REFORMING REGULATION TO KEEP AMERICA'S SMALL BUSINESSES COMPETITIVE

HEARING

BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

WASHINGTON, DC, MAY 20, 2004

Serial No. 108–66

Printed for the use of the Committee on Small Business

Available via the World Wide Web: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

94–132 PDF WASHINGTON : 2004

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THURSDAY, MAY 20, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:41 a.m. in Room 311, Cannon House Office Building, Hon. Edward L. Schrock [Chairman of the Subcommittee] presiding.

Present: Representatives Schrock, King, Case and Velazquez.

Chairman SCHROCK. This hearing will come to order.

Good morning, everyone. We are having this hearing today on keeping America's small businesses competitive. Our economy has turned the corner. Small businesses, which are responsible for employing half of our workforce and providing 75 percent of the net new jobs have led the way in this recovery.

Frankly, I think it is the job of Congress to set the right conditions for economic growth and then, quite frankly, get out of the way. Most small business men and women do not want a hand out or a hand up but just hands off. The United States has the most creative, most productive, most entrepreneurial citizens of any nation on this Earth. It is incumbent on the government to not mess things up.

Everyone here has heard the statistics about the cost of regulation to our economy. And I am sure we will discuss them further today. Some of the numbers that just get to me though are the hours of paperwork burden that agencies have imposed upon the public. Whether it is the 149 million hours imposed by EPA, the 165 million hours from Labor, the 254 million hours from the Department of Transportation, the 276 million hours from HHS and the 6.5 billion hours imposed by Treasury and the IRS. It is just a mass diversion of our economy's productive resources into red tape and paperwork. And other than paper mills, it is not stimulating the economy.

So today we have gathered some of the foremost experts on regulation to discuss possibilities for reforming the system. Several attempts at reform have even been made this week. On Tuesday we passed a series of reforms to improve the OSHA adjudication process which has for too long stacked the deck against small businesses. We also passed Representative Doug Ose's H.R. 2432 which will improve regulatory accounting and permanently authorize the

Congressional Office for Regulatory Review inside the General Accounting Office.

We are very lucky to have Representative J.D. Hayworth from Arizona with us today. J.D. has been a tireless warrior in the fight to fundamentally reform the system of regulation we have in place today. I am a co-sponsor of his legislation. And, Congressman, we are happy to have you here today. Creating a system where common sense, transparency and fairness rules the day in government regulations is one I look forward to. And I am anxious to hear the testimony of all our witnesses.

[Chairman Schrock's statement may be found in the appendix.]

We will now have any additional opening statements. And I would ask the Ranking Member on the full Committee Ms. Velazquez if she has any comments.

Ms. VELAZQUEZ. Thank you, Mr. Chairman and welcome, Mr. Hayworth.

Today the business world is getting increasingly competitive. It is more and more difficult for small businesses to maintain an edge. One reason for this is due to federal regulations. Unfortunately our government rules disproportionately weigh on our country's most important economic sector, small businesses. In fact, a recent report commissioned by the SBA Office of Advocacy showed that the annual regulatory burden is 60 percent higher for firms employing less than 20 employees than for firms with more than 500 employees. Instead of building their businesses and expanding their customer base our entrepreneurs are buried under a mountain of paperwork.

The Bush Administration has acknowledged just how bad the regulatory burden is for small business. The president has talked about it in several policy speeches around the country. He has also vowed on many occasions to do something about it. But the truth is this administration holds the paperwork burden record for the largest increase in a single year. Since the administration took office it has published about a quarter of a million densely packed pages of regulatory proposals, notices and rulings.

Another big problem is the failure of federal agencies to comply with the law. There are laws on the books that were enacted to protect small businesses in the rulemaking process. These include the Regulatory Flexibility Act and the Small Business Regulatory Enforcement Fairness Act. These laws require federal agencies to do their homework in an attempt to lessen the impact their rules will have on small enterprise by finding less burdensome alternatives. If these laws were being followed the SBA Office of Advocacy would not have reported to Congress that its intervention saved small businesses $30 billion in additional regulatory compliance cost.

Clearly this shows how agencies are reluctant to fully comply with their requirement of RFA. This is a shame for small businesses and it just puts them in another one down position when compared to their corporate counterparts.

There have been several proposals before this Committee on how we can make the regulatory environment more small business friendly. Even the president signed an executive order to this end but it did little more than restate current law. If we are going to

make changes to the system they need to be bold ones that place a premium on enforcement.

Just recently our Committee held a hearing on legislation that will strengthen the RFA. H.R. 2345, the Regulatory Flexibility Improvement Act of 2003 seeks to better define and expand which economic effects are to be examined by these agencies and requires them to use greater precision in performing the analysis. Most importantly, it brings the agencies that develop and implement regulations which weigh most heavily on small businesses, like the IRS, CMS and FCC, under SBREFA panels just like the EPA and OSHA.

Although there is no quick fix for providing small businesses with regulatory relief there are proposals out there that could ease the regulatory burden they currently face. If we could strengthen the laws already on the books and ensure enforcement of these laws, small businesses might just spend less time on paperwork and more time on helping their customers or hiring new employees.

With that I look forward to the testimony of the witnesses. Thank you, Mr. Chairman

Chairman SCHROCK. Thank you, Ms. Velazquez.

I believe the gentleman from Iowa, Mr. King, has opening comments. Mr. King.

Mr. KING. Thank you, Mr. Chairman. I appreciate you holding this hearing. And I appreciate you coming to testify, Mr. Hayworth.

I would associate myself with some of the remarks made by Ranking Member Velazquez in that we need to make some bold changes. And I am one of those people that believes that there are foundational issues that have to do with the Constitution and free enterprise and law that if we get them wrong in our foundational portion then things grow out of them that we never intended, things grow out of bureaucracy that are so complicated that if we begin to just go in and trim the bushes and rearrange and grab some branches out there we will never get at the root cause of the problem. We have got to at it and chop the roots, we have got to be bold.

And when I look back also in I have had now eight years in legislative life, sum total of state and federal, and I have seen time and time again that elected legislatures want to put a shield between them and accountability with the people. So we put a board or a commission or a bureaucrat in front of us to be a shield for accountability and we give those people the authority to make decisions. And what grows out of that? Inside the Beltway bureaucratic mentality where the bureaucrats that write the rules are looking across the table at the citizens who are affected by the rules but there is a disconnect because there is not a way that citizen can hold the bureaucrats accountable. And there is not really an effective way we, as members of this Congress, can hold the bureaucrats accountable.

So I am very interested in H.R. 110, not because I think that we will amend very many rules in Committee or on the floor of Congress, but because we can because then that bureaucrat that sits behind the table will realize that the citizen who is affected by the rules that they are about to write has an alternative to come to their member of Congress and make an appeal whereby then the

threat that we can amend the rule or remand it back to be written with instructions or repeal the rule is all part of Congress stepping up to their responsibility.

This is swinging for the fences in a way. The first 150 years of the United States that is how it was done. And it worked pretty well up to just before World War II. But today we need to get back to congressional accountability and streamline this regulatory process. And I think it will be streamlined incrementally because we will have changed the foundation and corrected it so that we have the right foundation.

So I am interested in the testimony. I appreciate the hearing. I am looking forward to it all. Thank you very much.

Chairman SCHROCK. Thank you, Mr. King.

And speaking of bold and tearing down barriers between the regulators and the public that is why J.D. Hayworth is here today.

J.D. Hayworth is not only passionate about this subject, J.D. Hayworth is passionate about everything he does up here. J.D. Hayworth is passionate about life. So he is probably the absolute perfect person to come up and speak to us. So with that, J.D., the floor is yours.

STATEMENT OF THE HONORABLE J.D. HAYWORTH (AZ-5), U.S. HOUSE OF REPRESENTATIVES

Mr. HAYWORTH. Chairman Schrock, Ranking Member Velazquez, Congressman King, Congressman Case, my colleagues, thank you very much. And with that wonderful introduction, Mr. Chairman, I would ask that my entire albeit passionate statement be included in the record this morning.

Chairman SCHROCK. Without objection so ordered.

Mr. HAYWORTH. I thank the Chairman.

Colleagues, the Constitution is clear. Article I, Section 1, "All legislative powers herein granted shall be vested in a Congress of the United States." And as Congressman King pointed out in his opening statement, for the first 150 years of our republic, the Supreme Court held that the transfer of legislative powers to another branch of government was in fact unconstitutional. In the late 1930s, however, the Court reversed itself, and upheld laws by which Congress merely instructed agencies to make decisions that served "the public interest." Since then, Congress has ceded its basic legislative responsibility to executive agencies that craft and enforce regulations with the full force of law. The Supreme Court has not invalidated a single delegation of power since 1935.

Now, law-making was never intended to be in the hands of executive branch employees. As the Constitution enumerates, the power to make laws was solely vested in Congress, because Congress is directly accountable to the people.

The founders knew that law-making authority vested in Congress would make for good government because our elected officials would be directly accountable to their constituents. I often ask those whom I am honored to serve: Do you believe unaccountable employees in the executive branch should have the power to make laws? To this day, I have not heard one person answer this question in the affirmative. My constituents understand the ramifications of granting broad powers to the executive branch to make

laws. Yet, to the chagrin of many whom I serve this is the case in America today.

It is no wonder why so many of our constituents, why so many citizens are so disillusioned with what they deem to be an unresponsive government. H.R. 110, the Congressional Responsibility Act, will rightly return legislative powers to the Congress by requiring Congress to vote on all rules and regulations, as defined in section 551(4) of title 5, United States Code, except those regulations of particular applicability, any interpretive rule, general statement of policy, or any regulation of agency organization, personnel, procedure, or practice. It is important to note this, my colleagues, Mr. Chairman, my legislation will apply only to new regulations and will not be retroactive.

Now, detractors say there is no way that Congress has the time to review all rules and regulations that are promulgated by the executive branch. Regardless of time implications, however, it is the duty of Congress to review rules and regulations, as I just pointed out and was clearly enumerated in Article I, Section 1 of our Constitution.

Now, I should also note that it has been my honor and privilege to serve on occasion as Speaker Pro Tempore of the House. And on more than one occasion, I have presided over largely ceremonial debate in which we took several hours to name federal installations after famous Americans, and some Americans quite candidly who might not be that famous. The question is simple and it is this: If we can name courthouses, airports, military bases, and other places, should we not take the time and do we not have enough time to vote on rules and regulations that profoundly affect the citizenry and the small businesses of this country.

With these time constraints in mind, however, the Congressional Responsibility Act provides an expedited procedure for considering rules and regulations. Within three days after an agency promulgates a rule, the Majority Leader of both the House and Senate, by request, must introduce a bill comprised of the text of the proposed regulation. If the bill is not introduced in three days, any member thereafter may introduce the bill. The bill is not referred to Committee unless a majority of the members agree and send it through the normal legislative process. Within 60 days of being introduced, however, the legislation must come before the respective chamber for a vote. The bill shall be limited to one hour of debate and cannot be amended. If a majority of members of the body vote for the bill, it is sent to the other body for approval. Upon approval of both bodies, the legislation would be sent to our president to sign or veto.

Some other opponents of this legislation might argue that this would delay the implementation of rules and regulations. In reality, I do not believe it would. Rules and regulations are often the subject of countless and endless lawsuits. For example, the final rule for leaded gasoline took nearly 10 years to promulgate because it was the focus of intense litigation. Congress now becomes the final arbiter in rule making and the Congressional Responsibility Act states that a regulation contained in a bill is not an agency action for the purpose of judicial review under chapter 7 of title 5,

United States Code. This would bring to a halt litigation that delays implementation of regulations.

Finally, opponents of delegation say this is a backhanded attempt at regulatory reform. The Constitution makes clear that all legislative powers are vested in the Congress. Article I asserts that this legislative power includes the power to regulate. By returning the power to regulate to the Congress, we will make Congress accountable for federal laws. This will make for better government. This will make for a real reform and restoration. It is a laudable goal that we as well as the American people should desire.

In my opinion, delegation is one of the root causes of the American people's disenchantment with government. We can take a step in the right direction by ending the unconstitutional delegation of powers. By taking this step, we will help restore confidence and integrity to the federal government. Many people agree with this analysis, and this is why the concept of non-delegation is embraced by folks across the political spectrum, by liberals, such as Nadine Strossen of the American Civil Liberties Union, and conservatives, such as Judge Robert Bork. In fact, it was new Justice Stephen Breyer who wrote in 1984 how the legislative veto should be replaced by an expedited procedure for Congress to resume its rightful role in passing rules and regulations.

Congressman Bob Ney, Congresswoman Ginny Brown-Waite, and I have each introduced legislation, as the good Chairman and the gentleman from Iowa have likewise co-sponsored, that will provide more congressional oversight of the regulatory process. My bill would end delegation of legislative power to the executive branch. Congressman Ney and Congresswoman Brown-Waite's legislation would set up congressional Committees charged with reviewing all of these regulations before they have the effect of law. The legislation they offer is modeled after the Ohio and Florida state systems respectively.

I see these new bills, and this weeks' highlighting of the need for a reduction in red tape, as Congress awakening to a very important issue. I have heard it said that Congress only considers the urgent, while brushing aside the important. The Congressional Review Act, signed into law in 1996, seems to reflect that adage. Congress only considers repealing regulations through the disapproval resolution process if the matter is made urgent. Congress should examine each proposed rule before it goes into effect.

Let me again pause and thank Congressman Steve King and Congressman Dennis Cardoza, who are co-sponsors of this bill, again, along with the aforementioned Chairman of this Subcommittee and my good friend, Ed Schrock, and so many other members who have helped out with the support. We have 22 other co-sponsors, including Congressman Paul Ryan of Wisconsin, who has supported this legislation since the day he came to Congress.

Mr. Chairman, my colleagues, I would like to end my testimony by quoting John Locke's admonition that "the legislative cannot transfer power of making the laws to any other hands." Delegation without representation is as wrong today as taxation without representation was in the 1700s. It is time Congress took back its constitutionally granted power to make laws.

Again let me thank you, Mr. Chairman. Let me thank all the members of the Subcommittee for allowing me this opportunity to testify here today. We have talked in Congress a lot about reform. Reform needs to move past rhetoric to reality. I think that ending the delegation of powers from the legislative to the executive branch could be the single most important reform this Congress addresses. I am hopeful we can make a substantial change to this glaring problem in the next year.

And again I thank you, Mr. Chairman. That concludes my testimony.

[Rep. Hayworth's statement may be found in the appendix.]

Chairman SCHROCK. Thank you, Congressman. You got us all energized now so I think we are ready to go.

Congressman, are you at all worried that Congress might stifle agency attempts at deregulation by stopping them with a vote?

