact analysis and supporting documents—and I think that is important—available on the Internet before a proposed or final regulation can be considered in the regulatory review process. Why? Because we think one very important aspect of improving Federal regulation is increasing transparency in the regulatory process. We have the Internet out there. Why not make better use of it?

Dr. Graham has done a great service to the public by putting more and better information on the OMB website. I think some of the other agencies are moving in that direction. I would like to see them move faster, and I would also like to see that include independent agencies.

Our second recommendation may sound surprising. All we would ask is that in the regulatory impact analysis that agencies are required to do for regulations that would impose burdens on the economy exceeding $100 million annually, that they include a simple executive summary with what we call a standardized regulatory impact summary. I include an example of the regulatory impact summary at the end of the testimony. It contains questions such as; Did you consider cost? Did you consider benefits and so forth? What is your bottom line?

So, if you are not interested in reading 300 pages of gobbledygook you can see what the bottom line is very quickly, or your staff can cut to the chase fairly quickly.

Our third recommendation, which is something I feel most strongly about, is that the Congress consider establishing what we

call Congressional Office of Regulatory Assessment. The essential idea is to be a counterpart to OIRA. Why? To keep it honest. We have the same process going on now with the Congressional Budget Office and the Office of Management and Budget. We already have legislation on the books, I believe, in the Truth in Regulating Act that puts this function at GAO.

Both Professor Litan and I think it would be a really good investment to appropriate the $5.2 million annually for the pilot project at GAO that is in that legislation. We think that OMB is constrained in what it can say about certain regulations because it is part of the White House and the executive apparatus. Having an agency that is outside of OMB providing an independent assessment is a good thing. So that is our bottom line there.

I see that I am out of time. I will stop there; and if you want to talk about any of my other recommendations, we can do that. Thank you very much for giving me an opportunity to talk.

Chairman PENCE. Thank you very much, Dr. Hahn. I am sure that Chairman DeMint and I will both have questions to follow up on your prepared remarks and your comments today.

[Mr. Hahn and Mr. Litan's statement may be found in the appendix.]

Chairman PENCE. The subcommittees will now hear from Andrew Langer, who is manager of Regulatory Affairs at the NFIB. Mr. Langer previously served at the Competitive Enterprise Institute and Defenders of Property Rights and is recognized for 5 minutes with appreciation.

STATEMENT OF ANDREW LANGER, MANAGER, REGULATORY AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. LANGER. Thank you, Chairman Pence and Chairman DeMint. It is my pleasure to be here before you today representing the National Federation of Independent Business.

A reasonable government regulation, especially on onerous paperwork burdens, continues to be a top concern. Regulatory costs per employee are obviously, as we have said, highest for small firms; and our members consistently rank those costs as one of the most important issues that NFIB should be working on. Thus, I am very pleased to be here to offer my perspective on behalf of the regulatory state on small business.

Our members view regulation as a serious problem. Most small business owners are unhappy with the difficulties regulation creates and the time it takes them away from their business, rather than any limitation on freedom those regulations might impose; and they identify Federal regulation as the biggest culprit in creating those difficulties.

The volume of regulation, obviously, is enormous. We all know just how long the CFR—how far the CFR is, how long it extends, 19 running feet; and that is only codified rules and not the other myriad documents that small business owners must follow.

But most important, of course, is the direct costs. As we have said, a couple of people have said repeatedly here, for businesses with fewer than 20 employees, which accounts for roughly 90 percent of all small businesses, the cost of regulation per employee is

nearly $7,000. Health, safety and environmental regulations are a huge chunk of this, of course, and the Crain/Hopkins study confirmed that.

But, unfortunately, it is difficult for our members to point to a single regulatory scheme which poses problems. To them, regulation is death by 1,000 pinpricks, the sheer volume of requirements coming at them from every direction.

NFIB continues to examine the impact that multiple agencies and duplicative regulatory regimes have when dealing with a single regulated entity. To us, a prime candidate for further examination is the soon-to-be-implemented reporting requirement for lead under the toxics release inventory. This new standard alone will, by EPA's own estimates, cost a small business owner 60 hours to prepare their necessary paperwork, and if errors should be found by EPA in that paperwork, an owner will spend an additional full business week correcting that problem instead of engaging in their business. Clearly, this is problematic, especially for a regulation which may not ought to have been implemented in the first place.

On the other hand, it is the paperwork associated with tax preparation that our members cite as their biggest regulatory headache. What began in 1913 as a two-page form backed up by 14 pages of law has now become a 17,000-page maze that requires 703 different forms. The Tax Code's 5.5 million words have created a nightmare of complexity that zaps the economy's strength by punishing work, saving, investment, risk taking and entrepreneurship, the backbone of our economy.

We believe Congress can make great inroads into relieving tax-related paperwork by, for instance, increasing section 179 expensing limits, addressing the alternative minimum tax, establishing a standard home office deduction, and clarifying the definition of what it means to be an independent contractor.

But NFIB wants to make certain that both subcommittees are aware of the efforts being made by this administration to shape policies which are small-business-friendly. As you know, President Bush himself made a commitment on this when he outlined his proposals on behalf of small business, and the IRS continues to address small business owners' greatest headaches with tax paperwork by, for instance, clarifying the rules on cash versus accrual accounting methods.

We are also pleased with how SBREFA requirements are being met by this administration but believe that, as always, more can be done. OIRA and SBA have continued to be particularly helpful. Not only has the Office of Advocacy board been working closely with OIRA in improving regulations themselves, but both are making great strides in reducing the overall burden by making what remains easier to understand. OIRA's efforts can only serve to benefit the small business community; and the use of such tools as prompt letters, return letters and especially comparative risk analysis will only help improve the regulatory state.

But one of our concerns is that OIRA, an organization that really does "get it," may not have the manpower necessary to take on the Herculean task of a regulatory state that continues to grow. And I would ask—we would ask that among the recommendations that

your Committee ultimately makes is to help OIRA by giving them the tools necessary to deal with what is absolutely an essential job.

We also appreciate the SBA administrator's efforts and those of his team. The Office of Advocacy is at the forefront of groups fighting on behalf of small business owners everywhere; and we are grateful that the Ombudsman Office, one that really has not gone recognized in this hearing, has made a strong commitment to ensuring that our members and other members of the community are not trampled by agency overreaching.

Thank you all for the opportunity to testify, and I look forward to any questions that you might have.

Chairman PENCE. Thank you, Mr. Langer.

[Mr. Langer's statement may be found in the appendix.]

Chairman PENCE. Our last witness comes not from the halls of government or the academic world but brings with him the bona fides of the trenches of small business America. We may well have saved the best for last.

The Chair recognizes the small business owner from Avon Lake, Ohio, Mr. Raymond Arth. Mr. Arth is President of Phoenix Products, a Cleveland-based faucet maker. Mr. Arth also serves as a member of the National Small Business United Board of Trustees and is currently chairman of their Legislative Affairs Council.

We are grateful in the midst of your busy schedule that you would travel to our Nation's Capital and bring your particular expertise to this conversation today. And you, Mr. Arth, are recognized for 5 minutes.

STATEMENT OF RAYMOND ARTH, PRESIDENT OF PHOENIX PRODUCTS, AVON LAKE, OHIO, FOR THE NATIONAL SMALL BUSINESS UNITED

Mr. ARTH. Thank you, Chairman Pence and Chairman DeMint.

Chairman Pence, you have already done my introduction for me, so we will see if we can get this done in a little less than 5 minutes.

As a small business owner and as a representative of National Small Business United, I can tell you that we support many of the points that have already been made, and I will try to avoid repeating information that has already been given.

The Crain-Hopkins report has had a lot of attention. I will tell you as a small business owner that the numbers feel right. There are people in my company and activities that we do that I can point to and say, this has nothing to do with running my business; this has to do with keeping me out of jail, avoiding penalties, avoiding fines, and so forth. And, unfortunately, a lot of those activities aren't necessarily making my workplace safer, making my benefits more fair to the employees, and things like that.

I think the numbers have a certain feel that, as I say, it kind of feels right to me. And to cite one number, they mentioned that the cost for manufacturers, which would be me, is about 3.4 percent of revenues. That is greater than my historical net before taxes earnings over 25 years in business. That is millions of dollars that my company has spent that didn't go into new products, improving processes, creating new jobs. And while not all regulations are bad, a lot of the hoops we have to jump through, as I say, don't

make the world any safer, don't make our products any safer, and doesn't improve the workplace to a great degree.

I also would like to emphasize a point that was made earlier in testimony about the impact that regulations have on job creation. Three years ago it was a stated goal at our company to increase our output without increasing employment. We had 98 employees at that time. We did not want to pierce the 100-employee threshold because a new round of regulations kick in at that point. Unfortunately, fate and the economy have intervened, and today we are now down below about 60 employees. But, again, recognizing the costs associated, we don't run out and add bodies, we try to find other ways to get production done and other ways to run the business without adding to the cost of payroll and full-time employees.

I would like to focus the balance of my comments here on that portion of my testimony that referred to a tax study that was recently completed and issued by NSBU. It was conducted for them by the Prosperity Institute, and the point of that study was to really focus on the way that the Income Tax Code deliberately or inadvertently discriminates against small business. The report has been circulated; I have a copy here that I could leave as part of the testimony, if that's appropriate, and it would be available at the NSBU Website, www.nsbu.org.

But essentially what they have done is looked at the way the Internal Revenue Code tilts the game in favor of bigger companies, in favor of C corporations versus sole proprietorships, kind of perverse situations where we want to encourage small businesses to offer fringe benefits, but we tie the hands of the small business owner in terms of the deductibility of their own costs for the benefits they offer to their employees; rules for qualifying plans that make it difficult to offer qualified benefits in the smallest companies; situations where you need at least seven employees before you would be able to meet the matching tests to have a qualified life insurance program, for example; all sorts of top-heavy testing that is required of small business owners.

I sponsor a 401(k) plan. I match my employees' contributions. That match almost literally comes out of my left pocket, which is the one I think of as the business, as opposed to the right pocket; yet my contributions to the plan are a function of my employees' contributions. There is no counterpart in the large corporate world where the owners, the leaders of those companies, have their hands tied, have their benefits restricted the way we do in small business.

And perhaps what is most frustrating about all of that is that it is hard to understand some of these rules, some of these regulations unless you assume that the people who enacted them believe that as a small business owner I am dishonest, I am unethical, I am ignorant, maybe I am stupid, because otherwise a lot of these things just don't make sense. It takes quite a toll as well.

That said, I think I will wrap up my comments and be glad to answer any questions. Thank you.

[Mr. Arth's statement may be found in the appendix.]

Chairman DEMINT. Mr. Langer, you mentioned the Tax Code, and that is probably the biggest regulatory problem of small business, and certainly I have experienced that. Does NFIB support a particular type of tax reform? And I hope you would support the

current sunset, the Tax Code proposal that we are trying to get back on the floor.

Mr. LANGER. Well, we are working on a number of different things. To be honest, tax issues aren't my specialty. I came on board NFIB just under 2 months ago to deal with general regulatory issues. And so I would be happy to share with you and bring with you NFIB's experts on that subject, if you would like.

Chairman DEMINT. Good. I look forward to that.

Mr. LANGER. And certainly NFIB's position is definitely reflected in my testimony on those issues.

Chairman DEMINT. Mr. Chairman, I don't have any additional questions. Thank you.

Chairman PENCE. Thank you, Chairman.

A couple of questions. Dr. Hahn, we are told on our Subcommittee that the problem with our current regulatory structure is that agencies not only use, as you said today, inadequate data, but they also use bad analysis to show that benefits outweigh costs. And in a meeting in my office not long ago with someone you would have heard of in the administration, that was in full display, that there just seems to be bad information that is followed by bad analysis.

Now, today you are saying that the Agency's own regulatory impact analyses, which are designed to prove their case, don't even pass the costs/benefit test. Is that your assertion today, or am I misreading your testimony and your comments?

Mr. HAHN. I think you are reading them correctly, but I wouldn't call it an assertion in the sense that I think that I have data to support that statement.

Let me respond to your comment a little bit more broadly. Now, Justice Stephen Breyer, who I consider one of the wisest and most intelligent people on the planet, wrote a book some years ago called Breaking the Vicious Circle. He was concerned with the fact that we had regulations—and I might not be getting this exactly right, but we had a Superfund regulation that he had to look at when he was on the Court. The essence of the regulation was that you had to make the dirt around a Superfund site clean enough so that if a kid ate it 300 days in the year, it wouldn't kill him by the time he was 70. And Justice Breyer probably scratched his head and said, well, what is wrong here? What is wrong with this picture? And part of what was wrong was fundamentally the way we structure our regulatory agencies today.

Each of our agencies is given a single mission: EPA, the environment; NHTSA, traffic safety; and you could go down the list, Consumer Products Safety, and so forth.

So, how did they further their own agenda? Well, they furthered their own agenda by trying to promote regulations in their domain. And so Justice Breyer labeled this phenomenon "tunnel vision". But a less polite way of looking at tunnel vision was the example you just gave, where there are incentives that people face in these agencies to develop regulations that look good when a disinterested observer like myself might say they don't pass a benefit/cost test.

I have seen such biases several times when I was working at the Council of Economic Advisers, where I really underwent a rude awakening, because I thought—when I used to teach cost/benefit

analysis at Carnegie Mellon, I used to teach and say these are the principles; and I came down here, and noticed all the fudge factors being written in, and the way benefits and costs were counted were not kosher, so to speak.

It is a very real problem. OIRA, to some extent, puts some constraints on that process. The reason I strongly endorsed the Congressional Office of Regulatory Analysis or its counterpart at the GAO is because I think it would also serve as a constraint—putting agencies on notice that, if they do bad quality regulatory analysis, you folks are going to hear about it and respond accordingly.

Chairman PENCE. Thank you.

Mr. Langer, your comments were memorable, particularly your reference to regulation as death by a thousand pinpricks. Good description.

Mr. LANGER. Thank you.

Chairman PENCE. What do you think we can do to get agencies to look beyond themselves, as Dr. Hahn just suggested, and see their regulations in a larger context, to understand that they are not the only agency that is regulating small business, and do the cost/benefit analysis in—whatever the opposite of a vacuum is. Many of them, as Dr. Hahn just implied, regulate as though they were operating in a vacuum. And how do we get on a practical level?

Mr. LANGER. Well, I think some of the best guidance can be had from the Office of Advocacy at SBA. You know, I think that using that office to act as a liaison, creating working groups between various agencies on regulations might be the best possible way to do it. If you get the agencies working together to see that their regs aren't alone, then we might be able to get some traction on this.

I think also that OIRA needs to be expanded. I briefly touched on that in my comments. It is very clear from OIRA's draft report to Congress that, well, they are only starting now to increase their staff levels. Their staffs have been decreasing for some time. I think it is very clear that in order to make greater headway—I mean, the fact is OIRA has gotten roughly 1,000 comments on their draft report to Congress, I think a little bit more, and it is going to take them quite a while to wade through those in addition to everything else that they are doing. I think giving OIRA additional resources and allowing them to have additional staff will allow them to get a better handle on these sorts of regulatory problems.

So I think with OIRA and the Office of Advocacy, the two of them really have to work together on this, and that is pretty much it.

Chairman PENCE. One last question for Mr. Arth, who I think wins the prize for the most eloquent statement of the day, Mr. Chairman, when he said, "A lot of these just don't make sense." I thought that really summed up what we struggle with. And although on that side of the table is a guy who is out there making a company work, it may seem as though people on this side of the table don't appreciate that reality, but many of us do, and I appreciated your candor.

A quick yes/no answer from your standpoint. Would you like to see the IRS subject to the Regulatory Flexibility Act? An awful lot of your comments related to the impact of the Internal Revenue

Service on your business and IRS as a regulatory agency. Do I imply from your comments that that is a strong affirmative?

Mr. ARTH. Yes. You asked for a quick yes/no. I will say yes, absolutely.

Chairman PENCE. Let me—duly noted.

Let me ask you a question about kind of where we started in the last panel. And, forgive me, Mr. Arth, I don't know if you were in the room when we began.

Mr. ARTH. Yes, I was.

Chairman PENCE. But Dr. Graham early on and Congressman McIntosh talked about anticompetitive practices. From your standpoint in the faucet business, is it your impression—and also from your position as chair of the Legislative Affairs Council for National Small Business United—is it your sense that the source of the regulatory momentum in this country is in Washington, D.C., or do you suspect that it comes more from your larger competitors?

Mr. ARTH. No. Quite frankly, I think that really the source is more here in Washington, D.C., but once we start down that path, I would say my competitors will look for opportunities to spin it to their advantage. And if you have a moment, I can give you a quick example.

Chairman PENCE. Sure.

Mr. ARTH. The 1996 safe drinking water amendments enacted required a new regime for chemical leaching with a heavy emphasis on lead leaching from brass castings into drinking water. The scientific basis for this whole thing is very questionable. I have talked to the chief engineers of Delta and Moen and others, and none of them are really convinced we have made the world any safer for our children or anyone who draws a glass of water out of our products, but their costs of compliance and my costs of compliance are virtually identical. I am talking probably close to a couple hundred thousand dollars over the last couple years for me to get lead letters, get product listings and all of the different things that are required, whether I am selling 2 million faucets a year or I am selling 2 million faucets a week. And so it clearly does put me at a competitive disadvantage just because the economies of scale really work to their benefit.

It was an industry consensus standard. The faucet manufacturers were there, but, of course, it was the big guys who have the engineering staff and the depth of resources to staff those committees. And I won't accuse anyone of nefarious motivations, but I have seen firsthand how all of us complying, the impact is certainly very different.

Chairman PENCE. Well, let me say that is a wonderful stepping-off point, and maybe we could enlist Chairman DeMint, that our Subcommittee is currently taking a very hard look at the EPA lead rules and may well convene hearings in the near term to examine the impact of those regulations on small business, Mr. Arth. So you can add your name to the people that have encouraged us to do just that.

Mr. ARTH. Very good.

Chairman PENCE. But thank you for your candid remarks.

And with that, Chairman DeMint, did you have any further questions or follow-up, closing remarks?

