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REGULATORY FLEXIBILITY IMPROVEMENTS ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

H.R. 682

JULY 20, 2006

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REGULATORY FLEXIBILITY IMPROVEMENTS ACT

THURSDAY, JULY 20, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 12:19 p.m., in Room 2141, Rayburn House Office Building, the Honorable Chris Cannon (Chairman of the Subcommittee) presiding.

Mr. CANNON. Now, the Subcommittee will please come to order.

Thank you, all. We apologize for being long on that vote. And my understanding is Mr. Watt is on his way and will join us momentarily, but we do have Mr. Coble, though, so we will get started.

Mostly, we will avoid boring Mr. Watt by not having to listen to my opening statement, which, actually, I think is sort of interesting.

I want to begin with some fairly astounding facts. First, according to OMB, no one has ever tabulated the sheer number of Federal regulations that have been adopted since the passage of the Administrative Procedure Act of 1946.

Second, and perhaps even more astounding, is the fact that OMB states that most of these existing Federal rules have never been evaluated to determine whether they have worked as intended and what their actual benefits and costs have been. We do know their costs have been high.

Last year, the Office of Advocacy for the Small Business Administration issued a report estimating that the annual cost to comply with Federal regulations in the United States in 2004 exceeded $1.1 trillion. It reported if every household received a bill for an equal share, each household would have owed $10,172, an amount that exceeds what the average American household spent on health care in 2004, which was slightly under $9,000.

I think these facts underscore several critical needs. Most importantly, we need to get the Administrative Conference of the United States up and running. As many of you know, I drafted bipartisan legislation that was signed into law in the last Congress that reauthorized ACUS. For 25 years, the Conference played an invaluable role as the Federal Government's in-house adviser on and coordinator of administrative procedural reforms.

I am in fact paraphrasing from a letter that the American Bar Association sent earlier this week to the Senate Appropriations Committee seeking funding for ACUS. With unanimous consent, I

would like to submit this letter for inclusion to the record, and hearing no objections, so ordered.

Second, these facts underscore the urgent need for continuing and aggressive congressional oversight over the regulatory process. To that end, the Subcommittee on Commercial and Administrative Law, at the request of the House Judiciary Committee Chairman Jim Sensenbrenner, with support of Ranking Member John Conyers, is conducting a comprehensive review of administrative law, process and procedure.

This project, which is being guided by the Congressional Research Service, will culminate with the issuance of a final report and the publication of the results of various studies focusing on succinct issues presented by the rule-making process. Third, these problems underscore the need for legislative redress. H.R. 682, I believe, is a very good start.

Essentially, this legislation addresses several significant shortcomings of the Regulatory Flexibility Act. Enacted in 1980, the act requires Federal agencies to assess the impact of proposed regulations on small entities, which the act defines as either a small business, small organization or small governmental jurisdiction.

One of the principal purposes of the act was to reduce unnecessary and disproportionately burdensome demands that Federal regulatory and reporting requirements placed on small entities. For example, the act requires agencies to prepare a regulatory flexibility analysis at the time certain proposed and final rules are promulgated. Among other things, the analysis must describe the reasons why action by the agency is necessary and identify any significant alternatives to the rule.

This analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Since its enactment in 1980, however, certain recurring deficiencies with the act have been identified. The GAO on numerous occasions has cited the act's uneven implementation and lack of clarity. I expect Mr. Mihm, who appears today on behalf of the GAO, will be able to elaborate on these concerns.

In response to these problems, Representative Don Manzullo, who Chairs the House Committee on Small Business, introduced H.R. 682, the Regulatory Flexibility Improvement Act. On unanimous consent, I ask that the record include a statement from the bill's author, Representative Manzullo.

Hearing none, so ordered.

[The prepared statement of Mr. Manzullo is published in the Appendix.]

Mr. CANNON. H.R. 682 consists of a comprehensive set of reforms intended to encourage Federal agencies to analyze and uncover less costly alternative regulatory approaches and to ensure that all effects, including foreseeable indirect effects, of proposed and final rules are considered by agencies during the rulemaking process.

The legislation currently has 18 cosponsors, including me, and is supported by the United States Chamber of Commerce and the National Federation of Independent Business. It is against this exceedingly interesting backdrop that we are holding this legislative hearing today.

When Mr. Watt arrives, we will turn to him for any comments that he would like to make. Without objection, his entire statement and any other Members who wish to submit a statement will be placed in the record.

Hearing no objection, so ordered.