Mr. HAYWORTH. No, I do not believe so. In fact, if you take a look—and I talked about the Supreme Court really kind of changing this concept in the 1930s—but take a look at the dynamic under which we serve right now. Let us just face it, as members of Congress how many times have we heard from constituents saying, Gee, as we are trying to work out this regulatory dispute we do not believe that the implementation of the regulation is really carrying out the will of Congress. We believe that the unelected are foisting their own prejudices on a certain rule because so often when we have dealt with a variety of issues we have used language that is open to interpretation.

And so we are put in a situation where we will call up or we will write an agency and we will say, in kind of an unfortunate and poor impersonation of Bill Murray in "Caddyshack" that seems to embody this, to show the frustration, we will go, Please, please, please, Mr. and Mrs. Unelected Regulator, wouldn't you just please, please, please take a second look because this is how we implemented the—this is how we enacted the legislation and this is how my constituent is trying to come back and deal with it. And yet you, who are unelected and unaccountable, say that it is just not good enough.

Understand what we structurally have put in place, and it was not because of any avarice or any type of evil. Indeed, in the progressive era it was Theodore Roosevelt in the early 20th Century who said we had to bring experts into government. We took a look at enacting safeties for food and drugs and cosmetics. But we have gotten away for three-quarters of the 20th Century and now into the 21st Century we have gotten away from experts helping us in terms of real science. Instead now the greatest growth has come in the notion of regulatory law. And the unelected bureaucrats, the one area of responsibility that is some form of merit is the promulgation of new regulations.

Some of them may be needed, because we certainly need a modicum of regulation in a variety of industries, but many of them are so parenthetical and so specific and, quite frankly, in terms of small business so out of touch with reality, that we end up with the massive amount of paperwork that the ranking member pointed out and criticized.

And I would say for today's purposes, mindful of the fact we are less than 170 days away from a general election, I will accept in good faith your criticism of this administration. I would say also that it spans other administrations. We have had real problems with all the rules proposed ending up in the federal register. And what we are doing with this legislation is this: we are rightfully restoring the role of Congress.

Now, to be frank about it a lot of our brethren are perfectly happy with not having the responsibility. A lot of folks like the situation where we go and we kind of by request we go hat in hand to the unelected. But, see, I do not believe we are elected to be ombudsmen or ambassadors from our district to the burgeoning bureaucracy known as the executive branch and all the alphabet soup of administrative agencies. I believe we are here to be law makers. And by enacting this legislation we control or we take final responsibility for the promulgation of rules and regulations.

Chairman SCHROCK. You said that in your proposal we will look at rules as we go forward, but what do you think we should do about all the unnecessary and burdensome regulations in the past? That is what is driving people crazy right now. How do we deal with that? One step at a time I gather?

Mr. HAYWORTH. That is true, Mr. Chairman, colleagues. In fact, something that we made use of in the 104th Congress, which I believe is still with us in the rules of the House, something called Corrections Day. And perhaps we ought to take a look at that as we are dealing retrospectively. But for our purposes for reform, you know, it is inherent, even something as sweeping as this type of restoration of rightful powers to Congress has to start somewhere. And I think it is better to start prospectively. But I would encourage you to take a look as we know other bills are out there. They are already in practice I believe, and I do not believe we have changed the rules of the House. We have within our power now to bring up in essence Corrections Day to eliminate some red tape.

But I think this restoration—it is really a misnomer to call it genuine reform—this restoration of rightful constitutional powers is so important and let us take it prospectively and we can look at a variety of other remedies to deal after the fact.

Chairman SCHROCK. Before I yield to Ms. Velazquez, what do we need to do to help you move this legislation forward?

Mr. HAYWORTH. Well, I would call on folks really, not even in a bipartisan manner but in a non-partisan manner, to take a look at this. I think it is important. And as I pointed out, folks across the political spectrum from the left to right understand the need to do this. Indeed, this procedure was outlined by now-Mr. Justice Breyer when he was talking about the constitutional problems that we have earlier in our history in the 1980s with the so-called legislative veto. He saw this as a constitutional way to restore the powers of article I, section 1.

And it is in that spirit we come today because, again, as the ranking member pointed out in her comment, there are some legitimate concerns. Because nobody here is talking about the decimation of regulation. We all understand that a modicum of regulation is required for so many businesses, for environmental protections,

for so many different agencies. But what we need to do is take back the responsibility. And that is what H.R. 110 will allow us to do.

Chairman SCHROCK. Thank you.

Ms. Velazquez.

Ms. VELAZQUEZ. Thank you for your testimony on your legislation.

You know, one of the characteristics of this Committee is that it is non-partisan compared to any other Committee. And I have to say that I strongly criticized the Clinton Administration regarding the economic impact on small businesses, regulations and paperwork. But there is a difference, the difference is that when this administration walked into the White House they made paperwork burden and regulations a top priority. The numbers does not, do not back that up. And that is what makes this quite amazing.

Mr. HAYWORTH. Well, I thank you, Ranking Member Velazquez. And again, I offer, I think you offer constructive criticism. And we all rejoice in the fact that in less than 170 days all Americans will go to the polls. And I think really this is more not so much partisan as it is institutional. It is our role to be law makers. It is our job to, I believe, to reestablish what the Constitution says in article I, section 1.

And so it is in that spirit I come today. And I would call on folks, Ranking Member Velazquez, I hope you will review the legislation, we would love to have you as a co-sponsor. Hope you can join with us in this effort.

Thank you.

Chairman SCHROCK. Mr. King.

Mr. KING. Thank you, Mr. Chairman.

I would just point out an anecdote that I think illustrates some of the problem that we have. And that is some months ago I wrote some legislation that I was the drafter of that legislation, introduced it and it went into the bill, a separate section. I will not give you the number here in this hearing. That separate section addressed with a specific issue, specific issue that had to do with things that I was concerned about. The legislation passed with my text precisely the way I drafted it.

But when the rules came out they did not reflect the legislative intent whatsoever and, in fact, it provided benefit to the people I was trying to bring the balance back in competition to. And the bureaucrats had the audacity to argue to my chief of staff that we did not understand the legislative intent. Well, there was no more definitive authority on that particular section of the bill than Steve King.

And I am going to ask you to speak to that kind of issue but also there is a couple things. First of all, it is a non-partisan and it is addressing an institutional, and I appreciate that testimony on that. I am going to ask you about how to address legislative intent and those kind of things, but also the how do we prevent as the rules are being written the undue influence on the amount of leadership and Committee chairs and ranking members on the rule writers? How do we counterbalance that with this legislation and how do we counterbalance it without that legislation?

Mr. HAYWORTH. Mr. Chairman, Congressman King, I think the answer is implicit in the anecdote that you offered us. In other

words, take a look at the process. Right now what you have is such—and I am sorry it is a strong term but I think it is realistic—what you have right now is a perversion of what our founders intended because you have the unelected, that is to say also the unaccountable and the unresponsive, drafting rules in their own image. And it is paternalism and arrogance of the worst variety.

And, quite frankly, I do not believe in the construct that Committee chairs or other legislative leaders in any way influence it because what we have set up in this bill within the process is to bring the proposed rule and regulation word for word to the floor of the Congress of the United States. And by doing so, we are offering, we are taking a look at the fact that, yes, we will grant that there is certain technical, scientific expertise that government must call on that all regulation is not bad, that yes, given the sophistication and the complexity of what we confront now as a society we do not believe it would be like lightening striking twice or something incredibly rare but, yes, from time to time the unelected can have good ideas, but that we should offer our imprimatur of approval or disapproval of those ideas and in that—and in so doing be responsible to our constituents. And that way we are resuming and taking back the responsibility the Constitution gave us and we are offering accountability.

And if there are those in the electorate who believe that the unelected should absolutely have that power to move forward or perhaps disagree with our take, then every two years we have the remedy likewise offered in article I of the Constitution in terms of the fact that we stand at the bar of public opinion and we can be replaced. But we will have in place, for lack of a better term, a forward loaded mechanism that brings legislation to the floor, that allows us in its purest form to say either yes or no to the promulgation of a regulation from an unelected and therefore unaccountable federal bureaucrat.

Mr. KING. Do you believe that under current structure of rules and legislation today that there are chairs, leaders, ranking members who occasionally will give a member language in the code but also provide license among the bureaucrats to take that effectiveness of that language away through the rules?

Mr. HAYWORTH. I believe that our system, and I am not a lawyer, do not play one on T.V., but just as a citizen who observes history I believe that it may not have been the intent but in essence the practical effect of what has happened for the bulk of the 20th Century, now into the 21st Century, has turned the entire process of legislative intent and the making of law and then the implementation on its ear.

And nowhere do we see it more than, as the ranking member pointed out, in the promulgation of all these regulations that show up in the Federal Register. And we need to move those front and center because they carry the weight of law, because if you violate these regulations you are subject in many cases to fines and/or imprisonment or sometimes both.

It seems to me in essence these are not rules and regulations, they are laws. So we bring it back to the source. And I think this has a restorative effect that brings back the proper balance and I think helps strike a blow for accountability of the elected and for

a sober reassessment of what has become in essence the fourth branch of government, the regulatory branch.

Mr. KING. Mr. Hayworth, I am in enthusiastic agreement. And I yield the balance of my time.

Thank you, Mr. Chairman.

Chairman SCHROCK. Mr. Case.

Mr. CASE. Thank you, Mr. Hayworth. Good to work with you.

Mr. HAYWORTH. Congressman Case, thank you.

Mr. CASE. I share your sentiments and I share your frustration. I think I speak for a lot of small businesses out there. We both have experience in small business.

I took a look at your bill very closely from that perspective, and came to my own conclusion that to require every regulation to go through Congress up front probably was not the way to go, just to be up front with you. But I am certainly looking for some way to get at the same problem that we both agree on. In putting your bill together did you consider why the current law passed in 1996 requiring congressional—the ability to Congress to disapprove of a rule or a regulation, why that is not used more by Congress, number one? And number two, whether there would be a way to improve upon that scheme which essentially gives Congress a veto right, I guess you could put it that way, over a regulation?

I guess what I am looking for is a midpoint that I could personally accept that improves on a system that does not seem to be working and yet does not go as far as your bill, to be quite honest.

Mr. HAYWORTH. Well, Congressman Case, I appreciate your thoughtful criticism. And let me offer this response. As one who came here with a new majority in 1995 and who introduced this I think as the first piece of legislation I have brought to the floor and it is reintroduced each Congress, again it is not a democrat or republican issue, it becomes institutional. It is far simpler to us—and I am not trying to indict everyone on the dais—but just us, Congress as congresspeople, it is far easier for us to go out and rant against a monolithic and faceless bureaucracy. And it is far easier, quite frankly, to be an ombudsman or an ambassador to that fourth branch of government rather than restore the powers the Constitution offers.

And I think it is the—do not mean to get Shakespearean on you—but the fault, Dear Brutus, is not in the stars, it is in ourselves. And that is just inherent, it is just too tempting to sit back and just be able—and for members from both sides of the aisle to play the hand we are dealt now where we go in supplication to the unelected and say will you not please, please, please reexamine this?

And to have, as one other noted thinker once said, if there were not a devil, man would certainly create one. And it is easier to demonize the bureaucracy and then to try and reconcile whatever problems we have on a case by case basis—that is one of the reasons we call it case work—for so many small businesses, for so many constituents rather than take this again by the roots and restore the fundamentals of the Constitution and take upon our shoulders clearly and unashamedly and unmistakably the imprimatur the founders gave us.

And, indeed, again not to make it partisan, but I have heard so many of my friends on the other side bemoan our current schedule and bemoan the naming of honorifics for Americans and being in the naming business for suspension bills so many times, it seems to me that we can make the time and, indeed, we should take the time for this fundamental reform. There have been efforts tried in the past. But until we take up a structural reform—this is where you and I have a legitimate disagreement—until we take up the structural reform it is just far easier to go ahead and let the unresponsiveness and the unaccountability of the unelected continue to proceed. It just happens to us.

On another note, when I was first elected, Congressman Case and Mr. Chairman and my colleagues, Senator McCain called me and he said, Hey boy, congratulations. He said, When you get to Washington you are going to feel like a mosquito in a nudist colony.

I said, Excuse me?

Yeah, he said, there are so many targets of opportunity, there are so many problems to solve.

And again there are some who rightly say just the sheer weight of this would be tough. And I appreciate that criticism but I think it is far better to deal with these on the front end because just with what we have to deal with and just the electoral or the political convenience, and that may not be the intent on either side of the aisle but it is the practical result. Which is why this ain't rhetoric, this is a reform that is a restoration that puts the Congress back front and center in making laws.

But I really do appreciate your thoughtful criticism.

Mr. CASE. Thank you very much for your efforts.

Mr. HAYWORTH. Thank you, sir.

Chairman SCHROCK. J.D., thank you very much. I was fascinated by the question of Mr. Case, how do we make this all happen? But if we do not do something we are going to continue to harm small business in this country that other companies offshore do not have to deal with. And every regulation we pass just hampers them more and more and more. And we simply have to get that under control.

And I think what you are doing here is trying to bring attention to it and, hopefully, get something done that is reasonable. And you are right, we can spend all day Tuesdays naming bridges, highways or whatever else. And to me that is okay but I think this is far more important to the vitality of business in this country. We have got to get this under control.

Mr. HAYWORTH. Well, Mr. Chairman, I thank you. And again, just to say to my colleagues if we are able to move forward with this, again embraced by members on both sides of the aisle, in fact outlined by now Mr. Justice Breyer in some of his writings, this is not a republican/democrat conundrum, this is a structural reform that is not a ruse, it is a restoration of the legitimate function of the legislative branch. And we ignore it at the peril of our country, the peril of small business and the ultimate peril of our citizenry. And I thank you very much.

Chairman SCHROCK. Thank you. Thank you for your patience and thank you for coming.

My 90, almost 91-year-old father thinks J.D. Hayworth was sent straight from heaven and is the finest congressman that he has ever seen. Not me but J.D. Hayworth. And he would be delighted to know that I spent time with you today. And we really appreciate you coming.

Mr. HAYWORTH. Mr. Chairman, thank you for that praise. I think you would get a few arguments both theologically and practically from other folks. But I appreciate your father's support and I appreciate the wonderful reception of the thoughtful criticism and the thoughtful plaudits for this legislation. And I hope we can move forward.

Chairman SCHROCK. Thank you very much.

Mr. HAYWORTH. Thank you.

Chairman SCHROCK. We will take about a four minute break while we set up for the next panel. Thank you very much.

[Recess.]

Chairman SCHROCK. Well, thank you all for being here. I feel sorry for the three of you that have to follow J.D. Hayworth. That is one tough act to follow. But he is really passionate about what he does. And I am glad you were here to hear him speak.

Before we begin testimony from these witnesses I would like to remind everyone that we would like each witness to keep their oral statements about five minutes. In front of you on the table you will see a box that will let you know when your time is up. When the light is yellow that means you have one minute remaining. When it turns red at the five minute point the trap door opens and away you go. Once the red light the Committee would like you to wrap up as soon as you can.