I would just simply like to thank this very distinguished panel, Mr. Langer, Mr. Arth, and Dr. Hahn, very insightful remarks. And we are adjourned.

[Whereupon, at 3:20 p.m., the joint subcommittee was adjourned.]

Joint Hearing:
Subcommittee on Regulatory Reform and Oversight
& Subcommittee on Workforce, Empowerment, and Government Programs
The Cost of Regulation to Small Business:
2:00 p.m. June 6, 2002

Rep. Jim DeMint – Opening Statement

Chairman Pence, I appreciate the opportunity to join with you in convening this joint hearing to examine the cost of regulation to small businesses and entrepreneurs. As a former small business owner, I am personally aware of the extraordinary burden that excessive federal regulations impose. At a recent field hearing in Spartanburg, South Carolina, I heard from a number of constituents who are struggling to comply with regulations and it is clear that the burden is more cumbersome on smaller firms than larger firms.

As Representatives serving on the Small Business Committee, it is vitally important that we pay close attention to the personal and macro economic costs of regulations and other strictures that government unnecessarily places on small business owners. We on this committee need to be an advocate for clearing the way for entrepreneurs to be free to run their businesses not jump through bureaucratic hoops.

I am pleased to note that regulations issued under President Bush are down in number although they still remain very high. The 2001 Federal Register contained 64,431 pages, more than a 13 percent decline from 2000. I am concerned that the unelected are doing the bulk of lawmaking. While unaccountable regulatory agencies issued 4,132 rules, Congress passed and the president signed into law just 108 bills in 2001.

The five most active rule-producing agencies (the departments of Transportation, Treasury, Interior, and Commerce, and the Environmental Protection Agency) account for 48 percent of all rules under consideration.

I want to thank all of the witnesses who are participating in the hearing today and appreciate the work that was done on the papers entitled, "The Impact of Regulation on Small Firms" and the "Draft Report to Congress on the Costs and Benefits of Federal Regulations." I look forward to hearing your testimony.

Statement of Mike Pence
Chairman
Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
United States House of Representatives
Washington, DC
June 6, 2002

Our hearing today addresses the cost of regulation to the small business community. Countless efforts to reform and reign in the regulatory state have met with increasing resistance from the government bureaucracy. In 2000, the Code of Federal Regulations required over 74,000 pages to record every executive agency rule and if laid down next to each other the volumes would extend 19 feet. From 1991 to 2000, the Code of Federal Regulations increased by 28% and showed no signs of stopping in 2000 when 4,699 rules were codified.

Last year a report put out by the Small Business Administration's Office of Advocacy calculated the cost of regulations to our economy at $843 billion per year or $8,164 for every household. That number rivals our massive federal budget this year. Even more troubling than that were statistics gathered on the impact of these regulations to small businesses. Small businesses face a regulatory burden that is 60% higher per employee than large businesses. Dr. Crain and Dr. Hopkins estimate in their report that the average small business is burdened with almost $7,000 per employee in regulatory

compliance costs. The worst offender in the federal government when it comes to disproportionate costs to small businesses is the Environmental Protection Agency. Fully half of the estimated regulatory burden for small businesses identified in the report, comes from environmental regulation.

One of the most powerful weapons in our arsenal dedicated to beating back the regulatory state is the Regulatory Flexibility Act. And often our chief warrior in this battle is the Office of Information and Regulatory Affairs or OIRA in the President's Office of Management and Budget. It is OIRA's mission to hold agencies accountable to the laws that Congress has passed and the Executive Orders of the President when it comes to performing appropriate analysis of rulemakings. We are very pleased to have Dr. John Graham, the Administrator of OIRA, with us today to testify to his progress in restoring the proper role of his office in the federal regulatory process. Dr. Graham will also be discussing the "Draft Report to Congress on the Costs and Benefits of Federal Regulations" which his office is statutorily required to prepare. The Subcommittee has taken note of your reviews of existing regulations to improve their net benefits and we look forward to continued progress on reducing the cost of regulations that are currently on the books.

We are also very lucky to have former Congressman David McIntosh with us today. I can say without question that there are very few members of this chamber who could rival his knowledge of regulatory issues or who had committed so much of their time to this important issue. Clearly, your days as Chairman of the National Economic Growth, Natural Resources, and Regulatory Affairs Subcommittee and your work leading the Competitiveness Council in the first Bush Administration speak to the weight with

which your testimony is held by this Subcommittee. We are anxious to hear your thoughts on how the regulatory reform initiatives which you helped put in place are working and how we can be doing things better. Your outside perspective is especially appreciated since it has allowed me to follow you in representing the Second District in the great state of Indiana.

In a time when our economy relies so greatly on small businesses to keep our country moving, we can not afford to stifle that progress by continuing to pile on costly regulations that disadvantage these groups. Half of our national workforce is employed by small businesses and 2/3 to 3/4 of net new jobs are created by small businesses. Now is the time to do everything in our power to limit the reach of the regulatory state and lower the cost of regulation to small businesses.

I look forward to your testimony and to that of our second panel. We'll now have opening statements from the Chairman of the Subcommittee on Workforce, Empowerment, and Government Programs and our other members.

STATEMENT OF
JOHN D. GRAHAM, PhD.
ADMINISTRATOR
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
BEFORE THE
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
AND THE
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT, AND GOVERNMENT PROGRAMS
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

June 6, 2002

Mr. Chairman, and Members of these Subcommittees, thank you for inviting me to this hearing. I am John D. Graham, Ph.D., Administrator, Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget (OMB). This hearing is to address the OMB Draft Report to Congress on the Costs and Benefits of Federal Regulations and the Crain/Hopkins report on "The Impact of Regulatory Costs to Small Firms." You also asked me to testify regarding OIRA's work on agency compliance with the SBREFA amendments to the Regulatory Flexibility Act, and our assessment of current mechanisms to help reduce the disproportionate burden of regulations on small businesses.

The Crain-Hopkins Report

We too were struck by the basic conclusion in the Crain-Hopkins report that "Firms employing fewer than 20 employees face an annual regulatory burden of $6,975 per employee, a burden nearly 60 percent above that facing a firm employing over 500 employees." The managerial resources of small businesses are often limited and focused primarily on the needs of the business, not on the legal, administrative, and reporting requirements that come from Federal (or for that matter, State and local) regulations. The cumulative requirements of many different regulatory programs may be difficult to sort out and reconcile with the limited resources available. Federal agencies, in developing and implementing their regulatory programs – either directly or working through State and local governments – need to be sensitive and, to the extent

practicable, responsive to the concerns of small business.

The Crain-Hopkins report is a good first attempt (using existing State-level and national data) to estimate the competitive disadvantage that small firms face relative to large firms in complying with Federal regulations. However, firm-specific data rather than State-wide averages are really needed to estimate accurately the magnitude and significance of these effects.

The Crain-Hopkins report estimates, even if accurate, tell only half of the story. We need to know the benefits of compliance expenditures by firm size. For example, according to BLS, mid-sized establishments (50 to 249 employees) reported generally more injury and illnesses per employee than larger (and smaller) establishments. Before we implement the Crain-Hopkins finding that there are economies of scale in complying with regulations, we need to look carefully at the micro-data on the benefits and costs of specific regulations in general and by firm size in particular.

Regardless, the need for agencies to be sensitive to the concerns of small business about regulatory burden is highlighted by data that appears in the recently released "Unified Agenda of Federal Regulatory and Deregulatory Actions, Spring 2002." This Agenda projects the regulatory and deregulatory activities of Federal agencies in the period April 2002 to March 2003. There is much regulatory activity that will have an impact on small business. During that period, the Agenda points out that Federal agencies have under development a number of economically significant or major rules. The top five agencies are EPA (24), HHS (24), USDA (12), DOT (11), and FCC (11). The Agenda also identifies those regulations under development which may have a significant economic impact on a substantial number of small entities: FCC (102), HHS (41), Commerce (35), DOT (23), SEC (20), USDA (18), EPA (15), Labor (14), Interior (11), SBA (10), Justice (8), FRS (7), FAR (6), DOD (5), NRC (5), Treasury (4), DOE (1), FEMA (1), GSA (1), NEA (1), Institute of Museum and Library Services (1), and Architectural and Transportation Barriers Compliance Board (1).

President's Small Business Initiative

President George W. Bush recognizes these concerns, and, in March, announced a number of steps to help small business, some of which directly involve OIRA. One of these initiatives was designed to increase coordination between OIRA and the Office of Advocacy in the Small Business Administration. The Office of Advocacy was created by an act of Congress in 1976 to be a key voice for small business within the Federal government. The Office is headed by a Chief Counsel who is appointed by the President and confirmed by the U.S. Senate. One of the primary responsibilities of the Office is to monitor agency compliance with the Regulatory Flexibility Act to ensure that Federal agencies do not impose unnecessary burden on small entities when crafting regulations and analyzing less burdensome alternatives. OIRA is pleased to be able to partner with the Office of Advocacy as we work toward our mutual goal of reducing unnecessary regulatory burden.

Specifically, the President announced that OIRA and Advocacy were entering into a Memorandum of Understanding (MOU) to reduce the Federal regulatory burden on small entities, and generate improved agency compliance with the Regulatory Flexibility Act. In the MOU, the two offices commit themselves to work together to ensure that Federal agencies properly comply with the Regulatory Flexibility Act. The offices will share information to ensure that agencies adequately consider the impact of their proposed regulations on small businesses in their regulatory flexibility analyses and certifications of economic impact. This agreement between Advocacy and OIRA will help implement the President's agenda of tearing down regulatory barriers to job creation by giving small business owners a voice in the complex and confusing Federal regulatory process.

In this context, President Bush specifically asked OMB to work with Advocacy to strengthen the enforcement of the Regulatory Flexibility Act. This Act requires agencies to prepare an analysis of the impact of new regulations on small businesses before they are put into place. It is established practice for OIRA to share draft agency regulations that have a small

business impact with Advocacy while these drafts are under review at OIRA under E.O. 12866, and OIRA has been careful to hear from Advocacy and take its views into consideration in the course of this review. OIRA is prepared to return any draft rules for agency reconsideration if they have not taken into consideration the impact of the draft rule on small businesses, as required by the Regulatory Flexibility Act.

In another Presidential initiative, President Bush asked OMB to seek the views and comments of small businesses on existing Federal government regulations, paperwork requirements, and guidance documents. On March 28, OIRA published its Draft 2002 Report to Congress on the Costs and Benefits of Federal Regulations for 60 days of public comment (67 FR 15014). In that draft report, OIRA called for public nominations of regulatory reforms in three areas:

- Reforms to specific existing regulations that, if adopted, would increase overall net benefits to the public, considering both qualitative and quantitative factors;

- Identification of specific regulations, guidance documents, and paperwork requirements that impose especially large burdens on small businesses and other small entities without an adequate benefit justification; and

- Reviews of problematic agency "guidance" documents of national or international significance that should be reformed through notice and comment rulemaking, peer review, interagency review, or rescission.

In Chapter IV of the draft report, "Recommendations for Reform," OIRA specifically cited the core conclusion of the Crain/Hopkins report, repeated its request for comments "on needed reforms of regulations unnecessarily impacting small businesses" and stated that we will coordinate with Advocacy on this initiative. This March, we increased our outreach efforts to ensure that academics, business groups, State and local groups, and public interest groups were

aware of this Federal Register notice to encourage them to make comments and recommendations for regulatory reform.

OMB's Draft 2002 Regulatory Accounting Report

As directed by the Regulatory-Right-to-Know Act, the OMB 2002 Draft Report contains estimates of the total annual costs and benefits of Federal Rules and paperwork (a) in the aggregate; (b) by agency and agency program; and (c) by major rule. Our estimates from previous years have been updated to take into account regulations issued between April 1, 1999 and September 30, 2001. We also provide, as called for by the Act, analyses of impacts of Federal regulations on State, local, and tribal government, small business, wages, and economic growth as well as recommendations for reform. Moreover, the OMB 2002 Draft Report also includes additional information in the spirit of the Regulatory Right-to-Know Act about the Administrations's efforts to make its centralized approach to Federal regulatory policy more open, transparent, and accountable to the public.

I would like to highlight some of the major features and findings in the OMB 2002 Draft Report:

1. In the last six months, OMB has reviewed 41 significant Federal regulations aimed at responding to the terrorist attacks of September 11th. These rules address urgent matters such as homeland security, immigration control, airline safety, and assistance to businesses harmed by the resulting economic disaster experienced in several regions of the country.

2. The Bush Administration's approach to regulatory review, through OIRA, is characterized by openness, transparency, analytic rigor, and promptness. OIRA's website puts that perspective on display, with daily updates and an unprecedented amount of information about OIRA's activities. The 20 significant rules that OMB returned to

agencies for reconsideration from July 1, 2001 to March 1, 2002 are more than the total number of rules returned to agencies during the Clinton Administration. Inadequate analysis has been the most common reason for returns.

3. Under the Bush Administration, OIRA is taking a proactive role in suggesting regulatory priorities for agency consideration. In order to play this role constructively, we have devised the "prompt" letter as a modest device to bring a regulatory matter to the attention of agencies. OIRA's initial five prompt letters have addressed a range of issues including the use of lifesaving defibrilators in the workplace, food labeling requirements for trans fatty acids, and better information regarding the environmental performance of industrial facilities.

4. Pursuant to statutory mandate, OMB has issued government-wide guidelines to enhance the quality of information that Federal agencies disseminate to the public. OMB is now working with agencies to finalize their guidelines by October 1, 2002. These guidelines will offer a new opportunity for affected members of the public to challenge agencies when poor quality information is disseminated. OMB has required each agency to develop an administrative mechanism to resolve these challenges, including an independent appeals mechanism.

5. The OMB 2002 Draft Report summarized regulatory reform activities now underway in developed countries throughout the world, with special focus on the European Union.

6. We examined major U.S. Federal regulations cleared by OMB from April 1, 1995 to September 30, 2001 to determine their quantifiable benefits and costs. The estimated annual benefits ranged from $49 billion to $68 billion while the estimated costs ranged from $51 billion to $54 billion.

The period for public comment on the OMB 2002 Draft Report closed on May 28. We

are now reviewing the roughly 2,000 comments we received. We plan to issue the final report later this summer.

Thank you very much for the opportunity to appear today. I am willing to answer any questions you may have.

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THE HONORABLE DAVID M. MCINTOSH

TESTIMONY

BEFORE THE SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT, HOUSE COMMITTEE ON SMALL BUSINESS

June 6, 2002

INTRODUCTION

Good morning Mr. Chairman, distinguished Members of this Subcommitee. I would like to thank you for inviting me here today to discuss a topic which I have had the opportunity to study in both private and public life – the impact of federal regulations on small businesses. I want to commend Chairman Pence for his strong leadership in focusing the Committee's attention on the question of how to safeguard our nation's small businesses from the heavy hand of unnecessary government regulations. I will begin by outlining my personal background in this area, then turn to an examination of some rather discouraging statistics which reveal the severity of the problem this Subcommittee is valiantly attempting to ameliorate. I will then delve into my three four areas of analysis:

First, federal regulations can play an important role in protecting small businesses from lawsuits by preempting certain state laws, in areas designated by the Constitution as appropriate for federal intervention. Second, the Regulatory Flexibility Act and the Small Business Regulatory Enforcement Fairness Act should be significantly strengthened, to ensure that federal regulations are equitable to small businesses. Third, current protections against takings of private property through federal regulations are inadequate. In particular, Executive Order 12630 should be legislatively enhanced. Finally, changes must be made to the government procurement process to ensure that small businesses are able to compete.

My theme throughout this discussion is simple: While well-crafted regulations can not only serve the public interest, but also benefit small businesses, current statutes and Executive Orders governing the administrative rulemaking process do not show sufficient sensitivity to the special needs and vulnerabilities of small businesses.

BIOGRAPHICAL BACKGROUND

I began my career in Washington, from 1986-87, as a Special Assistant to the Attorney General, and subsequently served for a year as a Special Assistant to President Reagan for domestic affairs. Following this, I had the privilege of working as an Assistant to Vice President Quayle, and as executive director of the President's Council on Competitiveness, from 1989-1993, where we coordinated White House review of all federal regulatory decisions. I then served as the Director of the Hudson Institute's Competitiveness Center, in my home state of Indiana. In 1994, the voters of Indiana saw fit to send me to Washington, where I served in the House of Representatives for three terms. During this time, I chaired the House Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs. I am currently a partner in the law firm of Mayer, Brown, Rowe & Maw.

GENERAL STATISTICS

Before turning to an analysis of the current statutory framework for protecting small businesses from overzealous federal regulation, I will begin by outlining what exactly it is I hope to protect them from. Businesses with less than 20 employees face an annual burden of just under $7,000 per employee due to federal regulations.[1] Think for a moment about your home

[1] *Regulatory Accounting: Costs and Benefits of Federal Regulation – Hearing Before the Subcomm. on Energy Policy, Natural Resources and Regulatory Affairs of the House Comm. on Government Reform*, 107th Cong. (Mar. 12, 2002) (statement of Rep. Ose, Chairman, House Subcomm. on Energy Policy), *available at* http://www.house.gov/reform/reg/hearings/openingstatements/031202omb.htm (last referenced May 31, 2002).

offices and your annual budgets. Imagine being required to pay over $100,000 every year just for the privilege of staying open to your constituents. That is the burden faced by small firms across the country. Family businesses, proudly passed on from generation to generation; entrepreneurial partnerships, taking advantage of the latest advances in technology; local shops, deeply enmeshed in the community and run by our friends and neighbors – all are gradually withering away, in part due to the sometimes unreasonable demands placed upon them by a cold, faceless bureaucracy hundreds, if not thousands, of miles away.