Without objection, all Members may place—we just did that. Without objection, the Chair will be authorized to declare recesses at any point of the hearing.

Hearing no objection, so ordered.

I ask unanimous consent that Members have 5 legislative days to submit written statements for inclusion in today's hearing record.

Hearing no objection, so ordered.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

The Subcommittee will please come to order.

I want to begin this hearing by noting some fairly astounding facts. First, according to OMB, no one has ever tabulated the sheer number of federal regulations that have been adopted since passage of the Administrative Procedure Act in 1946. Second, and perhaps even more astounding, is the fact that OMB states that "most of these existing federal rules have never been evaluated to determine whether they have worked as intended and what their actual benefits and costs have been."

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H.R. 682 consists of a comprehensive set of reforms intended to encourage federal agencies to analyze and uncover less costly alternative regulatory approaches and to ensure that all effects—including foreseeable indirect effects—of proposed and final rules are considered by agencies during the rulemaking process.

The legislation currently has 18 cosponsors, including myself, and is supported by the United States Chamber of Commerce and the National Federation of Independent Businesses.

It is against this exceedingly interesting backdrop that we are holding this legislative hearing today.

I am now pleased to introduce the witnesses for today's hearing. Our first witness is Tom Sullivan, who is the Chief Counsel for Advocacy at the Small Business Administration. The Office for Advocacy was created in 1976 to serve as the watchdog for small businesses as they interact with the Federal Government.

Last year, the office helped save America's small businesses more than $6.6 billion they would have otherwise had to spend in order to comply with Federal regulations, a truly commendable accomplishment.

Prior to assuming his current responsibilities at the Office of Advocacy, Mr. Sullivan was the Executive Director of the National Federation of Independent Business's Legal Foundation, which provides guidance on legal issues to small businesses and promotes a pro-small business agenda in the Nation's courts. We are now a big Nation of small businesses, overwhelmingly.

Mr. Sullivan received his undergraduate degree in English from Boston College and his law degree from Suffolk University in Boston.

Our next witness is Chris Mihm, who is the Managing Director of GAO's strategic issues team, which focuses on Government-wide issues with the goal of promoting a more results-oriented and accountable Federal Government. The strategic issues team has examined such matters as Federal agency transformations, budgetary aspects of the Nation's long-term fiscal outlook, and civil service reform.

As many of you know, Mr. Mihm testified last year before our Subcommittee regarding the administrative law, process and procedure project that I previously described, and, welcome back, Mr. Mihm.

Mr. Mihm is a fellow of the National Academy of Public Administration and he received his undergraduate degree from Georgetown University.

Our next witness is J. Robert Shull, who serves as the director of regulatory policy at OMB Watch. OMB Watch is a nonprofit research and advocacy organization that seeks to promote Government accountability, citizen participation in public policy decisions and the use of fiscal and regulatory policy to serve the public interest.

Before joining OMB Watch in 2004, Mr. Shull was a training specialist and child advocate. In that capacity, he worked at Children's Rights, a nonprofit advocacy organization based in New York that represents the interests of abused and neglected children. Mr.

Shull obtained his undergraduate degree from the University of Virginia and his law degree from Stanford Law School.

David Frulla is our final witness. Mr. Frulla is a partner with the law firm of Kelley, Drye, Collier, Shannon, where he is a member of the firm's litigation, environmental law and Government relations and public policy practice groups. Prior to joining Kelley Drye, Mr. Frulla was a founding partner and principal of Brand and Frulla PC, which specialized in civil, criminal and administrative advocacy before Federal and State courts and administrative agencies.

Mr. Frulla also serves as Chair of the Criminal Process Committee of the American Bar Association's Administrative Law and Regulatory Practice Section. Mr. Frulla received his undergraduate degree *summa cum laude* from Dartmouth College and his law degree from University of Virginia Law School.

I extend to each of you my warm regards and appreciation for your willingness to participate in today's hearing. In light of the fact that your written statements will be included in the record, I request that you limit your oral remarks to 5 minutes. Accordingly, feel free to summarize and highlight the salient points of your testimony.

You will note that we have a lighting system that starts with the green. After 4 minutes, it turns to yellow and then at 5 minutes turns red. It is my habit to tap the gavel at 5 minutes. We would appreciate if you would finish up your thoughts about that time. We don't want to cut anybody off, and I find that it works much better—we are actually not overflowing with Members who have questions to ask today—so it is not as serious as sometimes it is.