We are going to hear next from Susan Dudley. Ms. Dudley is the Director of Regulatory Studies Program at the Mercatus Center at George Mason University out in Fairfax County, Virginia. Additionally she is an adjunct professor at both George Mason University School of Law and Georgetown University. Ms. Dudley previously worked for the Environmental Protection Agency and the Office of Management and Budget in addition to positions within the Department of Energy. And she has written numerous articles on issues of regulation.

So we are delighted to have you today. And with that I turn the floor over to you.

STATEMENT OF SUSAN DUDLEY, MERCATUS CENTER

Ms. DUDLEY. Thank you, Chairman Schrock, Congressman King and Congressman Case. Thank you for inviting me to testify on this important issue of reforming regulations to keep America's small business competitive. My testimony reflects my own views today and not that of either university that I am affiliated with.

I appreciate your efforts this week to highlight the impacts of federal regulation. And I thought your opening statements were inspiring and right on point. Our research at the Mercatus Center supports your concern that regulatory activity and the burdens that activity imposes on small business is growing.

Our detailed survey of 100 U.S. manufacturers suggests that the average manufacturer spends roughly $1,700 per employee to comply with workplace regulations alone. For small manufacturers,

those employing less than 100 workers, costs are about $2,500 per employee, that is 68 percent higher than the cost per employee for firms with 500 or more workers.

So understanding the impact of federal regulation is the first step in reforming it. With that in mind I have three recommendations for regulatory reform.

My first recommendation is to explore ways to treat regulatory expenditures in a manner similar to on-budget expenditures. For federal spending to be dedicated, Congress must first authorize an activity, and then appropriate the necessary resources. Regulatory spending, the cost that consumers, workers, and employers pay to comply with regulatory requirements, on the other hand, is authorized in statute, often in broad terms, with little follow-on action.

Recognizing that regulations, like on-budget federal programs funded by taxes, divert private resources to broader national goals, Congress could consider treating regulatory expenditures more like on-budget expenditures. By adding the appropriations function that is missing from the current process, it could make implicit expectations of costs and benefits more explicit and provide much needed guidance to executive branch agencies to whom responsibility for promulgating regulations are delegated.

My second recommendation is that agencies condut—should conduct ex post analyses of the costs and benefits of regulations. After a regulation is in place, Congress and executive agencies should follow through to ensure that its intended impacts, both the benefits and the costs, are being achieved.

Executive Order 12866, SBREFA, and individual statutes require agencies to conduct benefit-cost analyses of significant regulations as they are being developed, but these ex ante predictions of the impacts of regulations are not always accurate. One way to improve our estimates of the real impacts of regulations would be to encourage more ex post assessments based on actual experience. When they have been undertaken in the past, these ex post assessments have proved illuminating.

Making retrospective analysis of the impact of regulations a standard practice rather than an exceptional exercise would inform the policy debate in beneficial ways. Policy makers would have information with which to eliminate or modify ineffective rules, expand more effective rules, and design future regulations that meet the needs of American citizens.

My final recommendation is for a legislative branch review body which could provide a more independent assessment of the regulatory costs and benefits.

It is not clear that the Office of Information and Regulatory Affairs, from its location in the executive branch, is in a position to provide the necessary check or independent assessment of costs and benefits. OMB should continue to enforce the principles of Executive Order 12866 and hold agencies accountable for ensuring proposed regulations do more good than harm. Americans may also benefit from a legislative oversight body. Indeed, Congress has authorized a Congressional Office of Regulatory Analysis to be housed in the General Accounting Office, but it has not been funded. Such a body could provide Congress and U.S. citizens with an independent assessment of the total costs and benefits of regulation,

and also help ensure that statutes are being implemented so the benefits to Americans outweigh the costs.

In conclusion, over 60 executive branch departments, agencies and commission employ over 190,000 people to write and enforce thousands of new regulations every year. It is important for the legislative branch to monitor this activity and set constraints. I truly appreciate this Subcommittee's recognition of this and its efforts to keep regulators accountable.

Thank you.

[Ms. Dudley's statement may be found in the appendix.]

Chairman SCHROCK. Thank you, Ms. Dudley. A hundred and ninety thousand people. That is bigger than 90 percent of the cities in this country, is it not?

Our next witness this morning is James L. Gattuso who is a Research Fellow in Regulatory Policy at The Heritage Foundation. He has previously served as the Vice President for Policy at the Competitive Enterprise Institute. His service also includes time at the Federal Communications Commission and the first Bush administration as Associate Director of the President's Council on Competitiveness.

And we are delighted to have you today and are anxious to hear what you have to say.

STATEMENT OF JAMES GATTUSO, THE HERITAGE FOUNDATION

Mr. GATTUSO. Chairman Schrock and members of the Subcommittee, thank you for inviting me today to testify on this important issue. First let me say the views expressed by me today are my own and do not reflect an institutional position of The Heritage Foundation or its board of directors.

Regulation is an overlooked issue, it is a hidden tax on Americans. It is unlike federal income taxes, there is no bottom line, no April 15 when the costs of regulation are paid but, as you know, they are real and substantial. I will not go over the numbers today. You know them. Here is the headline numbers; $843 billion in costs as reported by a study performed for the Small Business Administration. Let me say that I think even that number may be understated.

I have spent a lot of time, for instance, in the regulatory field involving high technology and innovative industries. And when you have regulation that constrains innovation, that constrains competition that leads to innovation, the costs are almost immeasurable. You know that you are losing something but you do not know what has not been invented.

To its credit I think the Bush Administration has recognized the problem of regulation and has taken several steps to try and slow the growth of regulation, revitalizing the Office of Information and Regulatory Affairs, and giving more authority to the Office of Advocacy at the Small Business Administration. And this has led to some successes. But while I think the growth of regulation has slowed somewhat, burdens are still growing, not shrinking. We are not winning this battle.

For instance, the 2003 addition of the Code of Federal Regulations weighed in at a whopping 144,177 pages, about 1,000 pages

less than 2002, the record year, but still 4 percent more than when President Bush took office in 2000.

Similarly, the number of federal rule making procedures—proceedings which increased burdens on the private sector still substantially outnumbered those which decreased burdens. According to General Accounting Office numbers, the database under the Congressional Review Act of all major regulations, if you look at regulations excluding those that are budgetary in nature, excluding those that do not clearly increase or decrease burdens on the private sector, there have been 30 major final rule makings under those criteria from the start of the Bush Administration to the end of 2003. Of these, 21, or 70 percent, increased regulations rather than decreased them.

Now, that is a little bit better than the record under the Clinton Administration where about 75 percent increased regulation.

These numbers, by the way, get higher if you exclude actions by independent agencies. The Clinton record was over 90 percent of rule makings increasing regulation if you look at their executive branch actions. Bush's, President Bush's executive branch actions increased burdens 74 percent of the time. So clearly regulation is expanding, not shrinking.

What can be done to curb unnecessary regulation? There are several proposals pending in Congress that represent steps in the right direction. I generally agree with the direction taken by H.R. 2345 and H.R. 2432. However, I do not think that they will totally solve the problem. In addition to a requirement, for instance, that agencies put more analysis into their regulations that they perform, more cost/benefit analysis, more regulatory flexibility analysis, we need to make those analyses independent and make sure that the effect of regulation is considered at every level of the debate, not just in a separate analysis done after the real decision has been made.

So let me suggest some reform proposals that would help move us in the right direction in addition to these two bills.

First, establishment of an independent Office of Regulatory Analysis. Congress is taking now a small step in that direction. I think much more needs to be done. Congress needs an independent source of analysis on regulations similar to the Congressional Budget Office.

Second, we should establish regulatory review offices, or mini-OIRAs, inside each agency. Regulatory review, consideration of regulatory costs, should not be begun once the regulation has left the agency, it should occur internally. I would have these mini-OIRAs somewhat independent from the agency itself, as a separate organizational unit, but involved in the regulatory process from the beginning as part of the agency.

Thirdly, we should designate regulatory reform 'czars' at each agency. There is no better way to ensure that an issue or a set of factors are considered than to make sure that someone in the bureaucracy has it as their focus. Make it part of their job description. They will not always win their internal battles but they will be there to make sure that the problems of regulation, that the costs of regulation are considered.

Fourthly, require independent agencies to submit analyses to OMB. A large portion, about one-third of the regulations, major regulations promulgated last year were by independent agencies. And those underwent no independent review whatsoever. A large number of those underwent no cost/benefit analysis even by the agencies that promulgated them.

If placing independent agencies completely under the executive branch review process is infeasible at this time, I think we should, Congress should at least require those agencies to prepare regulatory analyses of planned significant rules, and forward those analyses to OIRA for non-binding review as a first step.

And fifthly, I do think that Congressman Hayworth is correct that we need to have congressional approval of rules. Under the Congressional Review Act, Congress has the ability to veto new regulations but that authority has only been used once. Our system of government requires that Congress take responsibility for new rules imposed on society. Congressional review and approval of major new burdens should be required.

Thank you very much.

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

Chairman SCHROCK. Thank you. It is just developing the will up here to make that happen. And sometimes that is the most difficult thing.

Thank you very much.

Our last witness this morning is from the state of my birth, Ohio. And he is Raymond Arth who is a small business owner from Avon Lake, Ohio. He is the President of Phoenix Products, a Cleveland-based faucet maker.

We are getting ready to rebuild our house. Maybe I need to come see you, hey?

Mr. ARTH. We can talk.

Chairman SCHROCK. You can talk.

Mr. Arth also serves as the Chair of the National Small Business Association's Board of Trustees. And we are delighted to have you today and anxious to hear your testimony.

STATEMENT OF RAYMOND ARTH, PHOENIX PRODUCTS

Mr. ARTH. Thank you very much, Chairman, Schrock and Congressman King, Congressman Case. I appreciate the opportunity to be here today and I also want to thank you for taking the time to participate in person.

As you mentioned, I am Chairman of NSBA. And we just concluded our annual Washington gathering for small business owners around the country to come here, meet with the members of Congress, the administration and go and lobby our elected officials. It is clear to me after three days in Washington that Congress knows everything in my testimony and the testimony of the people who came before me. Virtually all of it came out of the mouths of the people who presented to us over the last couple days. So I am not going to presume to tell you anything that you do not know or waste a lot of time repeating what is in my testimony.

This week, as evidence of the fact that Congress is aware of this, you passed a handful of OSHA reform bills that we have lobbied to see passed. We appreciate the fact that they have moved

through the House. And we hope you can bring some pressure on the Senate to see action over there as well.

Chairman SCHROCK. Good luck.

Mr. ARTH. All I can do is write letters. You folks have a little more access perhaps than I do.

So I guess I would like to share some personal thoughts that maybe can at least bring something new to the table that you are not already familiar with. The first one is the real economic impact that regulations have.

My company for its entire history, for over 25 years we have faced foreign competition, most of it from Asia. And for 25 years we were very successful in meeting that competition time and again, finding ways to continue to offer a value proposition that made sense to our customers and to win more often than we lost. I think that we have seen some fundamental changes in the economic environment in which the United—that the United States' position in the world has changed fundamentally and that we are at a point today where I am losing more often than I am winning.

I think we are at a point today where the excessive regulation that we could afford in the past because of the unique position we had in the global economy is gone and that we need to start to really consider the costs of regulation and accept the fact that everything has been regulated several times and we can continue to regulate it. But at some point people have to understand that the trade-off is diminished economic performance and a decrease in the economic standard of living of Americans if we want to continue down this path.

We have to admit that fact. We have to educate the American public to that fact.

I also cannot emphasize enough that small businesses are not just miniature big businesses. Enron Corporation is a C corporation that had a 401(k) plan. Phoenix Products is a C corporation that has a 401(k) plan. They did some things that caused some problems that resulted in all sorts of legislation which will generate all sorts of regulation. Two C corporations, two 401(k) plans, we will both be treated essentially the same. But when you treat my company the same way you treat a global organization you end up with inappropriate and unreasonable regulations. What it becomes is overkill.

And "kill" is the operative word in there because at some point the costs—I have two choices, I either do not comply and run the risks of getting caught, or I bear the burden of complying which eventually becomes so costly that my 401(k) plan goes away because it is no longer worth the effort.

As legislation goes forward, as regulations are promulgated there has to be more consideration given to the legitimate differences between large businesses and small. And to give you one more quick example of that there was a company in Cleveland I am somewhat familiar with that recently was caught because of some irregularities with their pension plan, all of this years after the previously-mentioned Enron situation. It has been litigated. The individual is currently in bankruptcy where he belongs. The assets that could be recovered have been recovered and restored to the fund. And I think the criminal charges are moving along at appropriate pace.

He is not holed up somewhere in an estate while underlings are going before the mill.

In legislation I think there is an awful lot of too much of the how and not enough of the what. I did not realize it at the time but that statement that it depends on what your definition of "is" is, is as much as comment about the statement of our legal environment today as it is about the character of an individual. It seems as though no matter how carefully a regulation is crafted, no matter how smart the people are who draw it up there is always going to be someone out in the real world who is just a little craftier who is going to find that tiny little loophole that they can steer through which will create a whole new round of regulation, which is going to have a whole new bunch of loopholes.

Let us focus more on what the goals are and a little less on telling me exactly how I can make my punch press safe. I want to keep all my fingers, thank you very much. Trust me, I know how to do it as well or better than most of the people who actually write the regulations.

So I guess I will finish where I started. Congress knows, you have known since 1980 when the Paperwork Reduction Act was passed, and 25 years later paperwork it certainly has not gone down, and I shudder to think where it would be without it. We did SBREFA in 1996 and it is still pretty much a toothless tool that is not having the impact that all of us had hoped.

I think it is time that Congress turn that knowledge into action, not more legislation, but putting some teeth into those that already exist.

Thank you very much.

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

Chairman SCHROCK. Thank you very much, Mr. Arth. You make some incredibly good points on things we need to listen to up here.

Ms. Dudley, your testimony cites how many regulatory initiatives are funded in perpetuity without regard to their effectiveness. What kind of impact would a more extensive analysis of the effect of this, of each regulation do and what would actually be able to make a factual case that a regulation is not doing anything?

Ms. DUDLEY. Well, that is a good question. And I think we have not done enough retrospective analyses to know what they might show. In my written testimony I have an interesting story about Highway Safety Administration, the high-mounted brake lights on our cars, and how very careful benefit/cost analysis beforehand showed that the benefits in terms of accident reduction would be huge from that.

After the fact, after the brake lights were on everybody's cars they did a retrospective ex post look and found that, indeed, the accident reduction was one-seventh of what they predicted. Why? Because when you can see the brake light high you can drive closer to the car in front of you so you collide, you collide anyway.