In the past forty years, from 1961 to the present, the *administrative* costs alone of federal regulations, *after* adjustment for inflation, has increased from $2.5 billion each year to over $20 billion – an increase of eight times![2] Have our lives become eight times better as a result? Are our rivers eight times cleaner? Are our children eight times smarter? The *total* cost of federal regulations last year was estimated as exceeding $800 billion.[3] That's more than the combined gross state products Maryland, Virginia, and my home state of Indiana![4] It's as if the 18 million people living in those states are dedicating their lives just to keeping the federal bureaucrats in business.[5]

Businesses employing between 1 and 19 people spend 47% more per employee in complying with federal regulations than do businesses with over 500 employees.[6] While "small businesses employ 53% of the work force," they "shoulder 63% of total business regulatory

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[2] Id. (statement of Susan E. Dudley, Deputy Director, Mercatus Center, George Mason University), available at http://www.house.gov/reform/reg/hearings/testimony/dudley031202.htm (last referenced May 31, 2002); Id. (statement of Thomas D. Hopkins, former Deputy Administrator, OIRB), available at http://www.house.gov/reform/reg/hearings/testimony/hopkins031202.pdf (last referenced May 31, 2002).
[3] *Id.*
[4] *See State Government Summary*, The Political Reference Almanac, available at http://www.polisci.com/almanac/local/sgovern.htm (last referenced May 31, 2002).
[5] Id.
[6] Thomas D. Hopkins, Center for the Study of American Business, *Policy Study No. 132: Regulatory Costs in Profile* (Aug. 1996), available at http://www.rit.edu/~tdhbbu (last referenced June 3, 2002).

costs."[7] These statistics are all the more unacceptable, when we recall that roughly 99.7% of all businesses in the United States are considered by the SBA to be "small businesses."[8]

The reasons for the grossly disproportionate impact of federal regulations on small businesses are by now well-understood. First, small businesses are generally under-represented in federal regulatory proceedings, while large firms have the resources necessary to influence political and administrative processes.[9] Secondly, federal agencies often try to take a "one-size-fits-all" approach to regulation, which results in a disproportionate burden to small businesses. Finally, sheer numbers help to magnify the inequality.[10] "[I]f the cost of compliance with a federal regulation is fixed, then the smaller firm will suffer a more severe impact since it has a smaller output over which to recover its costs."[11]

Having discussed a little about the reasons why we should be concerned about the burdens of federal regulation on small businesses, I will now turn to three specific areas I believe merit further investigation by this Committee.

I. Federal Regulations Should Preempt State-Law Private Rights of Action Where Appropriate

In devising our federal system, the Framers of the Constitution did not create a national Parliament with unlimited authority, but instead established a Congress of carefully enumerated

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[7] Christopher M. Grengs, Note, *Making the Unseen Seen: Issues and Options in Small Business Regulatory Reform*, 85 Minn. L. Rev. 1957, 1959 (2001).
[8] Jeffrey J. Polich, Note, *Judicial Review and the Small Business Regulatory Enforcement Fairness Act: An Early Examination of When and Where Judges are Using Their Newly Granted Power Over Federal Regulatory Agencies*, 41 Wm. & Mary L. Rev. 1425, 1428-29 (2000).
[9] Barry A. Pineles, *The Small Business Regulatory Enforcement Fairness Act: New Options in Regulatory Relief*, 5 Commlaw Conspectus 29, 30 (1997).
[10] Id.
[11] Id.

powers relating to matters beyond the competence of individual States.[12] In doing so, the Framers recognized the authority and competence of the new national government to facilitate the free-flow of interstate commerce and to prevent impediments to such commerce.[13] Federal preemption, and federal *regulatory* preemption in particular, is one of the most critical areas in which the creative tension between federal and state governmental authority can be seen.

In its recent ruling in Geier v. American Honda Motor Co., the Supreme Court has rejuvenated interest in the doctrine of federal regulatory preemption of state laws.[14] Federal preemption is based on the Supremacy Clause of the Constitution, which provides that the "laws of the United States . . . shall be the supreme law of the land; and judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding."[15] The Geier court reaffirmed that in areas where federal regulations set a "floor," establishing *minimum* safety standards which must be met, a state common-law cause of action for failure to go above and beyond these minimum standards is permissible.[16] Conversely, where federal regulations establish the *exact* level of precautions which must be provided, or expressly give regulated entities the right to choose among a range of possible precautionary measures, a state common-law cause of action for failure to provide a specific, non-required precaution would conflict with the federal regulation, and so be preempted. [17] Even where a

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[12] See U.S. Const., art. I, § 8 (enumerating the powers of Congress); James Madison, Federalist Papers No. 45 ("The powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite.").
[13] See U.S. Const., art I, § 8, cl. 3 ("The Congress shall have power . . . To regulate Commerce with foreign Nations, and among the several States.").
[14] Geier v. Am. Honda Motor Co., 529 U.S. 861, 865 (2000). Michael L. Russell, *Beyond Geier: Federalism Faces an Uncertain Future*, 11 Seton Hall Const. L.J. 69, 71 (2000) ("[T]he outcome of Geier was anticipated for the potential impact that it would have on governmental preemption jurisprudence for years to come.").
[15] U.S. Const., art. VI, cl. 2.
[16] Id. at 870 (The Savings Clause "preserves those actions that seek to establish greater safety than the minimum safety achieved by a federal regulation intended to provide a floor.").
[17] Id. at 875 (A lawsuit for failing to take a particular precaution may be preempted by a federal regulation that "deliberately provided the manufacturer with a range of choices among different passive restraint devices.").

federal statute contains a Savings Clause, explicitly declaring that it should not be interpreted as restricting the availability of common-law suits, courts can nonetheless rule (as in Geier) that such suits would be inconsistent with particular regulations promulgated under that statute, and hence are preempted. [18]

In the same year that Geier, a so-called "conflict preemption" case, was handed down,[19] the Court issued three other rulings concerning the continued vitality of the various types of federal regulatory preemption. Norfolk Southern Railroad v. Shaklin[20] was an "express preemption" case, holding that, pursuant to explicit federal statutory provisions, regulations promulgated under the Federal Railway Safety Act preempted state law claims that particular safety measures were insufficient. The Court addressed "obstacle preemption" in Crosby v. Nat'l Foreign Trade Council,[21] striking down a state law that "undermine[d] the intended purpose and 'natural effect'" of a federal statute,[22] even though that federal statute did not expressly call for the preemption of state laws. Finally, in United States v. Locke, the Court spoke to both "field preemption," in which state laws are preempted because Congress has dominated a particular area with "a workable, uniform system" of federal regulation, as well as the type of "conflict preemption" with which Geier dealt.[23] Since Geier, the Court has expanded

[18] Id. at 869 ("Nothing in the language of the savings clause suggests an intent to save state-law tort claims that conflict with federal regulations.").
[19] This term derives from the fact that the preemption of a state measure arises due to a conflict between the state measure and a federal provision.
[20] Norfolk Southern Ry. v. Shanklin, 529 U.S. 344, 358 (2000) (holding that federal law explicitly "pre-empts respondent's state tort claim that the advance warning signs and reflectorized crossbucks installed at the Oakwood Church Road crossing were inadequate").
[21] Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 373-74 (2000) (ruling that a Massachusetts law penalizing businesses transacting with Burma was "an obstacle to the accomplishment of Congress's full objectives under the federal [Burma] Act. We find that the state law undermines the intended purpose and 'natural effect' of at least three provisions of the federal Act.").
[22] Id.
[23] U.S. v. Locke, 529 U.S. 89, 115 (2000); see also Charleston & W. Carolina Ry. Co. v. Varnville Furniture Co., 237 U.S. 597, 604 (1915) (noting that field preemption applies whenever "Congress has taken the particular subject matter in hand").

the realm of federal preemption yet again, ruling that litigants may not sue under state law for frauds perpetrated upon a federal agency, because such claims are necessarily preempted by the statute governing that agency's operations.[24]

These cases reveal some of the important salutary effects federal regulations can have, particularly for small businesses. First, as in Geier, preemptive federal regulations can provide "safe harbors" for small businesses against lawsuits based on more stringent state laws or regulations. By complying with preemptive regulations, small businesses not able avoid federal penalties, but are also able to protect themselves against civil liability.

Second, in areas the Constitution recognizes as being within the authority and competence of the federal government, preemptive federal regulations can establish a uniform law across all 50 states.[25] Such uniformity reduces the transaction costs of conducting business across state lines, allowing small businesses to expand beyond a local clientele and remain competitive with larger firms. This allows small businesses to avoid incurring the unreasonable costs associated with discovering and conforming to fifty different regulatory requirements.[26] The Court itself has recognized the benefits of such clear nationwide standards of conduct, ruling that in the absence of preemption, "the rules of law that judges and juries create in such suits

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[24] Buckman Co. v. Plaintiffs' Legal Comm., 531 U.S. 341, 348 (2001) ("[T]he plaintiffs' state-law fraud-on-the-FDA claims conflict with, and are therefore impliedly preempted by federal law. The conflict stems from the fact that the federal statutory scheme amply empowers the FDA to punish and deter fraud against the Agency, and that this authority is used by the Agency to achieve a somewhat delicate balance of statutory objectives.").

[25] Cf. Gurrieri v. William Zinsser & Co., 728 A.2d 832 (N.J. Super. Ct. App. Div. 1999) ("A finding that specific local warnings pursuant to state law must apply to products containing less than 4% of methyl alcohol would create a system of possibly fifty or more different labeling requirements throughout the country."); Jones Chem. v. Seier, 871 S.W. 2d 611, 612-13 (Mo. App. 1994) (ruling that the Federal Hazardous Substances Act preempts state common law claims about the adequacy of manufacturer warnings in part because of the "impracticality of having states produce potentially fifty different labels for a particular hazardous substance").

[26] See, e.g., M. Stuart Madden, *Federal Preemption of Inconsistent State Safety Obligations*, 21 Pace L. Rev. 103, 142 (2000) ("[T]he product cost for each drug would substantially increase if the drug manufacturers were forced to adopt the differing packaging requirements for different states.").

may themselves similarly create uncertainty and even conflict, say, when different juries in different States reach different decisions on similar facts."[27]

Third, like unwarranted regulations, frivolous litigation has a terrible impact on small businesses. Many small business men and women have invested their entire life savings into their businesses. They cannot afford to hire a team of in-house or outside lawyers. For a small business, the mere threat of an unwarranted lawsuit can mean the difference between life and death. Preemptive l

For these reasons, the Court's recent emphasis on regulatory preemption of state statutory and common law is a refreshing development for small business owners, and a welcome side-effect of the otherwise questionable increase in the scope of federal regulation.

II. The Regulatory Flexibility Act Should be Significantly Enhanced

A. *The Current Statutory Scheme*

Congress has already recognized the importance of small businesses, not only to the American economy, but to the American way of life. Yet although "a vibrant and growing small business sector is critical to creating jobs in a dynamic economy," small businesses "bear a disproportionate share of regulatory costs and burdens."[28] The Regulatory Flexibility Act[29] (RFA) was an important first step toward protecting small businesses from the potentially crushing weight of federal regulations. It required federal agencies to prepare "regulatory flexibility impact analyses" (hereafter, "reg-flex analyses") on rules that were likely to "have a significant economic impact on a substantial number of small entities."[30] The purpose of these

[27] Geier, 529 U.S. at 871.
[28] Contract with America Advancement Act of 1996, Pub. L. No. 104-121, §§ 202(1), (2) (1996).
[29] Regulatory Flexibility Act, 5 U.S.C. §§ 601-612 (West 1994).
[30] Id. at § 605(b).

analyses is to encourage agencies to consider alternate regulations less deleterious to small businesses.[31]

The Act was not effective in accomplishing these goals, however, because it explicitly prevented courts from reviewing the sufficiency of agency reg-flex analyses.[32] Even more problematic, however, was the fact – recognized by Congress itself – that the Act's requirements "have too often been ignored by government agencies, resulting in greater regulatory burdens on small entities than necessitated by statute."[33]

The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) addressed many of these problems, making federal regulators even more aware of, and sensitive to, the particular needs and vulnerabilities of our nation's small-scale entrepreneurs.[34] The SBREFA expanded the obligation of agencies to solicit and consider comments from small businesses on pending regulations. It even goes so far as to require that a panel of full-time agency employees "responsible for carrying out the proposed rule"[35] assemble to review comments, suggestions, and criticisms compiled from small business owners by the SBA, and "where appropriate . . . modify the proposed rule [or] the initial [reg-flex] analysis."[36] Most significantly, however, SBREFA made judicial review available, allowing courts to exercise oversight not only over the adequacy of agencies' reg-flex analyses and their determinations that a particular regulation is the least burdensome reasonable available for small businesses, but also over agency decisions to

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[31] Id. at §§ 603(c)(1)-(4), 604(a)(3).
[32] See Id. at § 611(a)("[A]ny determination by an agency concerning the applicability of any of the provisions of this chapter to any action of the agency shall not be subject to judicial review."); Id. at § 611(b) ("Any regulatory flexibility analysis prepared under . . . this title and the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review.").
[33] Contract with America Advancement Act, *supra* note 28, at § 5.
[34] Small Business Regulatory Enforcement Fairness Act of 1996, 5 U.S.C. §§ 601-612 (West 2001).
[35] Id. at §§ 609(b)(2)-(4).
[36] Id. at § 609(b)(6).

circumvent the reg-flex requirement by certifying that a particular rule will not substantially affect small businesses.[37]

Although the Regulatory Flexibility Act, as significantly strengthened by the Small Business Regulatory Enforcement Fairness Act, represents a tremendous victory for small businesses against regulatory domination, agency compliance with these laws is still abysmal. For instance, according to a study conducted by the Small Business Administration, "in numerous instances, federal agencies have not adopted regulatory alternatives that achieve their stated policy goals while reducing small entity burdens."[38] Fully one-third of federal regulations requiring a reg-flex analysis were either promulgated without one, or contained an analysis that failed to meet the RFA's relatively forgiving requirements.[39] Consequently, I propose the following measures to provide much-needed relief for small business owners trying to live the American dream, and breathe new life into what many agencies apparently believe to be a dead letter law.

B. *Legislative Recommendations*

1. Ensure that Agencies Actually Comply With SBREFA's Requirements – As noted earlier, one of the primary criticisms of the RFA was that agencies simply flouted its mandates.[40] The primary vehicle through which this occurred is § 605(b), which was left virtually untouched by SBREFA. This provision allows agencies to avoid issuing reg-flex analyses for proposed regulations where "the head of the agency certifies that the rule will not, if promulgated, have a

[37] Id. at § 611(a)(1).
[38] Walton J. Francis & Dr. Mark A. Joensen, *An Evaluation of Compliance with the Regulatory Flexibility Act by Federal Agencies* 1 (Apr. 5, 2001), *available at* http://www.sba.gov/advo/research/rs215tot.pdf.
[39] Id. at 2.
[40] See supra, text accompanying note 33.

significant economic impact on a substantial number of small entities."[41] While somewhat dated, the following statistics suggest the scope of the problem: In 1987, agencies performed 112 initial regulatory flexibility analyses, and filed 1,043 certifications that the RFA did not apply.[42] "In addition to agencies certifying rules in the majority of cases, agencies often use boiler-plate language in their certifications, which indicates the unwillingness of agencies to particularize the certification decision as required by the RFA."[43]

The situation was undoubtedly ameliorated by provisions in the SBREFA making certifications under § 605(b) subject to judicial review.[44] Nonetheless, this is often a costly and time-consuming prospect for small business owners, who may be forced to comply with a regulation promulgated in defiance of RFA and SBREFA requirements until the matter is resolved in court. Moreover, many agencies continue to blatantly disregard the provision. In 1999, 32% of promulgated rules lacking a reg-flex analysis did not contain the statutory-required certification that an analysis was unnecessary, or the "factual basis" justifying such certification.[45]

Congress can rectify this problem and close one of the most gaping loopholes in the Act simply by requiring that either the Administrator of OMB's Office of Information and Regulatory Affairs or the Chief Counsel for Advocacy of the Small Business Administration (whom agency heads intending to exploit this loophole are already required by SBREFA to

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[41] 5 U.S.C. § 605(b).

[42] Jennifer McCoid, Comment, *EPA Rulemaking Under the Regulatory Flexibility Act: The Need for Reform*, 23 B.C. Envtl. Aff. L. Rev. 203, 215 (1995).

[43] Id. The literature also contains more recent examples of agencies abusing the process. See Charles H. Helein, et al., *Detariffing and the Death of the Filed Tariff Doctrine: Deregulating in the 'Self' Interest*, 54 Fed Comm. L.J. 281, 299 (2002) ("In making its analysis of the October 1996 Detariffing Order . . . [t]he FCC shirked its responsibility in clear violation of the Regulatory Flexibility Act . . . [Its] perfunctory analysis of the [filed rate] doctrine does not meet the requirements set out in the [RFA]").

[44] 5 U.S.C. § 611(a)(1); see Thomas O. Sargentich, *The Small Business Regulatory Enforcement Fairness Act*, 49 Admin. L. Rev. 123, 128 (1997) (Judicial review "w[as] long sought by the small business community, which came to believe, as the Act's sponsors noted, that many agencies gave the RFA lip service at best.").

[45] Francis & Joensen, supra note 11, at 38.

notify[46]) review an agency's claim that the § 605(b) exception applies. One of these officials would have to agree that the proposed regulation was not likely to affect a significant number of small businesses before an agency could promulgate the rule. There is precedence for such an approach in the Paperwork Reduction Act,[47] which states that before private citizens can be required to file a particular form with a federal agency, the form must be approved by OIRA. It should be also noted that the General Accounting Office (GAO) has made a similar proposal, urging that the SBA's Office of Advocacy be permitted to promulgate rules necessary to ensure compliance with the RFA.[48] Especially because the applicability of this exemption determines the substantive requirements that must be followed throughout the rulemaking process, it makes sense for this determination to be reviewed by someone outside the agency at the outset. Moreover, it would protect small business owners from having to litigate the issue themselves later on.