So, if we could do that, we will have a significant amount of time, I think, to discuss your issues during questioning. After you present your remarks, the Subcommittee Members, in the order that they arrived, will be permitted to ask questions of the witnesses, subject to the 5-minute rule, which I will, depending upon how many people come, enforce more or less strictly.

Pursuant to the directive of the Chairman of the Judiciary Committee, I ask the witnesses to please stand and raise your right hand to take the oath.

Do you swear or affirm under penalty of perjury that the testimony you are about to give is true and correct to the best of your knowledge, information and belief?

The record should reflect that all of the witnesses answered in the affirmative.

You may be seated.

Mr. Watt, would you like to make an opening statement?

Mr. WATT. No, just welcome the witnesses. Thank you for being here.

Mr. CANNON. Mr. Sullivan, would you proceed with your testimony?

TESTIMONY OF THE HONORABLE THOMAS M. SULLIVAN, CHIEF COUNSEL FOR ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. SULLIVAN. Thank you, Mr. Chairman, Ranking Member Mr. Watt. I will try to be brief and actually try to go under the 5 min-

utes. Thank you for already including my written statement in the record.

The first part of my statement really goes through the history of the Regulatory Flexibility Act, and it is, I think, an important starting point. Why do we have an act that requires agencies to especially consider their impact on small business?

Well, I think that it is no surprise that we are a Nation, a big Nation, of small businesses, and those businesses are well known for being the job creators, the innovators and the community leaders. And there was a realization in 1980 that not only is small business the economic engine of the United States, but they bear a disproportionate impact when it comes to Federal rules and regulations. So shouldn't there be a law that tries to level that playing field for small businesses?

And that law is, in fact, the Regulatory Flexibility Act. It was amended in 1996 by the Small Business Regulatory Enforcement Fairness Act. In 1996, Congress realized that the requirement, or the encouragement, for agencies to do a small business impact analysis maybe just isn't enough incentive for agencies to do that. And so in 1996, Congress actually amended the RFA to include judicial review, so that if agencies do not conduct small business impact analysis and consider less burdensome alternatives, then they can be taken to court and a court will tell them to do so.

The most recent update to the Regulatory Flexibility Act actually came in 2002, when President Bush signed an executive order—and, again, that was an affirmation of small businesses' importance to this country, and an affirmation or realization that small businesses continue to bear a disproportionate regulatory impact, and even more work needs to be done to level the playing field.

This executive order really encourages agencies even more to do the type of small business impact analysis and work with my office than ever before, and it is working. The Regulatory Flexibility Act is working, and I certainly don't want anyone to proceed in this hearing to think that we are fixing an absolutely broken law. That is just not the case.

My testimony bears out that we are saving billions of dollars by filtering out parts of rules and regulations that don't make sense for small business, and by filtering them out, you are leveling the playing field without compromising regulatory protections, while still protecting the environment, protecting workplace safety, protecting our Nation's borders.

While the Reg Flex Act is working, it is not working perfectly, and now is the time where you look at the law, much like this Committee looks at the Administrative Procedure Act and has amended it close to 60 times over the past several years. It is time to look at the Regulatory Flexibility Act and ask, "How can it work better?" And H.R. 682 plugs many, if not all, of the loopholes that are contained in the Regulatory Flexibility Act.

My office believes that the biggest loophole that needs to be closed is indirect impact. Agencies right now are required to examine how their rules will impact those who are directly regulated. But that doesn't extend to the logically foreseeable secondary impacts, tertiary impacts, and I believe it is the Government's responsibility to inform the public before finalizing rules and regulations

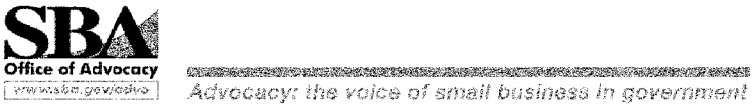
how will this rule work? How will it impact consumers? How will it impact the tourist industry? How will this rule impact homeowners and community leaders?

Those are the types of secondary and tertiary impacts that are sometimes ignored because the Reg Flex Act doesn't require it. H.R. 682 plugs that loophole.

There are other loopholes that exist in the Regulatory Flexibility Act. My statement goes in some detail into how H.R. 682 cures that and I am happy to answer any questions about the particulars of 682 or the Committee's curiosity on how my office works to enforce the Regulatory Flexibility Act.