So you do not catch these behavioral, the best cost/benefit analysis in the world cannot really capture some of these behavioral impacts of regulations.

So I think doing some more case studies would be a first start. But I think requiring it as a standard rule would be an excellent thing to do.

Chairman SCHROCK. Yes. They are putting sensors on front bumpers now, did you notice that, and back? I have it on the back and believe me it has saved me lots. And I wonder what putting them on the front is going to do. It is going to be interesting to see if that is really going to pay off.

Ms. DUDLEY. So it gives you an alarm, it that what a sensor does?

Chairman SCHROCK. Yes. So it could get you close to that light you know. Amazing.

Mr. Gattuso, you referred to hindered innovation being the primary cost of regulation. And how does this affect the future of the U.S. economy?

Mr. GATTUSO. You think I would have remembered that.

In today's economy we are more and more dependent upon innovations, upon change, upon inventions than ever before. The percentage of the economy that is information based is I believe a majority of the economy right now. I cannot say for sure. But it is clearly the driving force of the economy today and of the world economy.

It is no longer a situation where you can just look at a burden in terms of paperwork or a burden in terms of the cost to buy something. You have to look at these unknowables. It is just essential.

Chairman SCHROCK. Stifling innovative thinking obviously.

Mr. GATTUSO. That is right. And the worst part about it I think is that we will never know what is lost.

Chairman SCHROCK. That is right.

Mr. GATTUSO. We could do all sorts of studies.

Chairman SCHROCK. If you do not have something you cannot appreciate what you do not have.

Mr. GATTUSO. Exactly.

Chairman SCHROCK. Yes.

Mr. Arth, as a small business owner what do you feel is your greatest loss due to excessive regulations? And did this affect your ability to grow your business?

Mr. ARTH. My greatest loss due to regulation?

Chairman SCHROCK. Yes. What part of your business has been severely hampered by the regulation you are forced to live under?

Mr. ARTH. I think typically the first thing that small businesses will point to are all the costs, the compliance costs imposed by the Internal Revenue Service and Treasury Department, predictably.

You have to keep in mind that our best and brightest are the ones who are devoting their time and energy to making sure that all the filings are done on time. The money we spend to hire the best and brightest they are not working on new products, new marketing programs, on identifying customer needs, they are working on making sure that our eight monthly payroll deposits are being made on time, that 941s are filed on a timely basis. So, clearly, the time and money and energy that has been devoted to all of that.

And I will remind you the payroll tax issue in particular, you know, during down periods of time payroll taxes, the FICA and medicare tax is a tax on employees and so it discourages hiring. I may be losing money but I am still contributing that half of the FICA and medicare tax. I never asked to become the collection

agent for the federal Treasury and I am not compensated to do so. But should I be a day late in making one of those eight monthly deposit periods the IRS is not going to cut us much slack in imposing penalties and so forth.

So I cannot point to a thing, as was just said, it is the things that we did not develop or deliver because of the money and energy that we had to devote just to running the business legally and ethically to comply with all those regulations that exist that has been my biggest cost.

Chairman SCHROCK. Okay. For the three of you, what is the one thing that we up here could do for you this year that would help get the regulators under control?

Mr. GATTUSO. We only have one?

Chairman SCHROCK. Well, if there is more hit us with them.

Mr. GATTUSO. I think as important as I think that Congressman Hayworth's proposal is, and I think that is a critical reform to get congressional review, in terms of things that can be done this year I think that establishing review offices in each agency, establishing regulatory czars are ideas that can be done immediately. And I cannot see those as being too controversial but can have a real practical effect.

And next to that, establishment of a funded congressional review office that will provide real analysis and independent analysis of regulations.

Chairman SCHROCK. Ms. Dudley?

Ms. DUDLEY. Yeah, let me second that one because you have got—you have authorized this office. And funding it would give you the independent analysis that I think that you need. So that would be a quick step.

And then the other one would be when new statutes are written they should have a budgetary component. You should say this is how much we think it will cost. We have these goals for what this legislation will do and this is our expectation of how much it will cost.

Chairman SCHROCK. Economic impact on each regulation.

Ms. DUDLEY. Uh-huh.

Chairman SCHROCK. Mr. Arth?

Mr. ARTH. Well, I do not see much prospect of getting a law passed that would require members of Congress and the Senate to go back into the real world every few years and actually try to comply with all the regulations they have created. So I have got to say that as an organization we have been a strong advocate in favor of the cost/benefit analysis and regulatory review.

Chairman SCHROCK. That is a wonderful statement by the way.

Mr. Case.

Mr. CASE. Ms. Dudley and Mr. Gattuso, I just have to agree with Mr. Arth that Congress knows what the problem is but does not know what to do about it. We struggled with this in Hawaii and many other states have struggled with this over a long period of time. We thought about every single idea that has been proposed. We implemented some of them, some successfully, some not so successfully.

We thought about a legislative veto. We thought about the state equivalent of Mr. Hayworth's bill. We thought about the czar, the

ombudsman, the cost/benefit ratio, regulations applicable only to certain employees, over 20 employees, you know, certain companies over 20, every single thing under the book. I do not think we came up with a better answer or worse answer than any other state.

But it does strike me that the answer to this, how to get it done, having identified the problem pretty specifically, lies in part on the states. Are there states out there in your mind, to your knowledge that are doing a really good job in this area that have an outline that could work for us in the federal government?

Ms. DUDLEY. I will give you a quick two-part answer and then I would love to do some more research and follow up on that question because I think it is a good one.

The first part of the answer is that a large portion of the regulatory burden at the state level is federal regulations. So often, so that may be part of the answer that it is hard for a state. They can constrain maybe 10 percent or take control of maybe 10 percent of the regulatory activity but most of it comes straight from the federal government.

I know several states have got programs in place, including Virginia. I think Pennsylvania does. But I would love to offer to follow up on that and do some research on it and get back to you because I think it is a very interesting question.

Mr. CASE. Mr. Chair, I would ask consent for the Subcommittee to entertain that when it comes in.

Chairman SCHROCK. Without objection. That is a great idea.

Mr. CASE. Mr. Gattuso?

Mr. GATTUSO. If I may add, I think it is worth following up and providing specific information for you. I am aware that Colorado has a very active regulatory review and analysis of efforts going on, initiative. They have done a number of things to focus efforts, to increase reviews of regulation.

I do not know quantitatively what the outcomes have been yet. I believe this is a relatively new effort over the last couple of years. But that is one state to look at. And I also would like to follow up on that.

Mr. CASE. Thank you.

Switching back again, I am picking up on Mr. Arth here because he is the guy that lives in the real world, I was especially struck by his observation that small business is not big business in this area. And, frankly, when I took a look at the title of this hearing, how to make small business competitive, I was wondering whether we were talking about small business versus foreign companies or small business versus big business, because it is not a direct proportional relationship.

And we have similarly thought and even implemented in federal law from time to time distinctions between "small business" and "big business" in the regulatory scheme. But it always seemed to lead back to subversion really by non-small businesses to get themselves in under the box. We have seen, for example, on this Committee how non-small businesses have become small businesses for federal preference contracting. I have certainly seen it in my state where the Prepaid Healthcare Act applies to the employees or companies with employees of 20 hours or more per week. And all of a sudden you have a lot of 19 hour employees.

Is there in your view an effective way to distinguish between small businesses and larger businesses for the purposes of equalizing, if we can put it that way, the regulatory burden where you would in fact say to small businesses we are not going to ask as much of you? Because the consequence of going in that direction is that all of a sudden everybody tries to become a small business to drive through the loophole that Mr. Arth just noted. Because everybody wants to drive a loophole somewhere.

Is there anything that works from that perspective to—or is the answer, as I suspect it is, simply to reduce the burdens for everybody and let it, you know, take its proportional effect on small businesses?

Ms. DUDLEY. And I think all the points you have made are right. When you have a cutoff not only do you find people trying to cheat to get in the cutoff but you also prevent small businesses from growing. So someone who is innovative and has some good ideas cannot grow because then suddenly they will get whopped with the full burden. So it is difficult.

I think one of the things that happens in Washington, and I think your Committee is a counterweight to it, and people like Mr. Arth are a counterweight, is that the large companies—and everybody when it comes to regulation is trying to shift the burden to someone else. Large businesses they are very happy to take on some big regulations—I mean you, Chairman, you were talking about innovation. The innovators in pharmaceuticals and agricultural chemicals, large, large companies are more than happy to have difficult regulatory requirements because then when a small one comes up with a great innovation it has to get bought up by the large company in order to actually pursue it.

I guess I am agreeing with your problem but I am not sure I have got a good response. But James does.

Mr. GATTUSO. Thank you. Hand it over to me.

No, I am also I am skeptical about whether that can be done in a way that does not distort the economy, as Susan said, keeping people so that they can get in the system, maybe discouraging them from growing. Which I do not know whether it can be done.

I am also doubtful that it is something that should be done. I think it is important to remember that big businesses two or medium size businesses, businesses of any size are hurt by regulations and their consumers are hurt when those businesses are over-regulated. Excessive regulation on a Target or a Wal-Mart or a Southwest Airlines or United Parcel Service hurts consumers as much as excessive regulations on small businesses. So we have to keep ultimately the consumer in mind.

And also it is important to remember that regulations on larger businesses also come back and hurt small businesses. For instance, in the telecommunications field excessive regulations on telecommunications providers can keep new innovations or keep prices high for existing communications systems that are required and needed by small businesses.

So I would support keeping the focus on reducing regulation across the board without trying to segment the market.

Mr. CASE. Well, I will just conclude by observing what Mr. Arth is thinking here, which is that what hurts a big business drives a

small business out of business. And that is the dilemma that we have.

Thank you.

Chairman SCHROCK. Mr. Case talked about agonizing over these regulations. And every state goes through it. But I guess if you have to agonize, Hawaii is not a bad place to agonize.

Mr. CASE. Right.

Chairman SCHROCK. Mr. King?

Mr. KING. Thank you, Mr. Chairman.

As I sit here and listen to this testimony—and I appreciate the testimony of every one of you—I am particularly interested in Mr. Arth's because you are living under these regulations. And a little thing comes to mind that some years ago I remember a mentor of mine that told me when he was young he learned early on that if you are going to have anything to do with interest he wanted to be the one collecting it rather than the one paying it.

And it occurs to me if you are going to have anything to do with regulation you want to be the one that is writing and enforcing rather than the one that is complying. And particularly for me because the 31st of this month I marked the one year anniversary of my significant freedom from complying with regulations because I sold my 28-year business to my oldest son who now has that burden and who lobbies me continually about the load that you described here today.

There is so much that I would say about this. And but about 1991 or 1992, shortly after the Berlin Wall came down and the Soviet Union was breaking up and then reformed, somewhere in there I held a meeting in my office, my construction office in Odebolt, Iowa. I had 15 contractors from around the Midwest and Nebraska, Iowa, Illinois mostly. As they sat there around that table we discussed our business issues. And in the end I asked for a summary, what is the biggest problem that you have, the biggest difficulty you have in business?

They all said it a different way but after all 15 had had their say they came down to one word: regulation. And that is what we are against. There are 43 different agencies that regulate my King Construction. And I would ask this question, and it is only going to be rhetorical because I would not put anybody on the spot: if someone wants to volunteer and say they own and operate a business, particularly a small business, can make the allegation that they are in compliance with all the regulations out there out of those 43 agencies that would be a most foolish thing to do. The bureaucrats would find you and prove to you that it was an outrageously erroneous statement.

When we have that kind of a regulatory structure in this country it is time to move and change this. So I have got two big pieces here that I would like to address. And I am going to address them both to Mr. Arth. And hopefully I have got time.

But litigation and insurance, could we in your opinion dramatically reduce and eliminate regulations, both federal and state regulations where we could, and rely more on, I mean 3 percent of our GDP is consumed by the trial lawyers today anyway, can we not rely on that deterrent and could we not rely on the cost of insur-

ance premiums that have far less federal regulation and have more productivity, Mr. Arth?

Mr. ARTH. Congressman King, I think if I understand the question moving more to a civil action model as opposed to a government enforcement model, it may well work. The insurance piece may not fully apply because to the extent that it would constitute an intentional act, intentional tort, insurance benefits typically will not pay damages.

But, quite frankly, I sometimes feel that the regulatory structure actually gives people a wall to hide behind. When they are—when they have found that loophole they can get through it and after the fact say, but I complied with all the regulations.

I am often surprised when we have an event like some of the financial scandals that we have had over the last few years that it results in a flurry of new legislation. Because what was done, in my mind as I understood the law, and I practiced for a brief period of time as a CPA, was already illegal. So why are we passing yet a new round of laws when theoretic—I cannot imagine there are that many huge holes in the laws that exist today that many of the things that spur new legislation could not already be passed under what exist—or I mean could not already be punished under the laws that already exist, if that makes sense.

If I could, and I am sorry that Congressman Case had to leave, as we were talking about solutions I was reminded of something that almost might apply in this case. I ran across a theory in human relations management called the manage the worst trap which basically says that we all make a mistake with our employees because you have got a certain group that are always going to work very hard no matter what you do to them, a large group that will always work based on the rewards and penalties in place, and then that small group that no matter what you do they are always going to be scoundrels.

Those people, that little group of troublesome employees are the ones we write our handbooks for. So we discourage the big group who want to do things right in the first place and we put barriers in the way of that other group who are always going to behave appropriately no matter what you do and we come up with all these rules and regulations to try to outsmart the bad guys.

I think at some point we just have to admit there are always going to be bad guys, we should have laws broad enough that bad behavior like that is clearly punished, and quit trying to manage the worst through legislation and regulation.

Mr. KING. Thank you. Mr. Chairman, I ask unanimous consent for a few more minutes?

Chairman SCHROCK. Please.

Mr. KING. Thank you.

I would like to offer an opportunity to comment to each of the other witnesses on that question. Then I have another question I would like to raise. If you would want to address the subject matter of whether we could move more to a civil model and less of an enforcement model and what you might think of the protection or the shield that current regulations might provide for people? Mr. Gattuso?

Mr. GATTUSO. Just very briefly. I think as a general matter I prefer common law solutions, solutions in court rather than regulatory solutions. They are more flexible. When done properly they become better solutions than a one-size-fits-all regulation.

That is a very big caveat though because I do not think we have a well-functioning tort system right now. So I would hesitate to throw the solutions into the court system, the tort system as it now exists. So even though the common law is in theory a better alternative I do not think we have that court system working well enough to serve that role.

Mr. KING. I hope to be at that hearing too.

Ms. Dudley?

Ms. DUDLEY. I would agree that before we had the regulatory state that we have now we had a common law system that was much better at adapting to the circumstances of the individual cases. If somebody spilled waste in my yard I could take them to court and they would have to clean it up. Now if somebody spilled waste in my yard it is okay as long as it meets the standards that EPA has set. And I think a common law system would be better.