2. Apply SBREFA to Federal Regulations That Force State Compliance – Although federal law ostensibly mandates that agencies analyze the likely impact on small businesses of almost every proposed[49] and final rule,[50] the courts have carved out a significant, and likely unintended, exception to this policy. Our system of federalism devolves important policy-making responsibilities in several critical areas, such as the development of clean-air standards,

[46] 5 U.S.C. § 605(b) ("The agency shall provide such certification and statement to the Chief Counsel for Advocacy of the Small Business Administration.").
[47] Paperwork Reduction Act, 44 U.S.C. 3501, et seq. (West 2001).
[48] Grengs, supra note 7, at 2001; see also *SBA Advocacy Office Improvements: Hearing Before the House Small Business Comm.*, 106th Cong. (2000) (statement of Jere W. Glover, Chief Counsel for Advocacy, U.S. Small Business Administration), *available at* 2000 WL 19305053.
[49] See 5 U.S.C. § 603(a) (mandating that agencies prepare "an initial regulatory flexibility analysis" in conjunction with every "general notice of proposed rulemaking," as well as for "interpretive rule[s] involving the internal revenue laws of the United States").
[50] See 5 U.S.C. § 604(a) (mandating that agencies prepare "a final regulatory flexibility analysis" in conjunction with every "final [legislative] rule" or "final interpretive rule involving the internal revenue laws of the United States").

to state governments, which are often required to legislate within broad federal guidelines.[51] Many courts have held that federal regulations and other administrative/regulatory acts which require state governments to legislate do not themselves directly "have a significant economic impact on a substantial number of small entities,"[52] and so do not necessitate reg-flex assessments.[53] Such rulings are seen as an application of the broader principle that the RFA applies only when the entities to be directly regulated by the federal agency are small businesses.[54]

I urge Congress to reject this approach, and amend the SBREFA to clarify that federal regulations which call for state action that will directly impact small businesses are subject to the RFA's reg-flex analysis requirements. Such state legislation is enacted pursuant to, and must conform to the requirements of, federal regulations. The fact that the federal government chooses to use States acting within federal regulatory guidelines, as opposed to federal agencies acting within Congressional guidelines, as the proximate source of restrictions directly affecting small businesses is not the salient point. The main issue is that agencies have control over the boundaries within which States are authorized to act, and in many cases can identify the types of

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[51] See, e.g., Clean Air Act, 42 U.S.C. § 7407(a) (West 2001) ("Each State shall have the primary responsibility for assuring air quality within the entire geographic area comprising such State by submitting an implementation plan for such State which will specify the manner in which national primary and secondary air ambient quality standards will be achieved.").

[52] 5 U.S.C. § 605(b) (allowing agencies to avoid requirements of Regulatory Flexibility Act by certifying that particular regulations will not affect small businesses).

[53] See, e.g., Michigan v. EPA, 213 F.3d 663, 688-89 (D.C. Cir. 2000); American Trucking Ass'ns v. EPA, 175 F.3d 1027 (D.C. Cir. 1999) ("[T]he [federal regulations] themselves impose no regulations upon small entities. Instead, the several States regulate small entities through the state implementation plans . . . Because the [federal regulations] therefore regulate small entities only indirectly – that is, insofar as they affect the planning decisions of the States – the EPA concluded that small entities are not 'subject to the proposed regulation.'"), rev'd in part on other grounds, sub nom. Whitman v. Am. Trucking Ass'ns, 531 U.S. 457 (2001).

[54] See Mid-Tex Elec. Coop. v. FERC, 773 F.2d 327, 342 (D.C. Cir. 1985) ("The problem Congress stated it discerned was the high cost to small entities of compliance with uniform regulations, and the remedy Congress fashioned – careful consideration of those costs in regulatory flexibility analyses – is accordingly limited to small entities subject to the proposed regulation."); Motor & Equip. Mfrs. Ass'n v. Nichols, 142 F.3d 449, 466 (D.C. Cir. 1998) ("Because the deemed-to-comply rule did not subject any aftermarket business to regulation, EPA was not required to conduct a flexibility analysis as to small aftermarket businesses. It was only obligated to consider the impact of the rule on small automobile manufacturers [directly] subject [to it].")

provisions likely to appear in the resulting legislation. Were the federal agencies themselves issuing directives directly applicable to small businesses, the requirements of the Regulatory Flexibility Act would apply. Agencies should not be able to avoid the Act's requirements by taking advantage of federalism and directing the States to legislate in their place.[55]

3. Require an Estimate of Compliance Costs - Third, while the RFA and SBREFA call for an assessment of the "impact of the proposed rule on small entities," it does not actually mandate an estimation of the likely cost of compliance with proposed federal regulations.[56] Cost-benefit analysis is a critical part of public policymaking, and it seems inconceivable that regulators could in good conscience impose a new requirement on small business – or, for that matter, any segment of the general public – without first estimating compliance costs. By determining such costs, agencies are better able to determine whether proposed regulations are truly worthwhile. Similarly, small businesses are better able to gauge the degree to which they

[55] My critique here should *not* be interpreted as a criticism of federalism. I fully support devolution of authority to the States; I simply do not agree that the federal government should be able to avoid its obligations to small businesses by taking advantage of such devolution. Similarly, I should not be understood as suggesting that the RFA or SBREFA be extended to *all* federal regulations that have an indirect, adverse impact on small businesses. For instance, although the Federal Energy Regulatory Commission's restructuring of the natural gas industry undoubtedly affected energy costs for small businesses, there was no *direct* impact on small businesses because none of the regulations were applicable to them. See United Distrib. Co. v. FERC, 88 F. 3d 1105, 1170 (D.C. Cir. 1996) ("[T]he allegation that Order No. 636 may have a significant economic impact on [small businesses] is not sufficiency to trigger the mandate of the [Regulatory Flexibility Act]. FERC had no obligation to conduct a small entity impact of effects on entities which it does not regulate."). I only seek to ensure that regulatory flexibility impact analyses are conducted whether the federal government directly regulates small businesses, or does so indirectly, by requiring states to legislate within federally-established boundaries. In either case, the small business is the object of regulation, and in both cases the likely impact of the ultimate requirements (whether from federal regulation or state statute) can be anticipated. I merely seek to prevent federal agencies from making an end run around measures such as the Regulatory Flexibility Act by having states do the "dirty work" for them.

[56] It appears that the Act's requirement for a small-business impact analysis can be satisfied by merely determining how many small businesses will be affected by the proposed regulation, 5 U.S.C. 603(b)(3)("Each initial regulatory flexibility analysis required under this section shall contain . . . a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply."); see also 5 U.S.C. 604(a)(3) (same requirement for final regulatory flexibility analysis), and a description of what the act is likely to require of them, 5 U.S.C. 603(b)(4)(requiring each initial regulatory flexibility analysis to include "a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule . . . and the type of professional skills necessary for preparation of the report or record."); see also 5 U.S.C. § 604(a)(4) (same requirement for final regulatory flexibility analysis). Nowhere does the law specifically require an agency to estimate the cost, either on an individual or an aggregate level, for complying with the proposed mandates.

are likely to be adversely affected by proposed regulations, and adjust their planning, budgeting, and perhaps even political activities accordingly.

4. Defer to Small Business Administration Interpretations of the Regulatory Flexibility Act – Notwithstanding the shortcomings of the current statutory scheme, the Small Business Administration has done its best to advance the interests of small businesses by advocating constructions of the RFA and SBREFA that would foster, rather than stifle, their growth and well-being.[57] Congress should consider amending the SBREFA to include a provision directing courts to extend the same deference to SBA interpretations of the Acts' provisions as they would to an agency's interpretation of the statutes it administers. The Supreme Court, in the famous case Chevron v. Natural Resources Defense Council, explained what such deference would entail:

> If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress . . . [I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether . . . a reasonable interpretation [has been] made by the administrator of an agency.[58]

The reason why courts have uniformly declined to extend such deference to the SBA in this context is because the Chevron ruling is limited to agency interpretations of statutes it administers, and the SBA does not "administer" either the RFA or SBREFA.[59]

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[57] See, e.g., American Trucking, 175 F.3d at 1044 (noting the "Small Business Administration's interpretation of the [Regulatory Flexibility] Act . . . that [particular federal regulations] do impose requirements upon small entities."); see also Mid-Tex Elec. Coop., 773 F.2d at 341 ("Before the [FERC], the Small Business Administration ('SBA') advocated a similar interpretation of the FRA, arguing that FERC 'should have considered the impact of the proposed rule on wholesale and retail customers of the jurisdictional entities to rate regulation by the Commission.'") (internal citation omitted).

[58] Chevron, U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 842-44 (1984).

[59] See supra, note 14; see also Chevron, 467 U.S. at 842 (limiting its holding to "an agency's construction of a statute it administers").

Nonetheless, the same general reasons that underlie judicial deference to agency interpretations apply with equal force here. The Court has cited agency expertise as one of the primary reasons for Chevron deference.[60] No federal entity is better equipped than the Small Business Administration to recognize either the needs and abilities of small businesses, or the potentially devastating impact certain types of regulations can have on them. While individual agencies undoubtedly have expertise in their particular regulatory areas, they cannot hope to match the specialized knowledge of the SBA, enriched by the experiences of the thousands of small business owners with whom it interacts,[61] in anticipating the impact of federal regulations – both individually and cumulatively – on small businesses. Indeed, federal law requires that the Administrator of the SBA "be a person of outstanding qualifications known to be familiar and sympathetic with small-business needs and problems."[62] Moreover, the SBREFA already permits the SBA's Chief Counsel for Advocacy to intervene in court proceedings as an amicus, as of right, "to present his or her views with respect to compliance with this chapter, the adequacy of the rulemaking record with respect to small entities and the effect of the rule on small entities."[63] Thus, interpretation of the RFA and SBREFA, focusing as they do on the impact of regulations on small businesses, raises issues best left, in the first instance, to the SBA.

The importance of the particular interpretive issue to be resolved, as well as the complexity of the statutory scheme within which it arises, are other factors weighing in favor of

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[60] See Barnhart v. Watson, 122 S. Ct. 1265, 1272 (2002) (citing the "related expertise of the Agency" as one factor "indicat[ing] that Chevron provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue"); see also Board of Trade v. U.S., 314 U.S. 534, 548 (1942) ("We certainly have neither technical competence nor legal authority to pronounce upon the wisdom of the course taken by the Commission.").
[61] See Skidmore v. Swift & Co., 323 U.S. 134, 139-40 (1944) (recognizing that agencies can have "a body of experience and informed judgment to which courts and litigants may properly resort for guidance").
[62] Small Business Act, 15 U.S.C. § 633(b)(1).
[63] 5 U.S.C. § 612(b).

deference to agency interpretations.[64] The RFA and SBREFA govern the promulgation of federal regulations covering almost every aspect of commercial life;[65] the magnitude of the consequences for small businesses hinging on the interpretation of these statutes cannot be overstated. While these statutes do not form a statutory scheme of the complexity of telecommunications regulation, for instance, they are sufficiently intricate so as to give rise to the difficult interpretive issues discussed throughout this and previous sections.[66]

Finally, deference is justified when a statutory scheme leaves gaps that require the resolution of policy issues.[67] Again, however, courts find this justification for deference persuasive only in those cases where a statute explicitly empowers an agency to fill these "interstitial" gaps;[68] under current law, the SBA is not authorized to do so. By enacting the RFA and SBREFA, Congress expressed a policy preference in favor of special consideration for small businesses in the regulatory process. Right now, however, these statutes are "orphans;" no agency is empowered to issue interpretations to ensure that small businesses receive the full measure of statutory protection Congress intended. Until Congress takes the next step and empowers the SBA to resolve matters of interpretation arising in the nebulous "gray" areas around these statutes' outer peripheries, other agencies will continue to chip away at their protective aegis.

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[64] Barnhart, 122 S. Ct. at 1272.
[65] A "zebu" is "[a] domesticated bovine mammal." Webster's II New Riverside Dictionary 790 (Rev. ed. 1996).
[66] See supra, notes 10-12, 14.
[67] Deference is given "whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies." Chevron, 467 U.S. at 844; see also U.S. v. Shimer, 367 U.S. 374, 382-83 (1961) ("If this choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.").
[68] See U.S. v. Mead, 533 U.S. 218, 237 (2001) (emphasizing that either "express [Congressional] authority to fill a specific statutory gap" or "implicit congressional delegation" to do so is required for a court to afford Chevron deference to an agency's statutory interpretation); Christensen v. Harris County, 529 U.S. 576, 596-97 (2000) (Breyer, J., dissenting) (arguing that where there is doubt as to whether Congress intended to delegate interpretive authority to an agency, Chevron is "inapplicable).

5. Oversight - Congressional committees such as this one play a critical role in ensuring that federal regulators adhere to statutorily-delineated boundaries on their authority. I again commend this committee on the vigor with which it fulfills its responsibility in this regard, and support further Congressional oversight to protect small businesses that strive to flourish under the scrutiny of federal regulators.

6. Conclusion - Notwithstanding these changes, the impact of the RFA and SBREFA on agency decisionmaking will ultimately rest on the willingness of courts to engage in judicial review of the Acts' requirements.[69] "The impact-evaluation responsibilities of federal agencies like the FDA may continue to be given little weight by the core staff members assigned to a rule-writing team, as long as judicial reversal of their project is not likely. If judicial review is not a concern, then the small business effects of the rule will receive little attention."[70] Unless Congress and the courts emphasize that agencies must seriously consider alternative regulations that are less burdensome to small businesses,[71] agency staffs will continue "to adopt a conveyer-belt mindset [whereby] the staff focuses upon a single option early in a rule's germination and adheres to that option throughout the entire rulemaking process."[72]

III. Federal Regulations and "Takings" of Private Property

Finally, I would like to turn to the impact of federal regulations on private property. I will focus on two ways in which the government can adversely impact private property – by

[69] An early case revealing one judge's willingness to take advantage of SBREFA's judicial review provisions is Southern Offshore Fishing Ass'n v. Daley, 995 F. Supp. 1411, 1437 (M.D. Fla. 1998) (remanding regulations to an agency because it did not engage in certain findings required by the RFA).
[70] James T. O'Reilly, *FDA Rulemaking After the 104th Congress: Major Rules Enter the Twilight Zone of Review*, 51 Food Drug L.J. 677, 690 (1996).
[71] And punctuate these declarations with remands of rules to agencies where adequate consideration of less burdensome alternatives did not occur.
[72] Thomas O. McGarity, *Regulatory Analysis and Regulatory Reform*, 65 Tex. L. Rev. 1243, 1260 (1987).

physically seizing some or all of it in an "outright taking," or by dramatically curtailing its value through restrictive regulation, in what is termed a "regulatory taking." The protection of private property is, of course, one of the motivating factors behind civil society,[73] and a value enshrined in our Constitution.[74] President Reagan took steps to "hard wire" respect for private property into the regulatory process, through Executive Order 12630. The Order directs that "Executive departments and agencies should review their actions carefully to prevent unnecessary takings and should account in decision-making for those takings that are necessitated by statutory mandate."[75] It also mandates that agencies conform to guidelines established by the Attorney General for ensuring that unnecessary takings of private property are avoided.[76]

This measure is a laudable step toward the protection of private property. Nonetheless, it does not go far enough toward the ultimate goal of preventing regulators from taking private property only when necessary to accomplish a sufficiently important objective. In my remaining time, I would like to briefly outline several shortcomings of the Order, and suggest legislative enactments to both complement and bolster it. First, the Order is essentially an exhortatory measure; there is currently no mechanism through which its substantive provisions may be enforced. Second, the scope of the Order is too narrow; in confining itself to the narrow constitutional definition of the term "takings," it excludes a wide range of governmental activity that can have a severely deleterious effect on private property. Finally, the Order does not adequately safeguard a particularly important type of property – people's homes. Throughout

[73] See generally John Locke, Second Treatise on Government.
[74] See U.S. Const, amend. V ("No person shall be . . . deprived of life, liberty, or property without due process of law; nor shall private property by taken for public use, without just compensation."); amend XIV ("[N]or shall any state deprive any person of life, liberty, or property without due process of law."). The Declaration of Independence itself recognizes the need for protection from bureaucratic officials. See Declaration of Independence (protesting that the King "has erected a multitude of New Offices, and sent hither swarms of Officers to harass our people, and eat out their substance.").
[75] E.O. 12630, § 1(b).
[76] Id. at § 1(c).

my comments, I will emphasize an important theme: legislation is necessary to ensure that takings of private property – including both outright and regulatory takings – occur only when necessary to accomplish an important government interest.

A. *The Order Offers Insufficient Protection Against Unnecessary Takings Because it Creates No Private Right of Action, and Agency Decisions are not Subject to Judicial Review*

1. Takings should occur only when necessary to promote an important government objective - The goals of Executive Order 12630 are twofold: first, to estimate the degree to which a proposed regulation or policy will lead to takings; and second, to prevent unnecessary takings. Unfortunately, the Order does not provide concrete guidance for accomplishing this second objective. Once an agency identifies takings likely to result from a particular proposal, it is directed merely to "address the merits" of its proposal "in light of the identified takings implications."[77] That is, agencies must prepare a "takings impact analysis" of each proposed regulatory action, and include these evaluations in reports to OMB and Congress, as well as in notices of proposed rulemaking (NPRM's).[78]

While encouraging, this mandate does nothing to guide the agency in determining whether to go forward with a particular project in light of the takings that would result. The Order's requirements are met once potential takings are identified. What is needed is a strong, legislatively-enacted presumption *against* takings of private property, unless *necessary* to further an *important* government interest. Congress should extend the requirements of the Executive Order to invalidate any regulations that do not meet these relatively flexible criteria. Agencies

[77] Id. at § 5(b).
[78] See Id. ("Executive departments and agencies shall, to the extent permitted by law, identity the takings implications of proposed regulatory actions and address the merits of those actions in light of the identified takings implications, if any, in all required submissions to the Office of Management and Budget.").

should not be permitted to pursue a course of action involving takings if other, similarly effective measures exist that do not require reduction of property rights. Such a law would let agencies know, in no uncertain terms, when a taking is, and is not, appropriate or tolerable.