Mr. KING. Thank you.

And then returning to Mr. Arth, another thing that you said interested me significantly and that was that the heaviest regulatory burden that you have to comply with is the IRS and payroll withholding taxes and being a collecting agent for the federal government, an uncompensated collecting agent for the federal government.

And I am one of a growing number of members of this Congress who believes that we need to eliminate the internal revenue code, the Internal Revenue Service, untax our businesses since they are collectors of taxes, not taxpayers, and free this country up and move to a consumption tax on sales and service. The structure exists today in 45 states, there is about a trillion dollars of burden on our $11.4 trillion GDP that is because of our internal revenue code.

From a business perspective could you describe for this Committee how that might affect the way you do business, your bottom line and the employment levels you could offer and the benefits and payroll that you could offer?

Mr. ARTH. Certainly. Thank you.

You may be aware that NSBA is perhaps one of the first business organizations that came out in support of the Fair Tax which is in fact a national sales tax model predicated upon the elimination of the income tax system in its entirety. And the Fair Tax would provide not only revenue to fund the federal government but would also generate sufficient funds to replace the current payroll tax structure. So the organization and myself personally, you know, support this notion.

One area in particular—well, first of all let me say it is not going to be totally simple because the state of Ohio does have a state sales tax and, as you said earlier, anyone who would say they are in full compliance, you know, just ask the bureaucrats to come in and prove them wrong, there are even in the existing sales tax laws a great deal of complexity. And so all the complexity does not disappear.

But I think it would be a much more transparent process—I am sorry, not transparent—visible process. Everybody involved in paying taxes would see that they are paying taxes. We do not have that today.

In a competitive arena as we have now with global competition it would actually put us in a more advantageous position face to face with our foreign competitors. In fact, I find it ironic that we have got this problem with our foreign sales corporations that are I guess in large part a result of our current income tax structure as opposed to advantages inherent in the VAT taxes that other countries have.

So I can see economic advantages to it. I can see simplicity factors involved. All the way around I would support it 100 percent.

Mr. KING. I thank you, Mr. Arth. Would any of the other witnesses testify on that?

And I do not blame you for taking a pass on that. It is a little off the subject matter.

But I want to thank the Chair for indulging me. And any time I get the chance to get some of that on record, especially with the level of background and expertise that is demonstrated her I appreciate it. Thank you, Mr. Chair.

Chairman SCHROCK. Thank you, Mr. King.

Mr. Gattuso, in your testimony you called for new government bodies to be created to focus on regulatory analysis. And I think those are good ideas, very innovative ideas. Could not expansion of the SBA's Office of Advocacy serve the same purpose, could providing more resources to OMB do it?

Mr. GATTUSO. Well, I certainly think that that would be a contribution to the solution. But I think you also need an agency that is independent completely of the executive branch. Expansion of the SBA, obviously as I said, I do not believe would be a good substitute for a congressional review office.

Chairman SCHROCK. Separate and apart from either agency?

Mr. GATTUSO. That is right. That is right.

Chairman SCHROCK. In the president's manufacturing agenda he announced plans for a regulatory review function in the Department of Commerce. Its purpose though is to review regulation from other agencies. Does that have merit? Does that have promise?

Mr. GATTUSO. Oh, I am in favor of anyone who wants to take a hard look at regulations and see whether they in fact are serving their purpose as well or effectively as possible. Again, however, I think that there is a need for the review, some review, to be independent. Any review mechanism that is inside the executive branch will face institutional conflicts.

If it is the policy or especially looking at regulations that have already been adopted it would be very difficult for one department of the executive branch to come back and say, well, this was unjustified, this was not adequately done. Just politically that would be very difficult. That is again why you need independence.

Chairman SCHROCK. The bottom line is it needs to be independent?

Mr. GATTUSO. Yes. Among other places.

Chairman SCHROCK. Okay. Do you all have any concluding comments, any thoughts before we adjourn? Ms. Dudley?

Ms. DUDLEY. Let me just respond briefly to that.

Chairman SCHROCK. Sure.

Ms. DUDLEY. Because I agree with James. I think you need your own office that is independent from the executive branch. That does not mean that OMB is not doing a good job. And the Office of Advocacy I think they have been very effective since SBREFA was passed. So I have high hopes for the Commerce Department office as well because I think what you have done with those recent bills really, with the SBREFA really has made a difference. But you do need your own office.

Chairman SCHROCK. I think the Office of Advocacy, correct me if I am wrong, saved businesses $60 billion last year—$6 billion. Oh, it would be nice if it was 60. Six billion, that is a lot of money.

Ms. DUDLEY. Yes.

Chairman SCHROCK. So they do a good job.

Well, we thank you all. You have really given us a lot to think about. Thanks for coming all the way from Ohio, we really appreciate it. You are on the frontlines, you are at the top of the spear so you know very well what is going on and we need to listen to you.

Mr. ARTH. Well thank you.

Chairman SCHROCK. And I appreciate you being here because this is something we are going to go forward with. We are dead serious about making some of these things happen. Because I hear it when I go home all the time that we just need to make sure we put your words to actions and get on with it. And I think we will.

So thank you all for being here. This hearing is adjourned. Thank you.

[Whereupon, at 12:10 p.m., the Subcommittee was adjourned.]

Statement of Ed Schrock
Chairman
Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
United States House of Representatives
Washington, DC
May 20, 2004

Good morning. We are having a hearing today on keeping America's small businesses competitive. Our economy has turned the corner. Small businesses, which are responsible for employing half of our workforce and for creating 75% of net new jobs, have led the way in this recovery. Frankly, I think it is the job of Congress to set the right conditions for economic growth and then get out of the way. Most small businessmen and women don't want a "hand out" or a "hand up" but just "hands off." The United States has the most creative, most productive, most entrepreneurial citizens of any nation on this Earth. It is incumbent upon the government to not mess things up.

Everyone here has heard the statistics about the cost of regulation to our economy. And I'm sure we will discuss them further today. Some of the numbers that just get to me, though, are the hours of paperwork burden that agencies have imposed upon the public. Whether it is the 149 million hours imposed by EPA, the 165 million hours from Labor, the 254 million hours from the Department of Transportation, the 276 million hours from HHS, or the 6.5 billion hours imposed by Treasury and the IRS; it is just a

mass diversion of our economy's productive resources into red tape and paperwork. And other than paper mills, it is not stimulating the economy.

So today we have gathered some of the foremost experts on regulation to discuss possibilities for reforming the system. Several attempts at reform have even been made this week. On Tuesday we passed a series of reforms to improve the OSHA adjudication process which has for too long stacked the deck against small businesses. We also passed Rep. Doug Ose's H.R. 2432 which will improve regulatory accounting and permanently authorize a Congressional office for regulatory review inside the GAO. We are very lucky to have Representative J.D. Hayworth here with us today. J.D. has been a tireless warrior in the fight to fundamentally reform the system of regulation we have in place today. I am a cosponsor of his legislation. Congressman, thank you for being with us.

Creating a system where commonsense, transparency, and fairness rules the day in government regulation is one I look forward to. I am anxious to hear the testimony of all our witnesses. We'll now have any additional opening statements.

Testimony of Congressman J.D. Hayworth Before the Regulatory Reform and Oversight Subcommittee on May 20, 2004

Mr. Chairman, members of the subcommittee, and distinguished guests, thank you for affording me this opportunity to discuss one of the most fundamental reforms this Congress can undertake: ending the unconstitutional delegation of legislative powers.

Reducing regulatory red tape will increase American businesses' ability to compete in the world market. Small businesses are the driving force of the U.S. economy, and owning your own business is part of the American dream. Unfortunately, government regulation and bureaucracy are significant impediments to the success of every small business.

For too long, Congress has ceded its law-making authority to unaccountable, un-elected employees in the executive branch. Not only does this contradict the Constitution's "separation of powers" by making the executive branch the maker and enforcer of law, but it violates Article I, Section 1 of the Constitution, which states that, "All legislative powers herein granted shall be vested in a Congress of the United States." My testimony will focus on the unconstitutionality of delegation and why it makes for bad government.

My testimony today focuses on H.R. 110, the Congressional Responsibility Act, legislation I first introduced on December 6, 1995. I believe it is a long-term solution to our regulatory problem.

I believe our Founders understood the negative implications of delegation of powers. For this reason, the Founders defined the various roles of the three branches of government and emphasized their "separation of power."

For the first 150 years of our republic, the Supreme Court held that the transfer of legislative powers to another branch of government was unconstitutional. In the late 1930s, however, the Court reversed itself, and upheld laws by which Congress merely instructed agencies to make decisions that served "the public interest." Since then, Congress has ceded its basic legislative responsibility to executive agencies that craft and enforce regulations with the full force of law. The Supreme Court has not invalidated a single delegation of power since 1935. Unfortunately, law-making was never intended to be in the hands of executive branch employees. As the Constitution enumerates, the power to make laws was solely vested in Congress, because Congress is directly accountable to the people.

Today, evidence abounds that Congress has slipped from its constitutional moorings. The American with Disabilities Act tells employers to make "reasonable accommodation" of handicapped workers unless there is an " undue hardship," but leaves it to the Department of Justice to determine what reasonable and required.

Similarly, the Occupational Safety and Health Administration (OSHA) calls for workplace standards that are "reasonable, necessary or appropriate to provide sage and healthful employment" but allows the Secretary of Labor to decide what that means. The Clean Water Act mandates the protection of "navigable rivers" and permits the Army Corp of Engineers and the Environmental Protection Agency (EPA) to exercise control over any land that has certain minimum water content. By law, commercial banks can only affiliate if they are "well capitalized," a vague determination made by the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC).

Thus, delegation gives life to bad laws because it allows legislators to make ambiguous laws for which they can take credit without taking responsibility for their legal consequences or their costs. Essentially, delegation allows Congress "to have its cake and eat it too." Congress can reap the benefits of delegation and its excesses by helping constituents through the complexities of federal regulations. At the same time, it can blame bureaucrats for misinterpreting its intentions. The legislator can play both sides and win. Unfortunately, the loser in all of this is the electorate, because they are forced to pay for the excesses. If Congress acted constitutionally, it would have the ultimate responsibility for crafting these laws.

With delegation, we also sacrifice accountability in government. Originally designed to be the most accountable branch of government, Congress has grown increasingly irresponsible. The fundamental link between voter and lawmaker has been severed by un-elected regulators hiding behind bad laws. A handful of broadly written laws have spawned an alphabet soup of government agencies and an overwhelming regulatory burden that undermine the very idea of representative government. Many regulatory analysts believe more consequential law is generated in the executive branch than in the legislative branch. Even the *Federal Register*, which churned out 4,167 rules and regulations in 2002, admits that Congress has ceded much of its law-making ability to the executive branch. In the explanation of the *Federal Register's* purpose, it states that it "provides a uniform system for making available to the public regulations...having legal effect." 892 of these rules impact small businesses.

When you consider that Congress passed and the President signed into law only 269 bills in 2002, agency rulemaking stands out as a significant problem. Even more important to Members of this committee, small businesses face a regulatory burden that is 60% higher per employee than a large business. Bureaucrats are outpacing Congress over 15 to 1 in approving new rules.

Further, delegation allows powerful special interests to expend substantial resources in private to benefit the few at the expense of many. Simply put, if we are to restore integrity, responsibility, and confidence to the federal government, one of the best ways we can do this is by ending the unconstitutional delegation of legislative powers to the executive branch.

The Founders knew that law-making authority vested in Congress would make for good government because our elected officials would be directly accountable to their constituents. I often ask my constituents: Do you believe unaccountable employees in the executive branch should have the power to make laws? To this day, I have not heard one person answer this question in the affirmative. My constituents understand the ramifications of granting broad powers to the executive branch to make laws. Yet, to the chagrin of most of my constituents, this is the case in America today. It is no wonder why my constituents, and the American people, are so disillusioned with government.

H.R. 110 will rightly return legislative powers to the Congress by requiring Congress to vote on all rules and regulations, as defined in section 551(4) of title 5, United States code, except those regulations of particular applicability, any interpretive rule, general statement of policy, or any regulation of agency organization, personnel, procedure, or practice. My legislation will apply only to new regulations and will not be retroactive.

Detractors will say that there is no way that Congress has the time to review all rules and regulations that are promulgated by the executive branch. Regardless of the time implications, it is Congress's duty to review rules and regulations, as enumerated in Article I, Section 1 of the Constitution. However, I have frequently had the honor and privilege of serving as Speaker Pro Tempore. On more than one occasion, I have presided over largely ceremonial debate in which we took several hours to name federal installations after famous Americans. I ask you: If we can name courthouses, airports, military bases, and other places, don't we have enough time to vote on rules and regulations that profoundly affect the citizens of this country?

With these time constraints in mind, however, the Congressional Responsibility Act provides an expedited procedure for considering rules and regulations. Within three days after an agency promulgates a rule, the Majority Leader of both the House and Senate (by request) must introduce a bill comprised of the text of the regulation. If the bill is not introduced in three days, any Member thereafter may introduce the bill. The bill is not referred to a committee unless a majority of Members agree to send it through the normal legislative process. Within 60 days of being introduced, however, the legislation must come before the respective chamber for a vote. The bill shall be limited to one hour of debate and cannot be amended. If a majority of members of the body vote for the bill, it is sent to the other body for approval. Upon approval of both bodies, the legislation is sent to the President to sign or veto.

Other opponents if this legislation might argue that this would delay the implementation of rules and regulations. In reality, though, it would not. Rules and regulations are often the subject of countless and endless lawsuits. For example, the final rule for leaded gasoline took nearly 10 years to promulgate because it was the focus of intense litigation. Congress becomes the final arbiter in rule making and the Congressional Responsibility Act states that a regulation contained in a bill is not an agency action for the purpose of judicial review under chapter 7 of title 5, United States Code. This would bring to a halt litigation that delays implementation of regulations.

Finally, opponents of delegation will say that this is a backhanded attempt at regulatory reform. The Constitutions makes clear that all legislative powers shall be vested in Congress. Article I asserts that this legislative power includes the power to regulate. By returning the power to regulate to Congress, we will make Congress accountable to the people for federal laws. This will make for better government, a laudable goal that we, as well as the American people, desire.

In my opinion, delegation is one of the root causes of the American people's disenchantment with government. We can take a step in the right direction by ending the unconstitutional delegation of powers. By taking this step, we will help restore confidence and integrity to the federal government. Many people agree with this analysis, and that is why the concept of non-delegation is embraced by both liberals, such as Nadine Strossen of the American Civil Liberties Union (ACLU), and conservatives, such as Judge Robert Bork. In fact, it was now-Justice Stephen Breyer who wrote in 1984 how the legislative veto should be replaced by an expedited procedure for Congress to pass rules and regulations.