2. Agency determinations regarding takings should be subject to judicial review under an "arbitrary and capricious" standard - The Executive Order also emphasizes that it should not be interpreted as giving rights to any private parties, and is not subject in any way to judicial review.[79] The only mechanism for enforcement is that an official within each agency must be designated to ensure compliance.[80] Thus, when the government decides to take someone's property, or destroy that property's economic value through regulation, the owner currently has no way to ensure that the action is, in fact, necessary or justified. Everyone who has tried to litigate this issue has been unsuccessful; courts refuse to review executive branch compliance with the Order.[81]

I propose a second, simple legislative solution – provide for judicial review of regulations that require the physical taking, or severe depreciation in value, of private property. Such review would extend to two factors. First, litigants would have the right to ensure that the takings-impact analysis required by the Order actually occurred. Second, the court would be empowered, in conjunction with my first recommendation, to review the agency's determination that there were no feasible alternatives reasonably likely to further the particular governmental

[79] Id. at § 6 (The order is "intended only to improve the internal management of the Executive branch and is not intended to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States.").
[80] Id. at § 5(a).
[81] See, e.g., Ware v. Bureau of Land Management, 1997 U.S. App. LEXIS 8650 (Apr. 21, 1997) (unpublished opinion) (upholding government's ejectment of petitioner from unpatented mining claims on federal land); Duval Ranching Co. v. Glickman, 965 F. Supp. 1427, 1445 (D. Nev. 1997) (declining to find private right of action under Executive Order 12630); McKinley v. U.S., 828 F. Supp. 888, 893 (D.N.M. 1993) ("The appellant, therefore, has no basis to assert a claim against the Forest Service concerning compliance with E.O. 12630."); .

interest at stake, to ensure that the agency's conclusion was not "arbitrary and capricious."[82] If the regulation fails either of these prongs, it would be invalid as applied to the particular property owner. It is important to note that this cause of action would be *prior to* any claims for compensation in the Court of Federal Claims under the Tucker Act;[83] private parties would not have to exhaust their Tucker Act remedies before invoking judicial review.[84]

Judicial review of certain agency determinations is the norm under the Administrative Procedure Act,[85] and is part of what legitimates the right of unelected bureaucrats, some of whom cannot be removed from their jobs by the President himself,[86] to make important policy decisions.[87] Indeed, the Small Business Regulatory Enforcement Fairness Act of 1996 provides for this level of judicial review regarding the impact of federal regulations on small businesses;[88] don't we deserve the same level of protection for our homes? Moreover, "arbitrary and capricious" review is a deferential standard[89] – it does not allow the court to "substitute its

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[82] See 5 U.S.C. § 706(2)(A).
[83] Tucker Act, 28 U.S.C. § 1491(a)(1).
[84] It is important to note the difference between my proposed cause of action and a claim under the Tucker Act. I propose that legislation be enacted to empower private parties to *enjoin* federal agencies from taking private property unless certain procedural and substantive requirements are met; thus, the successful litigant in such a case retains their property. A Tucker Act claim, on the other hand, seeks compensation for a taking that has already occurred.
[85] The Act makes judicial review available to anyone "suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute," Administrative Procedure Act, 5 U.S.C. § 702 (West 1994), and provides for review of any "final agency action for which there is no adequate remedy in a court." Id. at § 704. The Act excludes from review only those decisions that are committed by law to agency discretion, Id. at § 701(a), or are specifically exempt from review by statute. Id. at 701(b). Determinations made pursuant to Executive Order 12630 would fall under this latter exception, due to the exclusionary language of § 6.
[86] Including both members of independent commissions and employees protected by civil service commissions.
[87] The heavy presumption in favor of judicial review of agency actions was reaffirmed by the Supreme Court in Abbott Labs v. Gardner, 387 U.S. 136 (1967).
[88] Small Business Regulatory Enforcement Fairness Act of 1996, 5 U.S.C. § 611(a)(1) (West 2001) ("[A] small entity that is adversely affected or aggrieved by final agency action is entitled to judicial review of agency compliance with the requirements of" the Regulatory Flexibility Act).
[89] Alenco Communs., Inc. v. FCC, 201 F.3d 608, 619-20 (5th Cir. 2000) ("APA arbitrary and capricious review is narrow and deferential, requiring only that the agency 'articulate[] a rational relationship between the facts found and the choice made.'") (citing Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983)).

judgment for that of the agency,"[90] but instead ensures merely that the agency acted rationally in making its determinations.[91] It is the least level of protection we can offer while still ensuring that executive agencies remain faithful to statutory directives.

An important fact to bear in mind is that federal law currently provides more protection for public parks than it does for a person's home. The Federal-Aid Highway Act provides that the Secretary of Transportation shall not approve the construction of a highway with federal funds that goes through state or local parkland unless there is no "feasible and prudent alternative" and plans are made to "minimize harm to such park."[92] Moreover, the Supreme Court held that the Secretary's decision regarding the viability of alternative routes was subject to judicial review under the "arbitrary and capricious" standard.[93] Shouldn't our homes receive at least this much protection?

A proposal similar to mine, the Private Property Protection Act of 2001,[94] has been introduced by Representative John Sweeney, and referred to the House Committees on the Judiciary and Agriculture.[95] The bill mandates that the Attorney General certify that a regulation complies with the takings-analysis requirements of the Executive Order before it could go into effect.[96] It also provides a limited private right of action, allowing private parties to block enforcement of regulations that did not undergo this process. I would suggest that such oversight authority be lodged in OMB's Office of Information and Regulatory Affairs, rather than the

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[90] Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971).
[91] See Automotive Parts & Accessories Asso. v. Boyd, 407 F.2d 330, 338 (D.C. Cir. 1968).
[92] Federal-Aid Highway Act, 23 U.S.C. § 138(1), (2) (West 1994).
[93] Citizens to Preserve Overton Park, 401 U.S. 402.
[94] Private Property Protection Act of 2001, H.R. 212, 107th Cong. (2001). See also Roger J. Marzulla & Nancie G. Marzulla, *Regulatory Takings in the United States Claims Court: Adjusting the Burdens That in Fairness and Equity Ought to be Borne by Society as a Whole*, 40 Cath. U.L. Rev. 549 (1991) (stating that a substantively similar bill pending before a previous Congress "could constitute another important component of the working set of procedures designed to protect private property.").
[95] See 2001 Bill Tracking H.R. 212, *available from* Lexis-Nexis.
[96] Id. at § 5.

Attorney General. Moreover, I would go even one step further,[97] and permit judges to review whether the agency's determination that a particular taking is necessary to further a particular governmental interest was "arbitrary and capricious," I would support even this more limited measure.

B. *The Order Offers Insufficient Protection for Private Property Because the Range of Government Decisions it Reaches is Too Narrow*

1. Takings legislation should apply to all cases where property value is substantially depressed through government regulation - My second concern is that the scope of government actions to which the Executive Order extends is unduly narrow. It applies only to cases where a "taking," in the constitutional sense of the term, occurs.[98] Both the President[99] and the Supreme Court[100] have recognized that, in theory, a taking can occur even in the absence of a physical seizure by the government, when regulations dramatically depress a property's value. Nonetheless, this is not how the Supreme Court's interpretation of the Takings Clause has evolved in practice. As interpreted in recent years by the Court, the Clause requires

[97] In 1995, Senator Dole introduced an even more radical proposal, which would have required reimbursement by the government to any private property owner whose estimated land value was diminished by 1/3 or more by federal regulations. Omnibus Private Property Rights Act of 1995, S. 605, § 204(a)(D) (1995). See also Danaya C. Wright, *Eminent Domain, Exactions, and Railbanking: Can Recreational Trails Survive the Court's Fifth Amendment Takings Jurisprudence?*, 26 Colum. J. Envtl. L. 399, 474 (2001) (discussing these measures); William L. Inden, Comment, *Compensation Legislation: Private Property Rights vs. Public Benefits*, 5 Dick. J. Env. L. & Pol. 119, 120 (1996) (comparing "assessment" legislation, such as Executive Order 12630 and my own proposal, which requires merely that the government accurately estimate the value of private property that will be diminished by regulation, and "compensatory" legislation, which mandates that property owners actually be reimbursed for such diminishment in value).

[98] See E.O. 12630, §§ 3(a), (e).

[99] Id. at § 1(a) (Mar. 18, 1988) ("[G]overnmental actions that do not formally invoke the condemnation power, including regulations, may result in a taking for which just compensation is required.").

[100] Goldblatt v. Hempstead, 369 U.S. 590, 594 (1962) ("This is not to say, however, that governmental action in the form of regulation cannot be so onerous as to constitute a taking which constitutionally requires compensation."); Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) ("[W]hile private property may be regulated to a certain extent, if a regulation goes too far it will be recognized as a taking.").

compensation *only* in those cases in which the property at issue is physically invaded,[101] whether temporarily or permanently,[102] or loses just about *all* its value to the owner.[103]

This latter point is particular important, because even severe reductions in value have been held not to fall under the Clause. In one case, for instance, government regulations reducing the value of property from $800,000 to $60,000 were held *not* to require compensation under the Fifth Amendment.[104] Because the Order's reach is coextensive with that of the Fifth Amendment, it excludes a wide range of executive activity that has a deleterious effect on property values, but is not sufficient to trigger the constitutional requirement for compensation.

Although not every regulatory burden is necessarily a "taking" of private property,[105] the Fifth Amendment exists "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[106] The values for which the Amendment stands apply equally whether government regulations eliminates half, most, or all of a property's value. Thus, any legislation should pertain not only

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[101] See Kaiser Aetna v. U.S., 444 U.S. 164, 180 (1979) ("[E]ven if the Government physically invades only an easement in property, it must nonetheless pay just compensation."); E.O. 12630 § 3(b) ("Actions undertaken by governmental officials that result in a physical invasion or occupancy of private property . . . may constitute a taking of property."); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 427 (1982) (A "permanent physical occupation of real property" is a taking.).

[102] First English Evangelical Church v. County of Los Angeles, 482 U.S. 304, 318 (1987) ("'[T]emporary' takings which, as here, deny a landowner all use of his property, are not different in kind from permanent takings, for which the Constitution clearly requires compensation."); E.O. 12630 § 3(b) ("Actions undertaken by governmental officials . . . may constitute a taking of property . . . even if the action constituting a taking is temporary in nature.").

[103] Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015-16 (1992) (ruling the Fifth Amendment requires that a property owner be compensated for only "a physical 'invasion' of his property" or where "a regulation denies *all* economically beneficial or productive use of land.") (emphasis added); see also Agins v. Tiburon, 447 U.S. 255, 270 (1980) (holding zoning ordinances constitutional under the Fifth Amendment so long as it does not "den[y] an owner economically viable use of his land"); Armstrong v. U.S., 364 U.S. 40, 48 (1960) (ruling compensation is required under the Fifth Amendment for "[t]he total destruction by the Government of all the value" of the property interest in question). The prior test, to which the Lucas court paid lip service in a footnote, called upon courts to evaluate "the economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action" in determining whether it effectuated a taking. Kaiser Aetna, 444 U.S. at 175.

[104] Hadacheck v. Sebastian, 239 U.S. 394 (1915).

[105] See Armstrong, 364 U.S. at 48 ("[N]ot every destruction to or injury property by governmental action has been held to be a 'taking' in the constitutional sense.").

[106] Id. at 49 (1960) (the Fifth Amendment exists "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.").

to formal takings, as currently defined by the Supreme Court, but to any case where the value of a person's property is significantly or substantially reduced.

2. Takings legislation should not exclude cases of formal eminent domain - Another puzzling restriction is that the Order explicitly excludes "[a]ctions in which the power of eminent domain is formally exercised."[107] That is, it does not require agencies to "prevent unnecessary takings" and "account in decision-making for those takings that are necessitated" when the government seeks to take title to land.[108] One would think that protection of individual property rights would be at their zenith when it comes to the government forcing an innocent landowner to sell his land. The need to ensure that a particular act of eminent domain is *necessary* to further an important governmental objective is of particular importance when we're talking about actually taking title to the home where a family has lived for generations, the farm they created by the sweat of their brow, the office or storefront of small business they started from scratch. Any legislation in this area should rectify the Order's omission, and explicitly include takings resulting from outright exercises of the government's eminent domain authority.

C. *Homes Should Receive Special Protection From Federal Takings*

I want to conclude by elaborating upon a problem I identified earlier, concerning the lack of standards currently governing administrative decision to engage in outright or regulatory takings. I discussed how, in general, takings should occur only where there are no reasonable alternatives, and a sufficiently important government interest is at stake. I want to introduce a final theme, however, one that is perhaps a bit too "soft" and subjective to be included in most discussions of issues like this.

[107] E.O. 12630, § 5(c)(1).
[108] Id. at § 1(c).

I have adopted the approach of Executive Order 12630 in speaking merely of "private property" as an undifferentiated amalgamation. This approach is not unreasonable, given that certain moral and policy reasons underlie our respect for all private property. Nonetheless, I can't help wondering whether certain types of private property deserve even further protection against takings. Consider Lonzo and Matilda Archie, an African-American family from Canton, Mississippi, who struggled to keep the home in which they have lived since 1941 – the first real property their family ever owned – in the face of state eminent domain proceedings.[109] Their plight is emblematic of the particular angst creates whenever the government attempts to seize someone's home. Without diminishing the importance of private property as a whole, in the absence of a broad consensus on the issues I raised, it seems particularly critical to assure these protections for people's homes.[110] "Every man's house is his castle"[111] – and the government should articulate an important reason for attempting to deprive him of it.

IV. The Government Procurement Process Should be Reformed to Allow Small Businesses a Fair Chance to Compete

Competition is critical to ensuring that the Government has access to the full range of capabilities in the market, including those of small businesses. This access, in turn, enables the Government to obtain high quality products and services at a lower cost for taxpayers. A number of reforms and initiatives over the last decade have streamlined the procurement system,

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[109] See Scott Bullock, *IJ* [Institute for Justice] *Enjoys Four Victories Against Eminent Domain Abuse*, Liberty & Law, May 2002, *available at* http://www.ij.org/publications/liberty/2002/index2.html (last referenced June 3, 2002).

[110] The special status of the home is an integral part of constitutional law, derived from our English heritage – "The poorest may in his cottage bid defiance to all the force of the crown. It may be frail – its roof may shake – the wind may blow through it – the storm may enter, the rain may enter – but the King of England cannot enter – all his force dares not cross the threshold of the ruined tenement." U.S. v. Ross, 456 U.S. 798, 822 n.31 (1982) (quoting William Pitt).

[111] See Semayne's Case, 5 Coke's Rep. 91a, 77 Eng. Rep. 194 (K.B. 1604).

but also have authorized competition on a significantly more restricted basis.[112] Studies by the General Accounting Office have indicated that agencies may not be taking full advantage of the diverse capabilities in the market when using contract vehicles such as Multiple Award Schedule and delivery and task order contracts.[113] Orders often are placed under these vehicles with little or no competition. These vehicles can be efficient and effective, but their intended benefits will not be realized if all contractors – large and small – are not given a fair opportunity to compete.

Requirements planning also is critical to obtaining the best value for taxpayers. Small businesses repeatedly have expressed concern that requirements are combined or "bundled" when they could be competed separately.[114] Bundling may have the effect of excluding small businesses, which might be able to compete to meet discrete requirements. Bundling thus may prevent the Government from realizing the full benefits that participation by small businesses can bring. While combining requirements can be administratively convenient, bundling does not ensure that the Government obtains maximum practicable competition, including from small businesses. Agencies need to plan requirements with the objective of obtaining the best value, including through participation by small businesses.

CONCLUSION

In conclusion, I want to encourage the Committee and the Chairman to continue seeking ways to strengthen legislative restraints on government regulators. Your hearing today has identified several ways of accomplishing this goal. In our modern state, such restraints are

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[112] *See, e.g.*, 10 U.S.C. §§ 2304a-d; 41 U.S.C. §§ 253h-k; 48 C.F.R. Subparts 8.4, 16.5.

[113] *See, e.g.*, GAO Report No. 01-125, *Contract Management: Not Following Procedures Undermines Best Pricing Under GSA's Schedule* (November 2000); GAO Report No. NSIAD-00-56, *Contract Management: Few Competing Proposals for Large DOD Information Technology Orders* (March 2000). *See also* DOD IG Audit Report No. D-2001-189, *Multiple Award Contracts for Services* (September 30, 2001).

[114] *See, e.g.*, GAO Report No. 01-746, *Contract Management: Small Businesses Continue to Win Construction Contracts* (discussing bundling concerns).

crucial checks and balances, of the kind envisioned by the Framers of the Constitution, necessary to promote freedom for all Americans.

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Recommendations for Improving Federal Regulation

Testimony before the
Subcommittee on Regulatory Reform and Oversight
House Committee on Small Business

Robert W. Hahn and Robert E. Litan

Testimony 02-5

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Robert W. Hahn and Robert E. Litan are the directors of the AEI-Brookings Joint Center for Regulatory Studies. A copy of this testimony can be obtained from the Joint Center's web site: www.aei.brookings.org. The authors would like to thank Mary Beth Muething, Patrick Dudley, and Erin Layburn for research assistance and Randall Lutter for helpful comments. The views expressed here represent those of the authors and do not necessarily reflect those of the institutions with which they are affiliated.

JOINT CENTER

In response to growing concerns about understanding the impact of regulation on consumers, business, and government, the American Enterprise Institute and the Brookings Institution have established the AEI-Brookings Joint Center for Regulatory Studies. The primary purpose of the center is to hold lawmakers and regulators more accountable by providing thoughtful, objective analysis of existing regulatory programs and new regulatory proposals. The Joint Center builds on AEI's and Brookings's impressive body of work over the past three decades that has evaluated the economic impact of regulation and offered constructive suggestions for implementing reforms to enhance productivity and consumer welfare. The views in Joint Center publications are those of the authors and do not necessarily reflect the views of the staff, council of academic advisers, or fellows.

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Executive Summary

This testimony identifies current and future regulatory reforms that could help improve the quality of regulatory analysis and the quality of regulatory decisionmaking. We review research from the AEI-Brookings Joint Center on regulatory impact analyses and provide five recommendations for improving the regulatory process. We believe these recommendations could be implemented with bipartisan support.