Congressman Bob Ney, Congresswoman Ginny Brown-Waite, and I each have introduced legislation this Congress that would provide more congressional oversight of the regulatory process. My bill would end delegation of legislative power to the executive branch. Congressman Ney and Congresswoman Brown-Waite's legislation would set up congressional committees charged with reviewing all of these regulations before they have the effect of law. Their legislation is modeled after the Ohio and Florida state systems respectively.

I see these new bills, and this week's highlighting of the need for a reduction in red tape, as Congress awakening to an important issue. I have heard it said that Congress only considers the urgent, while brushing aside the important. The Congressional Review Act, signed into law in 1996, seems to reflect that adage. Congress only considers repealing regulations through the disapproval resolution process if the matter is made urgent. Congress should examine each proposed rule before it goes into effect.

I would also like to thank Congressman Steve King and Congressman Dennis Cardoza, who are cosponsors of my bill, and who have reached out to other Members requesting their support. I would also be remiss if I did not thank the other 23 cosponsors of my legislation, including Congressman Paul Ryan who has supported this legislation since he came to Congress.

I want to end my testimony by quoting John Locke's admonition that "the legislative cannot transfer power of making the laws to any other hands." Delegation without representation is as wrong today as taxation without representation was in the 1700s. It is time Congress took back its constitutionally granted power to make laws.

Again, I want to thank you Mr. Chairman, as well as the subcommittee members, for allowing me to have this opportunity to testify here today. This Congress has talked a lot about reform. I think that ending the delegation of powers from the legislative to the

executive branch could be the most important reform this Congress addresses. I am hopeful that we can make a substantial change to this glaring problem in the next year.

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

REFORMING REGULATION TO KEEP AMERICA'S SMALL BUSINESSES COMPETITIVE

May 20, 2004

Testimony of Susan E. Dudley

Director, Regulatory Studies Program,
Mercatus Center, George Mason University
Adjunct Professor, George Mason University School of Law

Chairman Schrock, Congressman Gonzalez, and Members of the Subcommittee, thank you for inviting me to testify on the important issue of regulatory reform. I am Director of the Regulatory Studies Program at the Mercatus Center at George Mason University, and an Adjunct Professor at the George Mason University School of Law and at Georgetown University.[1] This testimony reflects my own views and does not represent an official position of either university.

I appreciate your efforts this week to highlight the impact federal regulation has on small businesses. Every year, over 60 federal departments, agencies, and commissions employ a combined staff of over 190,000 full-time employees to write and enforce federal regulations. Together, they issue thousands of new rules each year. Like the programs supported by taxes, regulations provide benefits to Americans. Indeed, the desired benefits of regulation are the force behind legislative initiatives that create them, and the benefits of regulation are often better understood, qualitatively, at least, than the costs. Unlike the direct spending supported by taxes, however, there is no mechanism like the fiscal budget for keeping track of the off-budget spending required by regulation.

Thus, efforts to track the change in regulatory activity over time often depend on proxies, such as the number of pages printed in the Federal Register, or the size of the budgets of regulatory agencies.

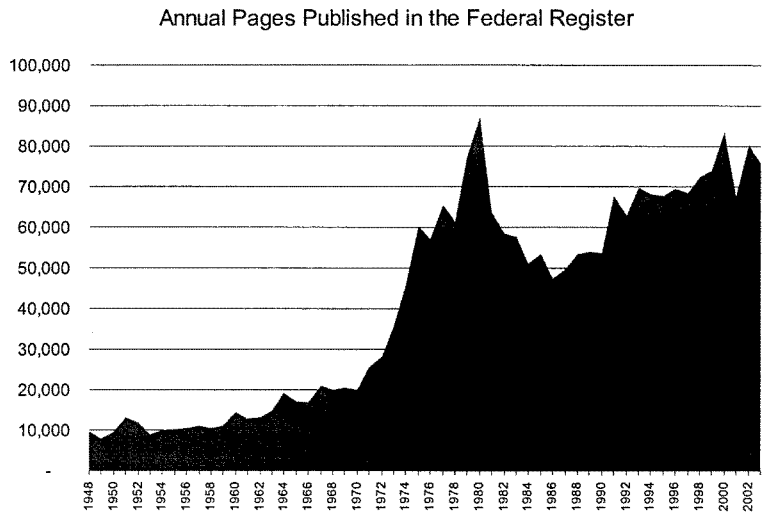
Estimating the size and scope of federal regulation

The size of the *Code of Federal Regulations* (which now occupies over 19 feet of shelf space) provides a sense of the magnitude of the stock of existing regulations with which

[1] I teach "Perspectives on Regulation" at George Mason University School of Law and "Business, Government, and Public Policy" through the Bryce Harlow Institute's summer program at Georgetown University.

American businesses, workers and consumers must comply. The number of pages in the *Federal Register* provides a sense of the flow of new regulations issued during a given period and suggests how the regulatory burden will grow as Americans try to comply with the new mandates. In 2003, the federal government printed 75,795 pages of rules and announcements. At 4 minutes per page that would require 2.5 people reading 8 hours per day for a year, just to keep up with the new rules and pronouncements. While not the highest page count ever (that occurred in 1980), both 2002 and 2003 represent a significant increase over the 67,702 pages published in 2001. The graph in Figure 1 shows the growth in the number of pages in the *Federal Register* over time.

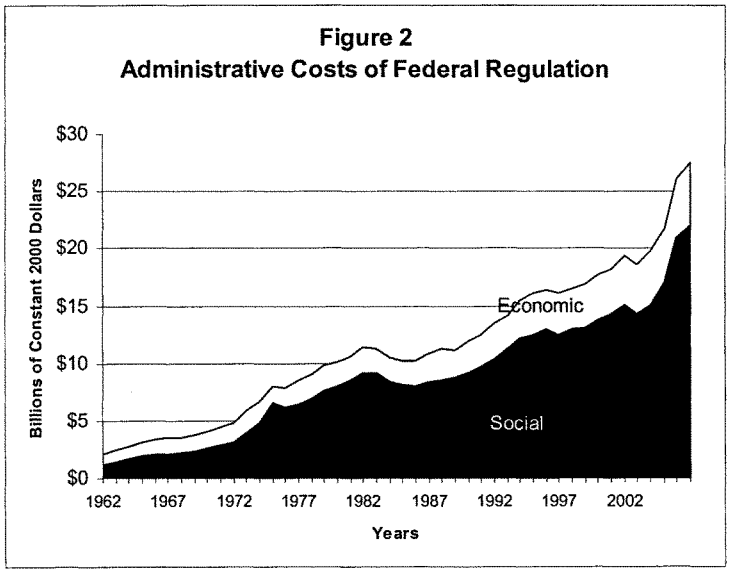
Figure 1



Source: Annual page count records kept by Mercatus Center.

Another interesting measure of regulatory activity and cost is the direct fiscal budget expenditures devoted to regulatory activity – the federal personnel and related expenses necessary to develop and enforce regulations. While this federal budget represents a small fraction of the estimated social costs regulatory agencies impose, the expenditures of federal regulatory agencies, and the trends in that regulatory spending over time, can serve as a useful barometer of regulatory activity, providing policy makers and others with useful insights into the composition and evolution of regulation.

The Mercatus Center works with the Weidenbaum Center at Washington University in St. Louis every year to determine the on-budget expenditures of regulatory agencies. Figure 2 is based on our forthcoming 2004 report, and shows the growth in the portion of the Federal budget obligated to writing and enforcing regulations between 1960 and 2005. Our preliminary estimates based on the President's budget request to Congress indicate that the on-budget cost of federal regulations will be $28 billion in FY 2004 and $30 billion in FY 2005.[2]



Source: Weidenbaum Center and Mercatus Center, forthcoming 2004.

Of course, regulations impose social costs on individuals and businesses beyond the direct tax dollars expended to write and enforce them, and *Federal Register* pages, agency staffing, and these on-budget costs are merely proxies for the indirect, and largely hidden, tax. Probably the best recent estimate of the social cost imposed by regulations is a 2001 report for the Small Business Administration by Professors Mark Crain and Thomas Hopkins. They estimated that in 2000 Americans spent $843 billion, or over $8,000 per household, to comply with federal regulations.

The Office of Information and Regulatory Affairs in the U.S. Office of Management and Budget has been keeping a running total of the costs and benefits of the major regulations issued over the previous 10 years. In its draft 2004 report, it estimates the cost of major regulations issued over the last decade at $34 to $39 billion per year, and the benefits at

[2] These figures are nominal, while Figure 2 graphs expenditures in real 2000 dollars.

$62 billion to $168 billion per year. OMB's cost figures are so much less than SBA's because they include far fewer regulations (only "major" regulations issued over the last decade for which agencies themselves have provided cost estimates) and they exclude certain costs.

OMB recognizes that its estimates are likely to be low, and two new Mercatus Center studies, which build on a regulation-by-regulation approach to estimate the costs of water regulation, confirm this.

- A recently released working paper by economist Joseph Johnson utilizes a cost estimation method similar to that used in the past by EPA to update and extend past estimates of the costs of regulations implementing the Clean Water Act (CWA). The report estimates that the costs of complying with water quality regulation totaled $93.1 billion in 2001. While this figure is based on conservative estimates of regulatory costs, it is significantly larger than the upper end of the cost or benefit estimates presented in OMB's report for the Office of Water ($3.3 billion and $8.4 billion per year, respectively).[3]

- A forthcoming Mercatus working paper on the costs of regulations implementing the Safe Drinking Water Act (SDWA) suggests that annual costs of SDWA rules issued since 1986 are close to $5 billion per year, with associated capital costs of over $18 billion.[4]

Another Mercatus Center study, issued in September 2001, estimated the total cost of workplace regulations at $91 billion annually. This stands in sharp contrast to OMB's estimate of $800 million in costs and $1.3 to $3.6 billion in benefits for Labor regulations issued over the last decade.

Summing our cost estimates for these three types of rulemaking alone (water quality, drinking water and workplace) provides an estimate five times larger than the total cost figure OMB presents for the last decade. The Mercatus studies suggest costs for these three categories of regulation of $189 billion per year, where OMB presents estimates of the costs of all major rules over the last decade of between $34.2 billion and $39.0 billion per year. While the Mercatus estimate is more comprehensive, both in the time period covered and the number of rules included within the three categories, it is by no means an upper bound estimate of costs. Each of the studies summarized above attempts to be conservative in its derivation of cost estimates.

[3] Joseph Johnson, Ph.D. "The Costs of Regulations Implementing the Clean Water Act." Mercatus Center at George Mason University, 2004. (http://www.mercatus.org/regulatorystudies/article.php/629.html)

[4] Robert Raucher, Ph.D. and John Cromwell. "The Costs of Compliance with Regulations Issued under the Federal Safe Drinking Water Act Amendments of 1996." Mercatus Center at George Mason University. Forthcoming 2004.

Impact on Small Businesses

Our research also supports this Committee's concerns that small businesses in the United States bear a disproportionate share of this regulatory burden. During the summer of 2001, the Mercatus Center conducted a detailed survey of 100 U.S. manufacturers (conducted with the help of the National Association of Manufacturers' Human Resources Committee) to understand the scope and cost of regulatory compliance with workplace regulations.[5] The survey suggests that in 2000, U.S. manufacturers spent an average of $2.2 million per firm to comply with federal workplace regulations, or roughly $1,700 per employee. The costs of complying with workplace regulations equaled 1.6 percent of gross receipts for the typical manufacturer. The burden falls disproportionately on small manufacturers, those employing less than 100 workers. The total compliance cost to small firms amounts to about $2,500 per employee, which is 68 percent higher than the cost per employee in firms with 500 or more workers.

The report also provides insights into the types of workplace regulations that impose the largest costs on manufacturers. Table 1 shows that, while the large firms in the sample rated Employee Benefits regulations as the most costly, accounting for a 31 percent of total compliance costs, small firms reported that Worker Health and Safety regulations were more burdensome, accounting for 42 percent of their compliance costs.

Table 1. Allocation of Costs by Type of Workplace Regulation in 2000

		By Firm Size (Number of Employees)		
Category	**All Firms**	**Less than 100**	**100 to 499**	**500 +**
Worker Health and Safety	33%	42%	35%	21%
Employee Benefits	27%	28%	24%	31%
Civil Rights	13%	9%	11%	20%
Labor Standards	11%	9%	11%	11%
Labor-Management Relations	10%	9%	12%	9%
Employment Decision Laws	6%	3%	6%	8%
Total Workplace Regulation	100%	100%	100%	100%

Source: W. Mark Crain and Joseph M. Johnson, "Compliance Costs of Federal Workplace Regulations: Survey Results for U.S. Manufacturers." Mercatus Center at George Mason University, December 2001.

[5] W. Mark Crain and Joseph M. Johnson. "Compliance Costs of Federal Workplace Regulations: Survey Results for U.S. Manufacturers." Mercatus Center at George Mason University. December 2001. The National Association of Man

The survey result that small firms bear a greater per-employee burden is not surprising. There are fixed costs associated with tracking, understanding, and complying with regulations. While larger firms pay a larger overall cost for regulations, the fixed costs assumed by all firms, regardless of size, impose a greater per-employee cost on small firms than large.

Past regulatory reform initiatives have met with mixed success.

For over thirty years, the White House has maintained, in one form or another, a centralized mechanism for executive branch oversight of regulations issued by federal agencies. Executive Order 12866 (issued by President Clinton and kept active by President Bush) and legislative initiatives over the last decade have continued this tradition, reinforcing the view that regulations should be based on an analysis of the costs and benefits of all available alternatives, and that agencies should select the regulatory approach that maximizes net benefits to society, consistent with the law.

These executive and legislative branch actions, along with extensive academic research, have improved our understanding of the impact regulations have on consumers, workers and companies. However, we still lack a reliable mechanism, analogous to the fiscal budget process, for tracking regulatory expenditures and ensuring they produce desired outcomes. Nonetheless, all our proxies indicate that regulations continue to grow, curtailing the choices Americans can make for themselves, and increasing the costs of goods and services.

Recommendations for regulatory reform

A better understanding of regulatory performance and results will help appropriators allocate budgets toward those agencies and activities that produce the greatest net social benefits. Studies reveal that a reallocation of current spending from lower risk to higher risk hazards could greatly increase the life-saving benefits of regulations designed to reduce health and safety risks and achieve other social goals.[6] If agencies and Congress better understand the benefits and costs of different programs, they can then evaluate how to reallocate resources from initiatives that are less effective to those that are more effective.