The recommendations include: making regulatory impact analyses publicly available on the Internet; providing a regulatory impact summary table for each regulatory impact analysis that includes information on costs, benefits, technical information, and whether the regulation is likely to pass a benefit-cost test; establishing an agency or office outside the executive branch to independently assess the economic merits of existing and proposed federal rules; requiring that the head of a regulatory agency balance the benefits and costs of a proposed regulation; and requiring that all regulatory agencies adhere to established principles of economic analysis when doing a regulatory impact analysis.

Recommendations for Improving Federal Regulation

Robert W. Hahn and Robert E. Litan

1. Introduction

We are pleased to appear before this subcommittee to provide our views on improving regulation and the regulatory process. We have studied and written about regulatory institutions for over two decades. Four years ago, we organized a cooperative effort between the American Enterprise Institute and the Brookings Institution to study regulation. The result was the AEI-Brookings Joint Center for Regulatory Studies.[1]

A primary objective of the center is to hold lawmakers and regulators more accountable by providing thoughtful, objective analysis of existing regulatory programs and new regulatory proposals. The Joint Center has been at the forefront of outlining principles for improving regulation, enhancing economic welfare, and promoting regulatory accountability.[2]

You have expressed interest in an assessment of current and future regulatory reforms that could reduce the burden of regulations on small businesses. An example of one such change is the creation of a congressional agency that would independently assess the quality of regulations. We have voiced support for this reform in earlier testimony and think Congress would be well-advised to implement it as soon as possible.[3]

Our testimony proceeds in four parts. First, we provide a brief overview of regulation. Second, we present some results from research undertaken at the Joint Center, which reviews the implications of economic analyses of regulation performed by the federal government. Third, in line with the focus of today's hearings, we offer some comments on the recent draft report on the costs and benefits of regulation from the President's Office of Management and Budget (OMB).[4] Finally, we offer some

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[1] All publications of the Joint Center can be found at www.aei.brookings.org.
[2] *See* Arrow et al. (1996).
[3] See testimony of Hahn and Litan on the the Regulatory Right-to-Know Act and the Congressional Office of Regulatory Analysis Act. Hahn and Litan (1999).
[4] We understand that the committee also is interested in addressing a study by Crain and Hopkins (2001). The study addresses the impact of regulation, and specifically regulatory costs, on small firms. We think this is an important area of inquiry. Theory would suggest the regulatory cost per worker could be higher for small firms than for large firms because of fixed costs associated with complying with regulation. The authors offer some empirical support for this finding. The study shows how compliance cost estimates vary

suggestions for reforming regulation to improve both the quality of analysis and the quality of regulatory decisionmaking.

2. Regulation and Oversight

Although regulations often have no direct fiscal impact, they pose real costs to consumers as well as businesses. Regulations aimed at protecting health, safety, and the environment alone cost over $200 billion annually—about two-thirds as much as outlays for federal, nondefense discretionary programs.[5] OMB's recent draft benefit-cost report states that "while the exact cost of regulation is uncertain, the total cost is comparable to discretionary spending—about $640 billion in 2001."[6] Yet, the economic impacts of federal regulation receive much less scrutiny than the budget.[7]

To encourage the development of more effective and efficient regulations, Presidents Reagan, Bush, Clinton, and Bush have directed agencies to perform analyses of major regulations that show whether a regulation's benefits are likely to exceed the costs, and whether alternatives to that regulation can achieve the same goal for less money. They also have attempted to increase agency accountability for decisions by requiring that OMB review all major regulations. In recent years, Congress embraced regulatory reform and inserted accountability provisions and analytical requirements into laws such as the Safe Drinking Water Act Amendments of 1996, the Small Business Enforcement and Fairness Act of 1996, and the Unfunded Mandates Reform Act of 1995.[8,9]

The most prominent and far-reaching of these regulatory reform efforts are President Reagan's Executive Order 12,291 and President Clinton's Executive Order

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across firms of different sizes, and in different industrial sectors, and across different types of regulation. See Tables 1, 5, 9A, 9B, 10A, and 10B.

[5] See Arrow et al. (1996) and OMB (2002a). OMB estimates the total annual monetized costs of social regulations as between $181 to 277 billion dollars. Cost figures are in 2001 dollars. See Table 11, OMB (2002a, 15037).

[6] OMB (2002a, 15015).

[7] See Joint Economic Committee Study (1998).

[8] Some examples of accountability mechanisms include regulatory oversight, peer review, judicial review, sunset provisions, regulatory budgets, and requirements to provide better information to Congress. Analytical requirements include mandates to balance costs and benefits, consider risk-risk tradeoffs, and evaluate the cost-effectiveness of different regulatory alternatives. See Hahn (2000).

[9] The Government Performance and Results Act (GPRA) of 1993 and the Paperwork Reduction Act of 1995 also set accountability requirements for agencies. For information on GPRA, see General Accounting Office (1996); for information on the Paperwork Reduction Act, see OMB (1995).

12,866. Both require agencies to prepare a Regulatory Impact Analysis (RIA) for all major federal regulations.[10] Agencies have prepared RIAs for almost twenty years in accordance with the executive orders and guidelines for economic analysis provided by OMB.[11]

The subcommittee is particularly interested in focusing on the impact of regulations on the regulated community and small business.[12] While we believe it is important to consider such impacts, particularly when they are significant, *we would urge the committee to focus its efforts on having an agency do a good benefit-cost analysis of a regulation, as economists typically define it.*[13] That analysis would include an evaluation of an agency's preferred option along with relevant alternatives. As we shall argue below, such good analyses tend to be the exception rather than the rule. When done well, such analyses can help provide a general measure of the social impact of regulations. In contrast, measures of industry-specific impacts, while important, do not adequately address whether the overall benefits of a regulation are likely to exceed the costs. In addition, it is often difficult to develop reliable measures of industry-specific impacts of a regulation.

3. What Do the Government's Economic Analyses of Regulations Tell Us?

The Joint Center has been engaged in conducting a systematic review of regulatory impact analysis since its inception. We wish to focus on three different efforts: one provides a comprehensive assessment of the costs and benefits of federal regulatory activities; a second examines the extent to which the costs and benefits of regulations are reported in the *Federal Register*; and a third assesses the quality of regulatory impact

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[10] President Reagan coined the term *regulatory impact analysis* in Executive Order 12,291, *see* 3 C.F.R. 128 (1981). President Bush also used Executive Order 12,291. President Clinton's Executive Order 12,866 changed the term *regulatory impact analysis* to *assessment, see* 3 C.F.R. 638 (1993). Executive Order 12,866 maintains most of Reagan's requirements but places greater emphasis on distributional concerns. Executive Order 12,866 also directs agencies to show that the benefits of the regulation "justify" the costs, whereas Reagan's executive order required agencies to show that the benefits of the regulation "outweigh" the costs. *See* Exec. Order No. 12,291, 3 C.F.R. 128 (1981–1993); Exec. Order No. 12,866, 3 C.F.R. 638 (1993–2000), *reprinted in* 5 U.S.C. § 601 (1994).

[11] See OMB (1996).

[12] Examples include estimates of the impact on employment in a specific industry or the impact on plant closures.

[13] See Arrow et al. (1996); see OMB (2000).

analyses.[14]

To assess net benefits of final regulations between 1981 and mid-1996 the Joint Center reviewed 106 RIAs. On the basis of the government's own numbers, these regulations are estimated to yield net benefits of close to $2 trillion.[15] The analysis also shows that the government can significantly increase the net benefits of regulation. Less than half of final regulations pass a neutral economist's benefit-cost test. Net benefits could increase by approximately $300 billion in present value terms if agencies rejected such regulations.[16] Net benefits could also increase if agencies replaced existing regulations with more efficient alternatives, or if agencies substantially improved regulatory programs. While one could argue with the particular interpretation of the numbers provided in this study, we feel comfortable saying that a significant fraction of the government's final regulations would not pass an economist's benefit-cost test using the government's own numbers. That suggests that the executive orders requiring a careful weighing of costs and benefits have not been taken very seriously.[17]

A second strand of research examined how the government used the *Federal Register* to convey important information on the impacts of regulation.[18] The *Federal Register* was selected because it is a key repository of information on regulation within the government.

Joint Center researchers examined seventy-two final rules promulgated by regulatory agencies from 1996 through February 10, 1998, that were subject to review by the OMB. Each rule was scored on pertinent information related to alternatives considered, costs, cost savings, benefits, and other essential economic information.[19] Two important conclusions emerge from that analysis. First, *Federal Register* notices that present regulatory analysis currently exhibit a great deal of variation in the kind of

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[14] See Hahn (2001), Hahn (1999), and Hahn et al. (2000).

[15] See Table 3-4, Hahn (2001, 42). The net benefits estimate does not include two rules on stratospheric ozone that, according to the Environmental Protection Agency, have net benefits in the trillions of dollars. Those rules would have a large impact on the overall estimate of net benefits (taking the government numbers as given), but not on the fraction of rules that pass a benefit-cost test.

[16] Hahn (2001, 4).

[17] An alternative interpretation is that those numbers were carefully weighed and then dismissed for other reasons, for example, because they left out important aspects of the problem.

[18] See Hahn (2000).

[19] Once each *Federal Register* notice was reviewed, the data were entered into a database. Each notice was then reviewed a second time to check for accuracy.

information that is presented.[20] Second, with some key changes in the requirements for including and presenting information, the content of those notices could be improved dramatically.

Further insight into the extent to which the government's analyses of regulations provide an adequate basis for decisionmaking can be found in a Joint Center study of regulatory impact analyses.[21] That study provides the most comprehensive evaluation of the quality of recent economic analyses that agencies conduct before finalizing major regulations.

Joint Center researchers constructed a dataset of final rules that includes analyses of forty-eight major health, safety, and environmental regulations from mid-1996 to mid-1999. That dataset provides detailed information on a variety of issues, including an agency's treatment of benefits, costs, net benefits, discounting, and uncertainty. The dataset was used to assess the quality of recent economic analyses and to determine the extent to which they are consistent with President Clinton's Executive Order 12,866 and the benefit-cost guidelines issued by the OMB.

The research revealed that economic analyses prepared by regulatory agencies typically do not provide enough information to make decisions that will maximize the efficiency or effectiveness of a rule. "The study of regulatory impact analyses shows that agencies only quantified net benefits—the dollar value of expected benefits minus expected costs—for 29 percent of the forty-eight rules...The agencies also did not adequately evaluate alternatives to the proposed regulation, another element of the Executive Order. Agencies failed to discuss alternatives for 27 percent of the rules and quantified the costs and benefits of alternatives for only 31 percent. In addition, the agencies often failed to present the results of their analysis clearly. Agencies provided executive summaries for only 56 percent of the rules."[22]

Taken together, those studies illustrate four key points. First, many major regulations are not likely to pass a standard benefit-cost test using the government's own numbers. Second, the quality of analyses is generally poor, though there is a great deal of

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[20] For example, there was little consideration of alternatives. For all seventy-two rules, thirty-one (43 percent) considered alternatives; only nineteen (26 percent) discussed specific alternatives; and eight (11 percent) quantified them. See Hahn (2000, 935).
[21] See Hahn et al. (2000).
[22] See Hahn et al. (2000, 861-862).

variation in quality. Third, many analyses are not readily accessible to the general public. Finally, useful summaries of the analyses are not readily available to the general public.

4. The Recent OMB Draft Report on the Costs and Benefits of Regulation

We believe that OMB's recent draft report on the benefits and costs of federal regulation is a significant improvement over previous reports in terms of the responsiveness to the congressional mandate, and the information it provides on recent improvements at OMB.[23] We think the changes that OMB has made to increase transparency and efficiency are significant. These include making greater use of the Internet to communicate information, sending letters to agencies encouraging specific regulations with net benefits, and providing information on turnaround time for reviewing rules.

There is still room for substantial improvement, however. In our formal comment on OMB's report, we offered six recommendations—one for Congress and five for OMB—that we believe would be helpful in holding regulators and lawmakers more accountable for the regulations they produce. Our recommendations focus on getting the regulatory agencies to produce better analysis, making that analysis more transparent and readily available, and making the regulatory process itself more transparent.

We recommended that Congress require agencies to comply with OMB's economic guidelines. We also suggested that OMB improve its report by including a scorecard on the extent to which regulatory analyses comply with their guidelines; providing more information on regulations aimed at reducing terrorism; and making greater use of its in-house expertise to improve estimates of benefits and costs for individual regulations.

5. Recommendations for Improving Regulation

A complete discussion of improving regulation is beyond the scope of this testimony.[24] Here, we wish to focus on a few key policies that will either promote economic welfare (broadly understood) or promote greater regulatory accountability. We believe the recommendations could be implemented with bipartisan support. We also

[23] See Hahn and Litan (2002) for a more extensive discussion of the recent draft OMB report.
[24] See, e.g., Breyer (1993) and Litan and Nordhaus (1983).

believe that proposals that are viewed as more far-reaching, such as requiring that a regulation pass a broadly defined benefit-cost test, are unlikely to be implemented in the near future because the political support will not be there.

Recommendation 1: Congress should require that agencies make each regulatory impact analysis and supporting documents available on the Internet before a proposed or final regulation can be considered in the regulatory review process.

Discussion: If the RIA is expected to inform the decision process, the analysis must precede the decisions themselves. Making such analyses widely available is an important first step in holding lawmakers and regulators more accountable for proposed and final regulations. Some agencies, such as the Department of Health and Human Services and, increasingly, the Environmental Protection Agency, are moving in that direction by eventually putting the regulatory impact analysis on the Internet. Requiring that an analysis and supporting documents be made available on the Internet before the regulatory review process starts at OMB provides an agency with an additional incentive to make it available to the public.

Recommendation 2: Each regulatory impact analysis should include an executive summary with a standardized regulatory impact summary table that contains information on costs, benefits, technical information, and whether the regulation is likely to pass a benefit-cost test based on the best estimate of quantifiable benefits and costs.

Discussion: The executive summary, regulatory impact summary table, and the requirement of standardization would all promote greater regulatory accountability. The standardization and summary will make it easier for the public, interest groups, and academics to obtain information on the government's views of the benefits and costs of regulation.

The information identified in the regulatory impact summary table is similar to that required by Executive Order 12,866, the Unfunded Mandates Reform Act, and the Regulatory Flexibility Act. Congress should simply consider passing an amendment

requiring that the information be summarized and produced in the form suggested here. The cost would be trivial, and the benefits could be potentially quite large.

We present an example of a regulatory impact summary table in Table 1. That information should be standardized across agencies to enable Congress and stakeholders to make comparisons when setting regulatory priorities.

Recommendation 3: Congress should create a congressional office of regulatory analysis (CORA) or a separate agency outside of the executive branch to independently assess important regulatory activity occurring at *all* federal regulatory agencies.[25] At a minimum, Congress should provide funding for the pilot project described in the 2000 Truth in Regulating Act (TIRA).[26]

Discussion: The 106th Congress passed important regulatory reform legislation, the Truth in Regulating Act , which was signed into law by President Clinton in October 2000. The TIRA established a three-year pilot project, supposed to begin in early 2001. The project, administered by the General Accounting Office, would review RIAs to evaluate agencies' benefit estimates, cost estimates, and analysis of alternative approaches, upon request by Congress. The cost of the pilot project is budgeted at $5.2 million per year.[27] We think this is an incredible bargain, given the upside potential associated with this investment.[28]

Requiring that a separate agency outside the executive assess important regulation is sound for three reasons. First, because it is likely to serve as an independent check on the analysis done in the executive branch by OMB and the agencies. Second, it will help to make the regulatory process more transparent. Third, Congress can use the independent analysis to help improve regulation and the regulatory process. Fourth,

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[25] See Hahn and Litan (1999) for a discussion of how the agency should be related to the Congressional Budget Office and the General Accounting Office. For the importance of addressing regulation at both independent and executive agencies, see, e.g., Hahn and Sunstein (2002).

[26] The initiation of GAO review under TIRA is contingent on appropriations. To date, funding had not been authorized.

[27] "There are authorized to be appropriated to the General Accounting Office to carry out this Act $5,200,000 for each of fiscal years 2000 through 2002." Truth in Regulating Act of 2000 (P.L. 106-312, § 5).

[28] Potential benefits include higher quality assessments of the likely impacts of specific regulations as well as identification of opportunities for effective reform.

CORA could help provide a more complete picture of the regulatory process if given appropriate statutory authority.

OMB's Office of Information and Regulatory Affairs (OIRA) faces inherent limits in the scope of its review of individual regulatory proposals. OIRA is headed by a political appointee chosen by the same administration that appoints the heads of the regulatory agencies. There is likely, therefore, to be some implicit understanding that the head of OIRA is not to press the agencies excessively hard because he or she is on the same team as the agency heads. Even if the head of OIRA were given authority to challenge regulations, the basis for those challenges is not often made public and the scope of those challenges is likely to be limited.

The constraints on the OMB are manifested in its annual report, in which it has, so far, simply accepted the benefits and cost estimates compiled by the agencies instead of providing any of its own assessments. CORA would not face those constraints but instead would be able to provide its independent analysis, much as CBO has done in the budget arena.

CORA could help provide a more complete picture of the regulatory process, especially in areas that OMB has not examined carefully. For example, we only have a very incomplete understanding of the benefits and costs of regulatory activities at independent agencies. Our understanding of the impacts of smaller regulations and regulatory guidance is also quite limited, although these may be used as substitutes for larger regulations that would fall under OMB review.[29]

Finally, CORA could help Congress implement its recent legislation, such as the Small Business Regulatory Enforcement Fairness Act. CORA could also aid Congress in periodically assessing the need to modify its own regulatory statutes. As it is now, if and when Congress chooses to do so, it will have to rely on the agency's own estimates of the impacts of a rule and on any other data that interested parties may or may not have submitted in the rulemaking record. Significantly, Congress now has no *credible, independent source of information* upon which to base such decisions. That is analogous to the pre-CBO Congress, which had to make budget and appropriations decisions based solely on the information developed by the executive branch.

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[29] Hahn (2001) and Furchtgott-Roth (1996) find that regulatory agencies provide very little information on the economic impacts of a large number of regulatory activities in which they are engaged.