Understanding the impact of federal regulation is a first step in reforming it. American citizens generally know how much they pay in taxes each year. But most are less aware that regulation of private entities – businesses, workers, and consumers – also diverts resources from the private sector to accomplish government goals. While taxes, and associated spending, are tracked annually through the fiscal budget, there is no

[6] See, for example, Tammy O. Tengs and John D. Graham, "The Opportunity Cost of Haphazard Social Investments in Life-Saving," in R. Hahn (editor), Risks, Costs, and Lives Saved: Getting Better Results from Regulation (New York: Oxford University Press, 1996), and W. Kip Viscusi, John K. Hakes, and Alan Carling, "Measures of Mortality Risk," Journal of Risk and Uncertainty 14 (1997): 228-29.

corresponding mechanism for keeping track of the off-budget spending accomplished through regulation.

Congress could explore ways to treat regulatory expenditures in a manner similar to on-budget expenditures.

It may be fruitful to explore further the analogy between the budget process and regulatory process. For federal spending to be dedicated, Congress must first authorize an activity, and then appropriate the necessary resources. Regulatory spending (the cost consumers, workers, and employers pay to comply with regulatory requirements), on the other hand, is authorized in statute – often in broad terms – with little follow-on action. In fact, regulatory spending is usually authorized in perpetuity, without a clear understanding of the commitments demanded or outcomes achieved.

When enacting new legislation and amending existing statutes, sponsors naturally focus on the potential benefits the laws will provide American people. But the debate is also influenced, implicitly at least, by perceptions of the costs as well as the benefits of different legislative approaches to a problem. Recognizing that regulations, like on-budget federal programs funded by taxes, divert private resources to broader national goals, Congress could explore ways to treat regulatory expenditures in a manner similar to on-budget expenditures. By adding the appropriations function that is missing from the current process, it could make its estimates of costs and benefits more explicit and provide much needed guidance to Executive branch agencies to whom responsibility for promulgating regulations are delegated. A more explicit recognition of the expected costs as well as expected benefits of achieving regulatory goals will help policy makers allocate scarce resources to activities that will produce the greatest net social benefit.

Agencies should conduct *ex post* analyses of the costs and benefits of regulations.

After a regulation is in place, Congress and executive agencies should follow through to ensure that its intended impacts (both benefits and costs) are being achieved.

Executive Order 12866, SBREFA, and individual statutes require agencies to conduct benefit-cost analyses of significant regulations as they are being developed, but these *ex ante* predictions of the impacts of regulations are not always accurate. One way to improve our estimates of the real impacts (both costs and benefits) of regulations would be to encourage more *ex post* assessments based on actual experience with regulations.

Such retrospective analysis of individual rules can yield interesting insights to inform the regulatory debate, as a study done by the National Highway Transportation and Safety Administration illustrates. NHTSA examined, retrospectively, the costs and benefits of its rule requiring center high-mounted stop lamps in passenger vehicles, and compared those with prospective estimates developed in the regulatory impact analysis (RIA) supporting the rule. It found that the RIA had underestimated costs by more than a factor of two and overstated effectiveness by a factor of more than seven. (Despite the revealed inaccuracies in prospective estimates, NHTSA concluded that the regulation still provided net benefits, they just were not as large as had been anticipated.) The reason for

the difference in actual and predicted benefits was that drivers responded to the more visible high-mounted brake lights by driving closer to the car in front of them. This behavioral response to the new brake lights was not accounted for in NTHSA's RIA, which based estimated benefits (reductions in collisions) on average driving distances before the rule. This reveals that even careful RIAs, such as the one prepared by NHTSA, may not predict actual effects because they do not take into consideration behavioral responses to regulations.

Making retrospective analysis of the impacts of regulations a standard practice, rather than an exceptional exercise, would inform the policy debate in beneficial ways. Policy makers would have information with which to eliminate or modify ineffective rules, expand more effective rules, and design future regulations that meet the needs of American citizens.

A legislative branch review body could provide a more independent assessment of regulatory costs and benefits.

It is not clear that the Office of Information and Regulatory Affairs, from its location within the Executive branch, is in a position to provide the necessary check or independent assessment of costs and benefits. A Congressional or other outside review body might be in a better position to report benefits and costs honestly and without deliberate bias.

While OMB should continue to enforce the principles of Executive Order 12866 and hold agencies accountable for ensuring proposed regulations do more good than harm, Americans may also benefit from a legislative branch oversight body. Indeed, Congress has authorized a Congressional Office of Regulatory Analysis to be housed in the General Accounting Office, but it has not been funded. Such a body could provide Congress and U.S. citizens with an independent assessment of the total costs and benefits of regulation, and also help ensure that statutes are being implemented so that the benefits to Americans outweigh the costs.

Testimony of

James L. Gattuso
Research Fellow in Regulatory Policy
The Heritage Foundation

To

The Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
United States House of Representatives

On

"Reforming Regulation to Keep America's Small Businesses Competitive"

May 20, 2004

Chairman Schrock and members of the Subcommittee, thank you for the opportunity to testify today on this important topic.

Costs of regulation. Every year, Americans are reminded of the costs of federal taxation when they filed their income tax returns with the IRS, and see a clear and specific bottom line telling them how much they paid to Washington. Not so with the cost of regulation. These costs are hidden – embedded in the prices of products and services, reduced innovation, and lost opportunities.

Yet, by any reckoning, these costs are staggering. According to the Office of Management and Budget, regulations adopted in the last ten years alone cost Americans some $34-38 billion annually. All federal regulations, OMB estimates, could be costing ten times that much, or some $380 billion.

This estimate, however, is likely a vast understatement. According to a comprehensive study conducted by economist Mark Crain and Thomas Hopkins for the Small Business Administration, regulations cost Americans $843 billion in 2000, or over

$8,000 per household.[1] That is almost half the amount collected in federal taxes, and nearly as much as Americans paid in personal income taxes ($999 billion).
Put another way, the total is about 10 percent of America's gross domestic product – and more than half the output of the U.S. manufacturing sector.

Crain and Hopkins also found that that these regulatory costs fell disproportionately on small businesses. In total, they found that firms employing fewer than 20 people faced regulatory costs of almost $7,000 per employee, compared to an average of $4,700 for all firms.

It should be noted, however, that even these numbers are estimates – the full impact of regulation is likely even higher. Crain and Hopkins, for instance, do not include indirect burdens in their study. For instance, a regulation that increases the cost of energy also would increase the cost of products that require energy to produce. Those secondary costs do not appear in the Crain and Hopkins totals.

Perhaps more important, some costs are by their nature unknowable. For many economic regulations, for instance, the major cost may not be any direct burden on consumers or businesses, but constraints on innovation. There simply is no way to assess such losses – you can't measure inventions that never were created. In today's 21st century economy, these unmeasurable costs are perhaps more harmful than the measurable burdens.

The economic harm from regulatory burdens is substantial – reducing economic growth, slowing job growth, and reducing Americans' income. The actual effects vary tremendously, based upon the type of regulation at issue. But the overall result is clear. Most recently, the World Bank released a study of regulation around the world – with a particular emphasis on rules critical to start-up enterprises, such as entry restrictions. The report underlined the connection between economic growth and regulation, finding that

[1] W. Mark Crain and Thomas D. Hopkins, "The Impact of Regulatory Costs on Small Firms: A Report for the Office of Advocacy, U.S. Small Business Administration," RFP No. SBAHW-00-R-0027.

"[h]eavier regulation is generally associated with more unemployed people, corruption, less productivity and investment."[2]

Americans can take heart that their regulatory burden is far less than much of the world. Yet, we shouldn't be too comfortable. The study offered three alternative methods of rankings of "least regulated" countries. The U.S. was in the top ten in only one, and on that we were tenth.

Bush Administration efforts. To its credit, the Bush Administration has recognized the problem of regulation, particularly in regard to small business, the traditional engine of growth and job creation in the economy. Over the past few years, the Office of Information and Regulatory Affairs, the OMB unit that oversees executive branch regulation, has been revitalized – taking a harder look at proposed new regulations, and implementing new standards for agency analyses of new rules. In regard to small business, the President signed a new executive order strengthening requirements for agencies to assess the small business impact of proposed new rules, and the expanding the role of the SBA's Office of Advocacy in that process.

This has led to some successes. The Office of Advocacy in particular reports that some $6 billion in potential new burdens were avoided in 2003 due to evaluations of small business impacts. Yet, much as I would like to believe that the regulatory problem is being solved, it is not. While the growth of regulation may have slowed, burdens still appear to be growing – not shrinking.

Continuing growth of regulation. The 2003 edition of the Code of Federal Regulations, for instance, weighed in at a whopping 144,177 pages, about a thousand pages less than in 2002, but still four percent more than when President Bush took office in 2000. This overall increase was led by nine percent increase in the sections on the environment and transportation.

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[2] "Doing Business in 2004: Understanding Regulation," p. xiv (World Bank, International Finance Corporation, Oxford University Press, 2004).

Similarly, the number of federal rulemaking proceedings which *increase* burdens on the private sector still substantially outnumber those which *decrease* burdens. Since 1996, the General Accounting Office has reported to Congress on major rules promulgated by agencies, as required under the Congressional Review Act. Excluding from this list those that are "budgetary" in nature – i.e. establishing terms and conditions for spending programs[3], and excluding those that did not clearly increase or decrease burdens, leaves 30 major final rulemakings from the start of the Bush Administration to the end of 2003.[4] Of these, 21 – or 70 percent -- increased regulation.

The record was even more lopsided during the Clinton years. From 1997 through the end of the Clinton Administration, some 106 such rulemakings were finalized – nearly twice as many per year -- with over 75 percent increasing regulation. Taking out rules adopted by independent agencies, the portion *increasing* burdens during the Clinton Administration hits 92.5 percent. Bush's executive branch actions increased burdens 74 percent of the time.

These numbers admittedly are only a rough measure of regulatory trends. However, they indicate that – while regulatory growth has been curbed during the Bush Administration - it has not been stopped. Regulation is still expanding, not shrinking.

Small business and regulation. It should be noted that while small businesses bear a disproportionate share of the regulatory burden, the issue should not be considered too narrowly in terms of small business. Most of the regulatory harm suffered by small business is not from regulations imposed specifically on such businesses, or even applied to them directly. Small businesses, like individual Americans, suffer from the higher prices, reduced economic activity and hindered innovation caused by excessive regulation. In this way, even regulation of "big" businesses such as telephone companies and electric utilities harms small business.

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[3] Such rules, of course, can burden the private sector. Medicare rules, for instance, are a major burden on doctors and hospitals. Such rules, however, do not directly limit or mandate action by private sector firms or individuals. Rather, they are conditions set by the government as the price for receipt of federal aid.
[4] For purposes of this analysis, "Bush" rules included those reported by the GAO after March 2001.

In addition, it should be remembered that the interests of small businesses are not *always* the same as consumers as a whole. Regulations that artificially protect small businesses can therefore be as harmful to Americans as those that hinder small businesses. In fact, many of the most heated controversies in regulatory policies have involved rules that limit competition to small businesses – ranging from insurance agents to car dealers to law firms – at the expense of the public as a whole. The goal of policymakers should be to eliminate unnecessary barriers, rather than provide regulatory advantage to, any enterprise.

Pending legislation. What then, can be done to curb unnecessary regulation? Several proposals are pending in Congress that would at least represent small steps in the right direction. One, H.R. 2345, would strengthen the Regulatory Flexibility Act in a number of ways, increasing requirements for agencies to analyze small business effects before promulgating regulations, and increasing the authority of the SBA's Office of Advocacy in a number of ways. Among other things, it would require agencies to evaluate the indirect, as well as direct, effects of regulation on small business. This is a positive step, for the reasons outlined above.

The legislation would also require agencies to periodically review existing rules for small business impacts. This also would be a positive step, and is similar to a provision of the Telecommunications Act of 1996 that requires the FCC to review its regulations every two years. Importantly, that provision explicitly requires the FCC to repeal or modify any regulation it finds is not in the public interest. A similar requirement would be helpful in this legislation.

In addition to H.R. 2345, the Government Reform Committee has reported H.R. 2432, by Rep. Doug Ose (R-CA). This legislation is primarily aimed at improving regulatory accounting – the calculation of the costs and benefits of regulation. Among other things, the legislation requires each agency to report to OMB each year on the costs and benefits of its regulations, and provides for a pilot program on "regulatory budgets."

Problems with regulatory accounting. Steps to improve the valuation and reporting of the costs and benefits of regulation are much needed. Despite improvements over the past few years in the federal government's ability to assess such costs and benefits – due in large part to efforts by OMB's Office of Information and Regulatory Affairs – the information produced by regulators on the impact of their regulations is still incomplete, inconsistent, and often unreliable. A large number of major regulations are routinely adopted without a quantification of both costs and benefits. According to OIRA, of 12 major non-budgetary rules it reviewed in 2003, costs and benefits were only quantified for six. In addition, at least nine major regulations were promulgated without OIRA review (primarily by independent agencies). Eight of these failed to quantify costs and benefits. The net result was that of at least 21 regulatory actions, costs and benefits were quantified for only seven – a rate of 33 percent. As a result, even though OMB is required by law to report annually on the costs and benefits of regulation, those numbers actually cover only a small portion of regulatory activity.

Moreover, even when costs and benefits are quantified, the numbers are based upon analyses performed by regulatory agencies themselves, as part of their justification for their rules. And despite efforts by OIRA to make the analyses uniform, they have varied substantially in quality and methodology. Although analyses are approved by OIRA as part of the review process, they do not present a reliable or consistent assessment of regulatory costs.

Steps to improve regulatory accounting are much needed. Simply put, policymakers and consumers deserve to be told more about the costs being imposed on them by federal regulators. Requirements, such as those in H.R. 2345 to expand analysis and reporting of costs and benefits, could be beneficial. At the same time, we need to recognize the limitations of such reforms.

Certainly, agencies should be required to provide more analysis. But to the extent that the same people who wrote the rules provide the analysis, the result will be a too-

rosy view of their efficacy. And, as mentioned above, even the best analysis cannot quantify every impact of a regulation – especially in innovative industries. Moreover, even perfect regulatory accounting would not ensure good regulatory decision-making. As anyone who has seen regulatory debates first-hand can verify, ultimately decisions are influenced for good or bad by the facts of the particular case, the values, principles and priorities of the decision-makers, and (yes) even politics.

Additional reform proposals. For these reasons, steps are needed to ensure *independent* analysis of regulations, to ensure that the risks of overregulation are fully considered at every stage of the regulatory process. Such steps could include:

1. **Establishment of an independent Office of Regulatory Analysis**. Such an office – charged with providing Congress with information on the cost and impact of, and alternatives to – regulation -- would provide an independent source of analysis on regulation. The model for this new office would be the Congressional Budget Office, with provides Congress with information on spending programs, and acts as both a complement to, and check on, the Office of Management and Budget.[5]

2. **Establish regulatory review offices, or "mini-OIRA's" within each regulatory agency.** Consideration of the costs of regulation should not begin when a proposal leaves an agency, but should take place within an agency as well. To be an effective check, however, analysis should be from *outside* the office or bureau implementing the decision. One model for this is the office I served in Office of Plans and Policy at the FCC, which reviewed every item presented before the Commission, and provided comments to the Chairman and Commissioners.