Recommendation 4: Congress should require agencies to balance the benefits and costs of major regulations.[30]

Discussion: While the Reagan and Clinton executive orders have encouraged agencies to consider the benefits and costs of regulations, executive orders do not have the authority of statutes. Executive orders are difficult to enforce in part because they are not judicially reviewable, and agencies cannot be sued for noncompliance. Congress should therefore require agencies by statute to comply with requirements similar to those in the executive orders and in the OMB's implementation guidance for the executive orders. Although some statutes already require agencies to balance the benefits and costs of regulation, these statutes apply to only a small number of major regulations and agencies often do not comply with the requirement. Other statutes either do not require benefit-cost analysis or actually restrict its use. The Clean Air Act, for example, precludes the consideration of costs for certain regulatory decisions. A congressional requirement to balance benefits and costs will increase the transparency of the regulatory process by forcing agencies to provide high-quality analyses that the courts could review in the event of significant controversy.[31]

Recommendation 5: Congress should require that all regulatory agencies adhere to established principles of economic analysis when undertaking a regulatory impact analysis.

Discussion: It is clear from a careful review of regulatory impact analysis that agencies are currently not taking the guidelines imposed by the executive branch very seriously in carrying out regulatory analyses. To add political weight to those guidelines, Congress should consider adopting the kinds of principles contained in the OMB economic guidelines. It should also consider requiring that an agency, such as OMB, enforce those guidelines. It, too, could help to enforce those guidelines by holding

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[30] We would actually go further and suggest that Congress require that all new regulations costing more than $100 million annually pass a broadly defined benefit-cost test. See Crandall et al. (1997, 12).

[31] If a balancing requirement is seen as problematic, then Congress should consider passing an amendment that does not preclude agency heads from explicitly considering costs and benefits in regulatory decisionmaking.

hearings. An obvious question is how far Congress would be willing to go in providing methods for enforcement. One possible mechanism that deserves consideration is not allowing agencies to move forward on regulations unless an oversight agency, such as OMB, determines that the guidelines are met.[32]

If Congress and the White House are serious about regulatory reform, they must cooperate to enforce the regulatory impact analysis requirement. Successful enforcement requires high-level political support, statutory language requiring all agencies to adhere to established principles of economic analysis, and rigorous review of agency analyses by an independent entity. If lawmakers are willing to exert the political muscle, real reform could be achieved.

[32] For a study on agency's compliance with OMB's economic guidelines, see GAO (1998), finding that "5 of the 20 analyses did not discuss alternatives to the proposed regulatory action, 6 did not assign dollar values to benefits, and 1 did not assign dollar values to costs—all of which are practices recommended by the guidance... Finally, only 1 of the 20 analyses received an independent peer review." GAO (1998, 3). Congress may also want to consider taking similar steps related to improving information quality. See OMB (2002b), which provides an explanation of what agencies should be doing to ensure information quality. These guidelines can be expected to improve the quality of information submitted to OMB by a regulatory agency, because they promote independent, external, expert peer review of an agency's data, and stress that an agency's data should be reproducible. See OMB (2002b, 8459, 8460).

Table 1

Regulatory Impact Summary	
I. BACKGROUND ON RULE AND AGENCY	
AGENCY AND DEPARTMENT/OFFICE NAME	
CONTACT PERSON	TELEPHONE NUMBER
TITLE OF THE RULE	
RIN NUMBER	DOCKET NUMBER
TYPE OF RULEMAKING (FINAL/INTERIM/PROPOSED/NOTICE)	TYPE OF RULE (REGULATORY/BUDGET IMPACT)
STATUTORY AUTHORITY FOR THE RULE	RULEMAKING IMPETUS
BRIEF DESCRIPTION OF THE RULE	
II. OVERALL IMPACT	

1. Will the rule have an impact on the economy of $100 million or more? ☐ Yes ☐ No
2. Best estimate of the present value of quantifiable benefits of the rule. $_____
3. Best estimate of the present value of quantifiable costs of the rule.[116] $_____
4. Do the quantifiable benefits exceed the quantifiable costs? ☐ Yes ☐ No
5. Report the dollar year of costs and benefits. _____
6. Report the discount rate used in the calculations for costs and benefits. _____
   If more than one discount rate was used in calculations, please explain why.
   _____
7. Discuss level of confidence in the benefit-cost estimates and key uncertainties. Include a range for costs and benefits._____
   _____
   _____
   _____
   _____
8. Identify benefits or costs that were not quantified. _____
   _____
   _____
   _____
   _____
   _____

III. COSTS AND BENEFITS

Estimated Incremental Costs

1. Costs and breakdown of quantifiable costs by type.

	Annual	Years in Which Costs Occur	Present Value
Total Costs	_____	_____	_____
Compliance Costs	_____	_____	_____
Administrative Costs	_____	_____	_____
Federal Budget Costs	_____	_____	_____
Local/State Budget Costs	_____	_____	_____
Other Costs	_____	_____	_____

Notes: _____

2. Give a brief description of who will bear the costs. _____

Estimated Incremental Benefits

1. Benefits and breakdown of quantifiable benefits by type.

	Annual	Years in Which Benefits Occur	Present Value
Total Benefits	_____	_____	_____
Health Benefits	_____	_____	_____
Pollution Benefits	_____	_____	_____
Other Benefits	_____	_____	_____

Notes: _____

2. Give a brief description of who will benefit. _____

IV. ALTERNATIVES TO THE REGULATION

1. List and briefly describe the alternatives to the rule that were considered and why they were rejected, including a summary of costs and benefits of those alternatives. If no alternatives were considered, explain why not.

_____

Source: Table 4, Hahn and Sunstein (2002, 1519).

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TESTIMONY OF ANDREW M. LANGER,
MANAGER, REGULATORY POLICY
NATIONAL FEDERATION OF INDEPENDENT BUSINESS
ON
THE IMPACT OF REGULATION ON SMALL BUSINESS

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT

THURSDAY, JUNE 6, 2002

Mr. Chairman and Members of the Committee:

It is my pleasure to be testifying here today before the Committee on Small Business' Subcommittee on Regulatory Reform and Oversight on the subject of the impact of regulations on small businesses. I am here representing the National Federation of Independent Business, the nation's largest organization of small business owners. NFIB has 600,000 members, and is represented in each of the fifty states. We are a 501C(6), membership-driven organization, meaning that my role here is to represent the determined interests of those members.

NFIB represents small employers. Our typical member has five employees and reports gross sales of around $350,000 per year. Our average member nets $40,000 to $50,000 annually. While there is no benchmark used to define a small business, our membership is very much a reflection of American small business when compared to data compiled by the United States Census Bureau.

We believe it is important to distinguish the type and size of businesses NFIB represents. Too often, federal policy makers view the business community as a monolithic enterprise that is capable of passing taxes and regulatory costs onto consumers, without suffering negative consequences. For small business this is not the case. NFIB members are not publicly traded corporations; they are independently owned and operated. They do not have payroll departments, tax departments or attorneys on staff.

Being a small business owner means, more times than not, you are responsible for everything—taking out the garbage, ordering inventory, hiring employees, and dealing with the mandates imposed upon your business by the federal, state and local governments. That is why simple government regulations, particularly when it comes to the paperwork they generate, are so important. The less time our members spend with "government overhead," the more they can spend growing their business and employing more people.

Growing businesses lead to job creation, which is one of the major roles small business plays in our national economy. Small business is the leader in job creation because it is the embodiment of the entrepreneurial spirit. Small firms with fewer than 500 employees employ 52 percent of the non-farm private sector work force as of 1998, and are responsible for 51 percent of the private sector business share of the nation's gross domestic product.

From 1994 to 1998, about 11.1 million new jobs were added to the economy. Small businesses with 1-4 employees generated 60.2 percent of the net new jobs over this period and firms with 5-19 employees created another 18.3 percent. It is because small businesses have such deep impact on employment and the national economy that we feel it is critical that the policies you shape account for the impact the law will have on small business.

As you hopefully know, unreasonable government regulation, especially onerous paperwork burdens, continues to be a top concern for small businesses. Regulatory costs per employee are highest for small firms, and our members consistently rank those costs as one of the most important issues that NFIB ought to work to change. Therefore, we are pleased to be able to offer our perspective on the impact the regulatory state has had and continues to have on small businesses.

Just last week, NFIB submitted comments to the Office of Information and Regulatory Affairs (OIRA) at OMB on their draft report to Congress on the state of regulation and offered recommendations for review. Our comments are appended to this testimony as Attachment A. We continue to be pleased with the efforts being made by Dr. Graham and OIRA, especially in working with the Small Business Administration to help rein in agency over-reaching, and our comments reflect that.

One of our concerns is that OIRA, an organization that "gets it," may not have the manpower necessary to take on the Herculean task of reforming a regulatory state that continues to grow—and we would ask that among the recommendations that your committee ultimately makes is to help OIRA by giving it the tools necessary to do what is a vital job.

How Our Members Feel

Each year, NFIB polls its members, and in 2001 we released the results of our poll on the impact of regulation on small business. This poll is appended as Attachment B. We found that 44 percent of our members view regulation as a serious or somewhat serious problem. Most small-business owners are unhappy with the hassles regulation creates for them rather than the limits it places on their freedom of action.

Many identify the extra paperwork created by regulation as their primary concern. More note the difficulty understanding what is needed to be in compliance and the dollars expended to comply. Some believe the primary problem associated with regulation is the time delay it causes, and a number feel the difficulty locating new regulatory requirements and the limits placed on their actions as the principal difficulty regulation creates for them.

Size and Cost of the Problem

Approximately half of those small business owners who participated in our poll identified the federal government as the biggest culprit behind their regulatory burden. The volume of government regulations is enormous. The Code of Federal Regulations alone extends 19 running feet and other governmental units add more length to the shelf space federal regulations already occupy.

According to the Cato Institute's Wayne Crews, 996 rules are expected to have significant economic impact on small businesses. This is down 5 percent from 2000. However, from 1997 to 2001, the total number of rules ***rose*** by thirty-five percent![1] Crews' report states:

> The Department of Transportation and the Environmental Protection Agency account, respectively, for 244 and 185 of the 996 rules that affect small business—far outstripping other agencies' rules in small business impacts. The runners up are the Federal Communications Commission with 117 rules affecting small business, the Department of Health and Human Services with 108, and the Department of Commerce with 89. Those five agencies together account for 743, or 74 percent, of the total number of rules that will affect small businesses.[2]

We know that the cost of regulation to small business, not just in terms of dollars expended, but in hours consumed, aggravation encountered and opportunities lost, are vast drains on these operations. In a 2001 report commissioned by the Office of Advocacy at the SBA, W. Mark Crain and Thomas D. Hopkins, it was found that for businesses with fewer than 20 employees (a number representing more than 90 percent of all businesses in America), the cost of regulation per employee was $6,975.[3] For firms with more than triple that number, the cost fell by nearly one-third.

These burdens make the federal government appear monolithic, not to mention difficult to deal with and fraught with potential pitfalls when you do. Our members fear exposure to errors in what they report, and they especially fear retaliation by agencies for complaints against overzealous regulators, or those whose actions are arbitrary or patently unfair. This presents groups like NFIB with a challenge.

We know from the established record that such abuses do occur, and we have received reports from members that they have been so targeted. We are concerned that we do not hear from more out of a fear of retaliation. We hope that this will begin to change, as small business owners see the improvements being made in the resources available to them, such as the SBA Ombudsman's office, and efforts being made by other agencies.

The Source of the Problem—Death By a Thousand Pin Pricks

Small-business owners cannot look to a single place for their regulatory requirements. Rather they must look to several bodies within at least three political jurisdictions—federal, state, and local. Of these three, owners most often identify the federal government as the major source of their problem.

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[1] Crews, Wayne, ***10,000 Commandments – An Annual Snapshot of the Federal Regulatory State***, The Cato Institute, 2002 (Draft at 16)
[2] Id.
[3] W. Mark Crain and Thomas D. Hopkins, "The Impact of Regulatory Cost on Small Firms," Office of Advocacy, Small Business Administration, Washington, DC, 2001, http://www.sba.gov/advo/research/rs207tot.pdf, at 7.

One important aspect of understanding the small-business problem is locating where it is generated. But many small-business owners argue that regulation is death by a thousand pin pricks; it is not so much a single regulation or regulatory agency but the shear volume of them coming from every direction. When offered the choice of describing their regulatory problem as stemming from a small number of regulations and/or agencies or the overall volume promulgated from multiple sources, owners split almost evenly.

Small-business owners name tax-related regulations most often as the type of regulation providing them the greatest headaches. Health, safety, and environmental regulations present significant difficulties as well. The Crain-Hopkins study confirms this, stating, "the cost disadvantage facing small business is driven largely by compliance with environmental regulations and tax-related paperwork."[4] Finally, regulations associated with the terms and conditions of employment, like the Family and Medical Leave Act, pose probems.[5]

Moreover, NFIB continues to examine the impact that multiple agencies and duplicative regulatory regimes have when dealing with single actions, instances, or individual subjects. It is difficult for one business to improve its operations, for instance, when a particular activity which can be improved must jump through multiple regulatory hoops in the process. If a small business owner has to file paperwork to EPA, OSHA, the Department of Transportation, and perhaps another agency or two, it becomes too problematic and difficult for that small business owner to take those steps that could lead to a marked improvement. It becomes even more difficult when these small business owners are faced with regulations that contradict each other. We hope that responsible parties will consider studying this problem, and we are happy to provide additional information to further that goal.

Most small-business owners primarily concerned with environmental or land use regulations have two specific issues in mind—zoning/land use issues, and chemical/waste disposal. While there are obvious overlaps, e.g., run-off and clean water, it seems clear that small-business owners are most concerned with environmental regulations that encroach on property rights. While the impact of regulation tends to be felt on an industry-specific basis, most of our members agree that it is the paperwork burden associated with regulation in general which is problematic.

A prime example of this is the proposed heightened standard for reporting requirements for lead under the Toxics Release Inventory. This new standard alone will require, by EPA's own estimates, sixty hours in preparation of the paperwork required to be filed. Further, while the EPA has been magnanimous in casually allowing filers to re-do their paperwork should mistakes be made (rather than holding them strictly liable for paperwork errors, as is true with most environmental regulations), this means that owners who have made errors will have to spend another week of their time writing, instead of

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[4] Id.at 10.
[5] An article by NFIB's Bruce Phillips on the economic costs of expanding the FMLA is appended as attachment C.

engaging in their business. Clearly, this is problematic, especially for a rule that has a marginal environmental benefit.[6]

Tax Paperwork

NFIB members consistently list the paperwork associated with tax preparation as their biggest regulatory headache. What began in 1913 as a two-page form backed up by 14 pages of law has now become a 17,000-page maze that requires 703 different forms. More than seven times longer than the Bible, the tax code's 5.5 million words have created a nightmare of complexity that saps the economy's strength by punishing work, saving, investment, risk-taking and entrepreneurship.[7] The private sector pays $250 billion just to comply with income tax laws. The average cost of compliance for small and medium-sized corporations is $7,240 for every $1,000 in taxes they pay. [8]

Congress could make great inroads into relieving tax-related paperwork burdens on small businesses by, for instance, increasing Section 179 expensing limits. A majority of NFIB members exceed the current small-business expensing limits in only three months. The limit currently is $24,000. Congress should immediately raise the threshold to $50,000 and index it for inflation. This will allow additional investments to be expensed, enabling small businesses to expand and create new jobs. This will lower the cost of capital for tangible property and eliminate depreciation record-keeping requirements. This change will also increase small business owners' ability to compete in today's high technology markets.

Also, Congress could address AMT Relief/Repeal. According to the Joint Committee on Taxation, fewer than one in 150 taxpayers is subjected to the AMT today. By 2007, however, that number is expected to grow to one in 14, with the largest increase coming from taxpayers earning between $50,000 and $100,000. The individual AMT is a remarkably complex and obtuse provision in a tax code not known for its clarity. It requires taxpayers to calculate their taxes twice, and then pay the larger amount. While originally designed to ensure that wealthy Americans pay a reasonable level of their income in taxes, the AMT has the side effect of hitting taxpayers -- increasingly middle-class taxpayers -- when they can least afford the bill. The AMT literally kicks taxpayers when they are down.

Congress should also establish a Standard Home Office Deduction. Business location currently complicates common tax deductions. Home-based businesses incur expenses that would be easily deductible if the businesses were not located in a home. Many business owners do not take legitimate deductions because of the complexity of the

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[6] The Lead TRI rule is discussed in our OIRA comments, appended at Attachment A.

[7] Dan Mitchell, ***Time to Sunset the Tax Code***, The Heritage Foundation, Executive Memorandum #645, (January 28, 2000).

[8] From the office of the Majority Leader of the House, at http://flattax.house.gov/taxfacts/irsfacts.asp, November 10, 1999, citing information from Commerce Clearing House, Standard Federal Tax Reporter, (1996 and 1997).

paperwork involved in doing so. The complicated record keeping now required by the IRS to qualify for a home office deduction is a barrier to many who would qualify but don't have the time and staff to do the paperwork. That barrier would be removed if a "standard deduction" for home-based businesses were allowed. Like the 1040 standard deduction, the deduction would be optional. Owners could choose to continue to deduct the depreciated amount plus operation costs, as they are currently allowed to do. Or they could choose the new standard deduction.

Finally, we recommend that Congress clarify the Independent Contractor Definition. One of NFIB's top legislative priorities has consistently been to better define who is an independent contractor. The current 20 common law factor test for determining who is an employee versus an independent contractor has for too long handcuffed small businesses. These instructions are at best vague and unclear, making it difficult for small employers to honestly know whether they are complying with the rules.

Understanding and Complying with New Rules

Since most small-business owners play no part in rule development, the first element in the regulatory process for the large majority is discovering or finding out about a regulation that potentially affects them. In this regard, owners can either actively go out and seek new or changed regulatory requirements or they can respond when they encounter previously unknown demands. The overwhelming majority not surprisingly follow the latter course.

In our survey, eighty-two percent of small businesses reported that their approach can best be described as "coming across new rules in the normal course of business. Few claimed to search agency websites (as opposed to the internet in general), or regularly perused publications relating to their business. Many simply waited for the regulatory agency to notify them of new rules or regulations. Unless small-business owners are systematically searching for regulatory information, it is not likely that they would visit such a site.