[5] The cost of such a new office need not involve increased spending. It could easily be funded by reallocating some of the nearly $30 billion spent by federal regulatory agencies each year.

3. **Designation of "regulatory reform czars" at each agency.** Sometimes, the best way to ensure that an issue is given consideration is to confer responsibility on an individual for making sure that is done. In 1992, as part of the first Bush Administration's regulatory review executive order, each agency was required to designate such officers, known informally as "regulatory czars." No new staff positions were created, as the individuals typically were the general counsels or policy directors of the agencies, but ensuring regulatory restraint became part of their job description. Certainly, not every one produced a success story, but some did become jealous advocates of reform, making the case for better regulation inside their agencies.

4. **Require independent agencies to submit analyses to OMB.** Independent agencies such as the Federal Communications Commission and Securities and Exchange Commission produce a substantial share of the major rules finalized each year – seven of 21 for FY2003. The overall impact of these agencies is even greater, as they cover some of the economy's most dynamic and vital sectors. Yet, these agencies' rules are not subject to outside rule before they are promulgated, and only rarely are their costs and benefits analyzed. The problem could be resolved by putting independent agencies under the requirements of Executive Order 12866. If that cannot be done, Congress should at least require these agencies to prepare regulatory analyses of all planned significant rules, and to forward the analyses to OIRA for non-binding review.

5. **Require congressional approval of major regulations that place new burdens on the private sector.** Under the Congressional Review Act, Congress has the ability to veto new regulations coming from agencies. To date, however, that authority has only been used once – to stop a new ergonomics rules from taking affect. Our system of government requires that Congress take responsibility for new rules imposed on society. Congressional

review and approval of major new burdens should be required. (Rep. J.D. Hayworth has proposed such a step in H.R. 110.)

Conclusion. There is no "magic bullet" for controlling the continuing growth of regulation. The proposals now pending in Congress do largely move in the right direction, but much more is needed to solve the problem.

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TESTIMONY OF

Raymond Arth

Phoenix Products, Inc.

On behalf of

THE NATIONAL SMALL BUSINESS ASSOCIATION

Regulatory Reform

Before the House Small Business Subcommittee on Regulatory Reform and Oversight

May 20, 2004

Thank you. Chairman Schrock, Ranking Member Gonzalez, members of the Committee, I appreciate the opportunity to speak on behalf of the National Small Business Association (NSBA). My name is Raymond Arth, and I am the President and CEO of Phoenix Products, a faucet manufacturer based in northeast Ohio. Prior to becoming a manufacturer, I practiced as a CPA for several years. I currently serve as the Chair of NSBA, and I am a past Chair of the Council of Smaller Enterprises, which is the largest local small business organization in the nation and an affiliate member of NSBA. NSBA reaches more than 150,000 small businesses in all fifty states. Our association works with elected and administrative officials in Washington to improve the economic climate for small business growth and expansion. In addition to individual small business owners, the membership of our association includes local, state, and regional small business associations across the country. The goal of NSBA is to protect and promote our members and all of our nation's small businesses before Congress and the Administration.

As a small business owner and long-time board member of NSBA, I can attest to the dire need for regulatory relief for small business owners across the country. I would like to commend this committee and the numerous diligent members of Congress in your support of a variety of bills aimed at improving the regulatory climate for small businesses. In this very important week designated to look at the problem of red tape and the multitude of problems caused by burgeoning regulatory burden, I'd like to again state NSBA's staunch support of the following bills that are working to keep the federal regulatory juggernaut in check.

The Small Business Advocacy Improvement Act of 2003 (H.R. 1772)
In June of 2003, the House passed H.R. 1772 to strengthen the Office of Advocacy. As the federal government's "watch-dog" on small business regulatory issues, an independent Office of Advocacy is imperative.

The Paperwork and Regulatory Improvements Act of 2003 (H.R. 2432)
This bill will give Congress the necessary information to more aptly review regulatory burden reduction as well as add a necessary element of transparency in the costs and benefits of regulation.

Regulatory Flexibility Improvements Act (H.R. 2345)

In an effort to enhance the Regulatory Flexibility Act (RFA), this bill requires federal agencies to complete a more detailed economic impact analysis, and gives more enforcement authority to the Office of Advocacy.

OSHA Bills (H.R. 2728, H.R. 2729, H.R. 2730, and H.R. 2731)
This series of four bills aimed at improving OSHA oversight and fairness towards small business will alleviate some of the burdens facing small businesses without sacrificing any safety and health protections.

A special thanks to Chairman Schrock for either sponsoring or co-sponsoring all of those bills save one.

Overview

Let me be quite frank with you on my opinion of the regulatory climate we find ourselves in today. Burdensome regulation is a symptom, not the root problem. Government's tendency to over-regulate is the source of all the paperwork; did you know that that Government actually regulates the amount of water our toilets are permitted to flush?

We all know what the numbers say: federally mandated paperwork equates to 8 billion hours with the IRS accounting for 80 percent of that figure. The Small Business Administration reports that the average per-employee cost of all federal regulation for companies with fewer than 20 employees is approximately $6,975, 60 percent higher than what large companies pay. In many cases, paperwork is a burden imposed after a business enterprise has taken steps to comply with the regulation in question.

By their very nature, unnecessary federal regulation and paperwork burdens discriminate against small businesses. Without large staffs of accountants, benefits coordinators, attorneys, or personnel administrators, small businesses are often at a loss to implement or even keep up with the overwhelming paperwork demands of the federal government. Big corporations have already built these staffs into their operations and can often absorb a new requirement that could be very costly and expensive for a small business owner.

Those who know me can attest to the fact that while I certainly do not shy away from criticism, I also do not shy away from pointing out improvements and giving praise where praise is deserved.

Certainly our regulatory climate needs improvement, however Congress and the Administration have made several very important steps towards ensuring that small business concerns are represented within government.

RFA – The Regulatory Flexibility Act, passed in 1980 directs federal agencies to consider the impact of new regulations on small businesses. Agencies must analyze alternatives that would minimize impact on small-businesses and make those alternative analyses available for public comment. It is important to note that the RFA, along with small business collectively, does not seek special treatment, merely equal treatment and consideration under the regulatory process.

SBREFA – The Small Business Regulatory Enforcement Fairness Act, enacted in 1996 amended the RFA to give small businesses increased involvement in the regulatory process. The Chief Counsel for the Office of Advocacy, under this law, has the authority to file amicus briefs on behalf of small business when an agency is non-compliant with the RFA. SBREFA also enhanced the congressional role in major regulations as well as mandating issuing agencies to provide compliance assistance with any proposed rule.

SBPRA - The Small Business Paperwork Relief Act, passed in 2002, requires the Office of Management and Budget (OMB) to publish an annual list of compliance assistance resources, mandates each federal agency to establish a single point of contact to act as a liaison for small business, and to work on paperwork reduction. SBPRA also requires agencies to report to Congress on enforcement and abatement actions against small businesses as compared to large businesses.

Office of Advocacy – The most important government entity for small businesses, the Office of Advocacy is the federal government's primary watch-dog for small businesses. Charged with analyzing the role of small businesses in the economy, pursuing policies that support small business growth, and ensuring that small firms are heard by the federal government, the Office of Advocacy's role in regulatory relief is vital. Executive Order 13272, signed by President Bush in 2002, enhances and solidifies Advocacy's role of ensuring that regulations are reasonable and fair to small business.

Overall Regulatory Burden

Each of these steps moved us closer to where we ought to be in terms of our mind-set in regulation. However, there is much to do. Most federal officials who develop regulations are largely unaware of the many activities and requirements of their fellow agencies. Furthermore, and I can honestly tell you this, many of those federal officials are so far removed from the stakeholders and those impacted by the rules, their perspective is skewed. The SBA Office of Advocacy is working day and night to change that. Through their SBREFA panels and their Regulatory Flexibility Analysis Trainings, which by the way are outstanding, Advocacy is making great strides in working to create an atmosphere of cooperation between agencies and small business versus the traditionally adversarial relationship we've had.

Duplication is another serious concern. Agencies must seek ways to eliminate duplication of paperwork. The paperwork requirement for pesticide registration forms is an excellent example. One of NSBA's Board members has to re-register each of his products annually on a page-per product form. Even if there is no change from the previous year, he is forced to fill out the materials. This is in addition to the state forms he must fill out which happen to be much easier, more streamlined and only 3 pages for all his products.

Common sense exemptions in certain rules are much needed, along with increased flexibility in enforcements for first time offenders. At another hearing last year, one of our members brought the stacks upon stacks of paperwork he is currently mandated to complete due to EPA Toxic Substances Reporting Inventory. EPA lowered the threshold for reporting from 10,000 lbs. of lead used per year in a business to a mere 100 lbs. per year. Through their Web site, which includes 195 pages of instruction on how to complete the two different forms, the EPA estimates that both forms will take approximately 82 hours combined, to complete. This member runs a 4th generation family-owned pipe-organ building business. I urge you to keep in mind that when an agency is estimating the burden hours, they are not taking into account that a pipe-organ builder who owns his own business knows pipe-organs, not complex federal regulations. The time it takes to wade through the forms, read the multiple schedules, exemptions, extras, so on and so forth significantly increases any number of hours proposed by a federal agency.

Compliance assistance is necessary, but it must also be streamlined and plain-language. Receiving huge envelope on a quarterly basis packed with books and pamphlets on how I can best comply with regulations is somewhat unrealistic. Though as small business owners, we appreciate the efforts and hard work put into creating detailed instruction manuals, we are

pleading with agency officials to consider the time it will take for us to read through a 195 page instruction manual (TRI). I strongly urge both agency officials and Congress to recognize that the time I spend reading through lengthy compliance materials is time not spent on growing my business.

Given my training and experience as a CPA, I have an advantage in translating legalese and in deciphering the convoluted directions that accompany most government forms. This enables my company to do certain regulatory or reporting tasks in-house that other companies our size would farm out. Based on this experience, I feel qualified to express the opinion that much of the regulatory compliance is pointless. Consider just a few examples:

> Phoenix Products has won several awards from the State of Ohio Bureau of Workers Compensation for our operation; the most recent recognition for no lost-time injuries in 2003. Compiling, completing, filing and displaying the mandatory OSHA log is a waste fo time. There is nothing to report. But the penalties for failing to file and to display the log in our plant are very real.
>
> Speaking of workplace safety, consider Right to Know regulations. We make faucets for delivering potable water. We use non-toxic materials, FDA approved food grade lubricants, etc… Nonetheless, our Material Safety Data Sheet binders are over two inches thick. The MSDS for petroleum jelly is about four pages long. I've learned that ingesting petroleum jelly will cause intestinal irregularities.

I also have seen where the unintended consequences of regulations are actually harmful. They create incentives for small companies to stay small and below the employee thresholds where new compliance is required. The Family and Medical Leave Act (FMLA) does not apply to companies with less than 50 employees; and that fact will be a significant obstacle to our hiring the 50th employee.

Along that line of unintended consequences, did you know that the Americans with Disabilities actually discourages attendance incentive programs?

Though the pain of April 15th is dimming for many of us, I urge you not to let the lapse of time dull the sharpness of need for reform. In a recent hearing on the tax paperwork burden, another

NSBA member extolled the virtue of the IRS's mountains of duplicative paperwork. He loves them because he is a CPA. He hates them because he is a small business advocate and knows all to well the extreme complexity in IRS specific burden.

Particularly egregious tax burdens include reporting for Social Security and Medicare. Employers must file quarterly payroll tax returns on form 941 and ensure that all payroll trust funds are in perfect order or face severe personal penalties. The Federal Unemployment Tax (FUTA) must be reported on form 940 and calculated quarterly. An owner's FUTA requirement will be affected by varying state unemployment tax rates, again a very complex and time-consuming task. Section 125 accounts, qualified retirement plans, group life insurance and other benefits increase costs to employers and require special reporting measures. Owners who wish to provide their employees or themselves (when possible) with fringe benefits further increase the amount of paperwork and liability they face.

Finally, an ever-increasing thorn in our sides and source of income to CPAs, the Alternative Minimum Tax in both its personal and corporate form continues to be selected by those business owners brave enough to attempt it on their own as some of the most burdensome and complex calculations required by the IRS. While the small corporation exemption is welcome, the IRS must continue its efforts to notify small businesses of their eligibility. As noted in a Treasury Inspector General for Tax Administration report from 2003, (Reference number 2003-30-114) over 3,600 taxpayers have paid more than $37 million in corporate AMT even though they were eligible for exemption. For those that do not qualify for the exemption, pages of calculations and varying depreciation tables relegate AMT reckoning almost exclusively to computer programs.

Conclusion

All this being said, I do understand there is a need for some regulations and paperwork collection. Yet the small businesses who make up 99 percent of all employers are by and far carrying the brunt of the burden. As NSBA has been urging for years through our Tax Equity Study, small businesses need more government resources dedicated to reducing the burden imposed by the IRS. I encourage not just the members here today, or those on this subcommittee or even the full committee, but ALL members of Congress to put regulatory reform on the top of the list.

If you ask any small business owner his or her opinion of federally required paperwork, the responses overwhelmingly will indicate there is redundancy and excessiveness in the filing process. I, and many small business owners like me, don't want to "play outside the rules" we merely want to stay in the game.

Large and small companies alike are facing enormous competition from foreign companies, with the fiercest competitors coming from Asia where regulations are lax for business. Regulation and paperwork are impairing American companies' ability to compete in global markets, which are all markets now-a-days, and thus costing jobs in the U.S. While our primary goal is to reduce the burden on small businesses, we must keep in mind the ramifications of excessive regulation on all businesses, and the economy overall.

We can talk all day about good versus bad regulations and paperwork requirements, but the bottom line is this: when I'm completing paperwork or trying to comprehend new regulations, there are multitude of things I'm not doing. I'm not researching ways to provide the most competitive health insurance package to my employees. I'm not selling additional product. I'm not growing my business. I'm not hiring new employees.

The total cost of regulatory compliance has been estimated at $850 billion by the Small Business Administration Office of Advocacy, a burden that falls disproportionately on small businesses. The SBA reports that the average per-employee cost of all federal regulation in companies with fewer than 20 employees is approximately $7,000, which is nearly three times what large companies pay. A recent study by the Manufacturers Alliance/MAPI stated "compliance costs for regulations can be regarded as the 'silent killer' of manufacturing competitiveness." Looked at another way, $850 billion dollars is only slightly less than the entire GDP of Canada, our largest global trading partner or Mexico, our neighbor to the south. How long can we maintain our global economic leadership if we continue to allow regulation and paperwork to consume nation-sized chunks of our output?

I'd like to again thank you, Chairman Schrock and Committee Members, for this opportunity to speak. I welcome any questions you may have for me.

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