We are encouraged that the SBA is taking proactive steps to assist small business owners in their ability to find out about and comply with new rules and regulations. According to my colleagues there, they are working on a new internet-based portal system which will allow these employers to search for, understand, and learn how to comply with new regulations—a one-stop shopping place for small business to learn about new rules and regulations. Once the system's effectiveness has been evaluated, NFIB will most likely steer its members and other interested parties towards it.

OIRA

NFIB is very pleased with the interest taken in small business issues by OIRA. Their formalized relationship with the Office of Advocacy at the SBA is a key step in ensuring that the regulatory burden faced by small businesses will be taken into consideration when new regulations are being addressed. Overall, OIRA's commitment to openness

and transparency can only serve to benefit the small business community, which continues to view the federal regulatory state as a near-impenetrable morass of laws and regulations, hard to understand, difficult to deal with, and costly.

NFIB is in favor of the decision to once again utilize "Return Letters" as part of OIRA's regulatory toolbox. We agree that agencies must take their responsibilities seriously in creating quality analyses of regulations—and "Return Letters" should prove effective in helping to bring this about. We are also encouraged by the public availability of these "Return Letters", and their easy access on OIRA's website. We hope to see OIRA continuing to rely upon this tool in coming years.

We also applaud OIRA's efforts to be more proactive, and use "Prompt Letters" to "suggest regulatory priorities". It is incredibly helpful for regulatory stakeholders to gain a sense of OIRA's priorities for agency decisionmaking, and the openness of the "Prompt Letter" approach is vastly more informative than the former, informal approach. While we understand the hesitation OIRA faces due to potential legal ramifications, we believe that the benefits far outweigh the risks involved.

We are encouraged by OIRA's efforts to bring a scientific approach to its overall regulatory review efforts. In the same way that unbiased fact-based analyses by other agencies have been beneficial in mitigating the impact of onerous and unnecessary regulations on the economy, the use of truly scientific cost-benefit analyses by OIRA can have extraordinary results. We believe it is absolutely essential to determine whether the benefits of regulations clearly outweigh their costs. We hope that OIRA will exercise careful oversight in the selection process for your Scientific Advisory Panel, and bring together esteemed professionals for reviewing OIRA's various interests. We also hope that small businesses are consulted in this process as well.

Conclusion

The NFIB appreciates the opportunity to share its concerns with Congress. With the cost of regulation being such a high priority for our 600,000 members, we are glad that we could bring our perspective to the Committee, and we are even more glad that you recognize the tremendous impact the regulatory state has on our members and the small business community in general. I would also like to thank William Dennis and Bruce Phillips on the NFIB staff, whose research serves as the foundation of this testimony.

I would now be happy to answer any questions the committee members might have.

TESTIMONY OF RAYMOND ARTH
CHAIR, LEGISLATIVE ACTION COUNCIL

NATIONAL SMALL BUSINESS UNITED

The Cost of Federal Regulations on Small Firms

Before the House of Representatives Committee on Small Business,
Subcommittee on Regulatory Reform and Oversight
Subcommittee on Workforce, Empowerment and Government Programs

June 6, 2002

Chairman Pence, Chairman DeMint, and other Members of the Subcommittees on Regulatory Reform and Oversight and Workforce, Empowerment and Government Programs:

Thank you for inviting me to testify today. I am Raymond Arth, the president of Phoenix Products, a producer of faucets for the manufactured housing and recreational vehicle industries. Phoenix is the largest single supplier of faucets to the manufactured housing industry and a major supplier to the recreational vehicle manufacturers industry. We have earned this position by providing innovative and cost-effective product designs to meet the specialized needs of our customers. Our company enhances its reliable product line with short lead times and excellent fill rates. In fact, our organization has been designed from the shop floor to its outside sales staff to provide our customers with reliable products and excellent service at competitive prices. I have about 60 employees and we are located in Avon Lake, Ohio.

I am the current chair of the Legislative Action Council of National Small Business United, and am a member of its Board of Trustees. NSBU is the nation's oldest bipartisan advocacy association for small business representing over 65,000 small businesses in all fifty states. In addition to individual small business owners, our membership includes local, state and regional small business associations across the country. I am a member and past chair of the Council of Smaller Enterprises (COSE), a division of the Greater Cleveland Growth Association, located in Cleveland, OH. COSE represents over 16,000 businesses in the Cleveland area and is the largest regional affiliate of National Small Business United.

I am pleased to appear before the committee to express our views on the cost of Federal regulations on small firms. In fact, paperwork reduction and regulatory reform issues were voted as one of our top legislative priorities for the 107th Congress, and have been a priority for our association for over 30 years.

As it happens, this week NSBU is holding its annual Washington Presentation, and over 100 small business owners from across the country are here in the nation's capital. When we received this invitation to testify we considered all the small business representatives who could appear today. In the beginning, we focused on our members who could provide "horror stories" about regulations run amuck. For example, we have a member who manufactures agricultural, lawn and garden chemicals. He's got great stories to tell, but the focus of this meeting is on the impact on all small businesses. So, I'm here to talk about the big picture and all the things that most small firms face, not just the worst case at the margin.

The regulatory burden is so pervasive, that many of us have lost sight of it altogether. The federal government intrudes into our workplace in so many ways. We have become so accustomed to complying with all the rules and the regulations that we've almost forgotten they exist. That's good if you're a legislator/regulator with an agenda; but the truth is, it's taking a serious toll on our ability to compete in a global market.

Small business owners have been increasingly vocal with their frustrations regarding the enormous amounts of paperwork that must be completed, filed and submitted to keep their firms in

compliance with the myriad of Federal laws they are subject to. Most of these small business owners would cite the Internal Revenue Service, the Occupational Safety and Health Administration, and the Environmental Protection Agency as the main sources of paperwork burden for their firms.

My experience indicates that the regulatory burden has several components. First and foremost are the paperwork requirements. Next are the often pointless incursions into the workplace. Third is what I consider the "psychic component". And finally, are the immeasurable "things that did not happen."

Starting with my friends at the IRS, I think it's fair to say that every American, whether in business – or just a private citizen – can attest to the fact that our income tax collection system is incredibly complex and time consuming. Also, based on the annual survey of tax preparers who compile returns from identical information, I doubt many of us believe it's possible to actually comply with the law.

Employers are required to withhold income and FICA/Medicare taxes and remit same on a schedule that can include up to eight monthly reporting periods. The penalties for failure to comply can be substantial.

The Department of Labor, through the Fair Labor Standards Act, imposes 19th century and depression era workplace rules on the workplace of the 21st century. Ironically, Federal workers

enjoy the flexible scheduling options that private workers would like to be able to apply to their workplaces. The Federal government has adopted the benefits of options like compensatory time off in lieu of overtime pay, etc. Why can't we play by the same rules?

When it comes to OSHA itself, it appears that legislators and regulators have lost sight of the most important factor in the small business workplace. That is, in most cases, the small business owner works in their workplace; most likely, family members do as well. We want to maintain a safe working environment because it is our own working environment. My three daughters have all worked the assembly lines at Phoenix, and believe me, I care about a safe work place. Also, more often than not, we know how to make our workplace safe and effective. The one-size-fits-all model that OSHA has adopted doesn't really work as well as custom worksite initiatives would.

Other well-intentioned efforts, like the Americans with Disabilities Act (ADA) or the Family and Medical Leave Act (FMLA), also unnecessarily disrupt the day-to-day operations of all businesses, but hit small businesses especially hard. We don't have the depth of staff to absorb the absences that have become routine since missing work became a protected activity. Planning our daily production schedule is done each morning before the start of the shift and is an exercise in optimistic projection. The reality is that the plan is rarely fully staffed because of unexpected absences.

I'd like to make it clear that our company has always had a very generous and flexible policy

with respect to personal leave. Prior to the FMLA we provided up to six months of leave for an employee disability with short term disability benefits if the leave was the result of illness or injury to the employee. But we've cut the leave to ninety days as required by law for all FMLA issues so that we don't run the risk of discriminating between employee and family issues.

We also used to offer an attendance bonus program which allowed employees to earn additional paid time off for perfect attendance. We have had to terminate that program since the courts have held that absences related to FMLA or ADA issues shouldn't be counted as absences.

The "psychic" toll of regulation is a personal matter and one that I will touch on briefly. Basically, many laws and regulations exist that can only be understood if the legislators and regulators believe that small business owners are shifty, dishonest or otherwise untrustworthy. There is no "top-heavy" test that applies to the people who run big companies like, say Enron. But let me set up a retirement program for my employees, funded with money that almost literally comes out of my pocket, and I'm suspect. The fact is we're the ones creating new jobs, new industries and moving this country forward. Give us a break!

Moreover, we must recognize that there is no mechanism in place to measure the things that did not happen: businesses that weren't started because the potential entrepreneur just didn't want the hassle; jobs that weren't created because it would push an employer over certain arbitrary limits and force compliance with a new round of regulations; products that weren't introduced because complying with well-intentioned regulations just was not worth the effort. I believe that

some of the greatest losses have occurred in the realm of things undone.

When one talks about paperwork reduction and regulatory reform, especially small business owners, the conversation always turns to the Regulatory Flexibility Act, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996. Congress passed these laws in order to ensure that regulations issued by certain Federal agencies considered adverse impacts on small firms before the rules became final policy.

Almost 22 years after passage of the RFA, and six years after the passage of SBREFA, we in the small business community find ourselves frustrated by what we see as blatant agency non-compliance with the law. Whether it is the work of the entire Small Business Committee trying to get the Centers for Medicare and Medicaid Services to consider the potentially adverse financial impact of their proposed and final rules on small firms, or the refusal of the IRS to consider themselves subject to the provisions of the RFA law, it seems to the average small business owner that the fight for fair government regulation will never be completed.

I don't mean to paint a totally negative picture. Thanks to the supremely dedicated staff of the Small Business Administration's Office of Advocacy, six years after the enactment of SBREFA, I think it would be fair to say that the law has had some real successes, but could yet be improved through a few technical amendments. In the last Congress, the Senate Committee on Small Business and Entrepreneurship approved a bill (S. 1156) that would have streamlined the SBREFA Panel process and made the Internal Revenue Service subject to the law. NSBU

strongly supported this effort, and we are willing to work with this Committee to ensure if a similar bill is introduced this session, that it ultimately becomes law.

Additionally, just before the Memorial Day recess, the full House passed the Small Business Advocacy Improvement Act of 2002. Introduced by Chairman Manzullo and co-sponsored by Vice Chairman Bartlett and Ranking Member Velazquez, the bill would require the Office of Advocacy to recommend ways small businesses owned and controlled by socially and economically disadvantaged individuals, women and veterans could receive financial assistance and maintain economic databases with desperately needed small business data. The bill also sets up a separate line item appropriation for the Office, a top legislative priority for NSBU. We would like to thank all members of this Committee for all of their hard work in ensuring that this critical bill becomes law. This legislation goes a long way in providing support to the greatest champion of small firms, the Office of Advocacy.

Small business regulatory reform efforts and paperwork reduction efforts are only as strong as the Federal agency commitment to be fair to small firms. After the passage of the Paperwork Reduction Act, some firms actually had an increase in the amount of paperwork that had to be completed and fully understood by the regulated universe of small firms. I liken this situation to the old proverb about a tree falling in a forest, no one hearing it, and the question being raised about it ever making a sound. If Congress passes a paperwork reform law, or a regulatory reform initiative, and no Federal agency shows willingness or an interest in working with the small business community to mitigate adverse financial or paperwork hour burden, then was a law

really passed? I make this statement not to criticize Congress, but to simply buttress the point that Federal agencies must pay attention to the Congressional intent of laws already "on the books."

On March 28, the OMB released its Draft Report to Congress on the Costs and Benefits of Federal Regulation in the *Federal Register* (67 FR 15014). In its announcement, the agency cited the Administration's explicit recognition "to be sensitive to the impact of regulations and paperwork on small business with Executive Order 12866." In the notice, OMB outlines provisions of E.O. 12866, citing the need for short forms and streamlined regulatory approached for small firms. We at NSBU hope that the Administration will follow up on these initiatives and plan to follow with great interest the OMB's response to the comments filed by the Office of Advocacy in response to the notice published.

According to the report, *"The Impact of Regulatory Costs on Small Firms,"* authored by W. Mark Crain and Thomas D. Hopkins, small businesses bear a disproportionately large share of the federal regulatory burden. In fact, the authors cite this as the most important finding of the entire study. "Environmental regulations and the paperwork burdens of tax compliance are particularly disproportionate in hitting small business," the report states. "Firms employing fewer than 20 employees face an annual regulatory burden of $6,975 per employee, a burden nearly 60 percent above that facing a firm employing over 500 employees." These are real costs, and is "real money" to those small businesses that are good actors, and are simply tying to drive the engine of the American economy.

What small businesses want is a fair playing field in a regulatory environment. We need no special breaks or benefits, just an opportunity to play the game with the same rules large businesses do.

Along these lines, NSBU recently released a report on tax equity commissioned by the Prosperity Institute. The study takes a look at America's tax regime (the Internal Revenue Code) with the object of examining which of its provisions directly and unfairly disadvantage small firms—or their owners—compared with large firms. The purpose of this report is to identify sections of the Code, which discriminate against small firms and to propose revisions that would establish true equity between small businesses and their larger counterparts. I have brought copies of this report with me, and the report is also available on our website at http://www.nsbu.org.

Earlier this year NSBU Director of Government and Public Affairs Damon Dozier testified about a General Accounting Office report entitled *Regulatory Reform: Compliance Guide Requirement Has Had Little Effect on Agency Practices*. This report found that six federal agencies including the Commerce Department, the Environmental Protection Agency, the Federal Communications Commission and the Securities and Exchange Commission failed to produce small business guidance documents as required by the Small Business Regulatory Enforcement Fairness Act of 1996.

This particular report focused on Section 212 of SBREFA, which requires agencies to publish

compliance guides for each rule or group of related rules for which the agency is required to prepare a final regulatory flexibility analysis. Most alarmingly, not only did the six agencies fail to provide compliance guides, some of the documents provided by the agencies "appeared to have been identified as small entity compliance guides only in response to our inquiry," according to the GAO. The findings of the GAO show that most Federal agencies simply are not committed to agency outreach, and thus, fail to comply with most of the RFA's provisions.

This example shows again, that the interests of small firms continued to be ignored, in direct contravention of the law.

However, legislation authored by Representative Velazquez would track for the first time the paperwork requirements of regulation compliance that burden small firms. The Small Enterprise Paperwork Reduction Act seeks to track paperwork burden for small businesses by industry type. This type of reporting is critical to bringing to light the trials and tribulations small businesses must go through simply to stay in business. NSBU is happy to support the Congresswoman's bill.

We at NSBU believe that while paperwork and regulatory reform legislation is desperately needed, more fundamental reform is still necessary in two areas: risk assessment and cost/benefit analysis. A cost/benefit analysis would require agencies to assess the benefits of a new rule against its potential costs and ensure the new rule was "worth it." Risk assessment deals with determining the levels of risk associated with certain activities. Scientifically sound risk

assessment would determine the actual level of risk to humans and thus suggest appropriate regulations. Instead, regulators without scientifically sound assessment create expensive rules designed to preclude risk that might not even exist.

I appreciate this opportunity to testify before these subcommittees today, and I would be happy to answer any questions that you have at this time.

Association for
Competitive Technology

June 6, 2002

Honorable Mike Pence
Chairman
House Small Business Committee, Subcommittee on Regulatory Reform and Oversight

Honorable James DeMint
Chairman
House Small Business Committee, Subcommittee on Workforce, Empowerment and Government Programs

United States House of Representatives
Washington, DC 20515

Dear Chairman Pence and Chairman DeMint:

The Association for Competitive Technology (ACT) represents over 3,000 technology companies and professionals. The bulk of our membership is comprised of small and mid-size companies and their executives. This reflects the fact that nearly 80% of technology companies can be classified as small business. ACT members have one goal: the creation of innovative e-commerce business models. We believe that the costs of invasive government regulation have already and will continue to stifle our members' ability to accomplish this goal.

The costs of government regulation can be measured in terms of actual dollars spent on compliance as well as lost productivity and business opportunities. There is one striking example that brings this point home. The regulations that flowed from the Child Online Privacy Protection Act (COPPA) are a disaster that has tainted an otherwise laudable goal.

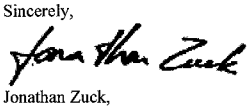
In terms of privacy there is no greater concern than protecting children. In 1998, Congress passed COPPA as part of an omnibus budget proposal and left the details to FTC regulators. While much remains unknown as to what benefits will come from regulating privacy, there is already evidence that this attempt was a costly mistake. The FTC concluded in its certification to avoid a Regulatory Flexibility analysis that, "any additional costs of complying with the Rule, beyond those imposed by the statute or otherwise likely to be incurred in the ordinary course of business, are expected to be comparatively minimal." Were they ever wrong.

Each and everyday, small IT companies make decisions critical to their survival. The complexity and costs associated with a regulatory scheme such as COPPA force these companies to forgo other needed investments or incur significant additional costs. For example, Wall Street Journal Interactive reported that FreeZone, a web portal for kids between 8 and 14, estimates it will spend about $100,000 per year to comply with COPPA. Another company, Zeeks.com, pulled all of its interactive content because the $200,000 per year cost to employ chat-room supervisors, monitor phone lines to answer parents' questions, and process COPPA permission forms was "the straw that broke the camel's back."

Another and more egregious problem is that COPPA rulemaking did not actually solve the problem identified in the underlying legislation. COPPA doesn't apply to sites that don't target minors--like porn sites. So, the costs of compliance are imposed only on web sites that are "good actors" by acknowledging that they want to responsibly serve minors.

ACT believes that because of the myriad of costs, there is no way to impose a "light" regulatory hand. Further, the right public policy goal should be to resist regulating where innovation exists to meet the needs of all interested parties. I thank you for convening this important hearing and look forward to working with you on this and other technology issues of interest.

Sincerely,



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