[The prepared statement of Mr. Sullivan follows:]

PREPARED STATEMENT OF THE HONORABLE THOMAS M. SULLIVAN



Testimony of

The Honorable Thomas M. Sullivan
Chief Counsel for Advocacy
U.S. Small Business Administration

U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Date:	July 20, 2006
Time:	11:30 A.M.
Location:	Room 2141 Rayburn House Office Building Washington, D.C.
Topic:	Regulatory Flexibility Improvements Act – H.R. 682

Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. The Chief Counsel for Advocacy, who is appointed by the President and confirmed by the U.S. Senate, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Issues are identified through economic research, policy analyses, and small business outreach. The Chief Counsel's efforts are supported by offices in Washington, D.C., and by Regional Advocates. For more information about the Office of Advocacy, visit http://www.sba.gov/advo, or call (202) 205-6533.

Chairman Cannon, Ranking Member Watt, Members of the Committee, good morning and thank you for the opportunity to appear before you today to address H.R.682, the Regulatory Flexibility Improvements Act. My name is Thomas M. Sullivan and I am Chief Counsel for the Office of Advocacy at the U.S. Small Business Administration (SBA). As Chief Counsel for Advocacy, I am charged with monitoring federal agencies' compliance with the Regulatory Flexibility Act (RFA). Because the Office of Advocacy is an independent office within SBA, the views that I express do not necessarily reflect the views of the Administration or the U.S. Small Business Administration. This statement was not circulated to the Office of Management and Budget (OMB) for comment.

Background of the RFA and the Small Business Regulatory Enforcement Fairness Act

In 1980, Congress enacted the RFA after determining that uniform federal regulations produced a disproportionate adverse economic hardship on small entities. In order to minimize the burden of regulations on small entities, the RFA mandates that federal agencies consider the potential economic impact of federal regulations on small entities. The RFA also requires agencies to examine regulatory alternatives that achieve the agencies' public policy goals while minimizing small entity impacts.

Agency compliance with the RFA, however, was not judicially reviewable. Since agencies could not be held legally accountable for their noncompliance with the statute, many agencies ignored the RFA and did not conduct full regulatory flexibility analyses in conjunction with their rulemakings. In response to this widespread agency indifference, Congress amended the RFA in 1996 by enacting the Small Business Regulatory Enforcement Fairness Act (SBREFA), which reshaped the requirements of the RFA and provided for judicial review of agencies' final decisions under the RFA.

The RFA requires agencies to prepare and publish an initial regulatory flexibility analysis (IRFA), when proposing a regulation, and a final regulatory flexibility analysis (FRFA) when issuing a final rule for each rule that may have a significant economic impact on a substantial number of small entities. The purpose of the analysis is to ensure that the agency has considered the economic impact of the regulation on small entities and that the agency has considered regulatory alternatives that would minimize the rule's economic impact on affected small entities. The RFA allows the head of an agency to certify a rule in lieu of preparing a regulatory flexibility analysis if the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. Pursuant to the RFA, the agency must provide a factual basis for the certification.

Executive Order 13272

Even with the additional requirements under SBREFA and the threat of judicial review, some agencies were not complying with the requirements of the RFA. On March 19, 2002, President George W. Bush announced his Small Business Agenda, which included

the goal of "tearing down the regulatory barriers to job creation for small businesses and giving small business owners a voice in the complex and confusing federal regulatory process." To accomplish this goal, the President sought to strengthen the Office of Advocacy by enhancing its relationship with the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) and creating an executive order that would direct agencies to work closely with the Office of Advocacy and properly consider the impact of their regulations on small entities. On August 13, 2002, the President signed Executive Order (E.O.) 13272, titled "Proper Consideration of Small Entities in Agency Rulemaking." [1]

E.O. 13272 enhances Advocacy's RFA mandate by directing Federal agencies to implement written procedures and policies for measuring the economic impact of their regulatory proposals on small entities. It also requires agencies to notify Advocacy of draft rules that are expected to have a significant economic impact on a substantial number of small entities and to give every appropriate consideration to any comments provided by Advocacy, including publishing a response to Advocacy's comments in the *Federal Register*. The Office of Advocacy must provide periodic notification, as well as training to all federal agencies on how to comply with the RFA.

The *Report on the Regulatory Flexibility Act, FY 2005* includes information about agency compliance with E.O. 13272. With the exception of the Department of State, all Cabinet-level departments have developed written plans in compliance with E.O. 13272. The performance of the independent agencies, however, has not been as successful. Of the 75 independent regulatory agencies, only 16 responded to the requirements of the E.O. Of those 16, only eight have provided written procedures, six claimed that they do not regulate small entities, and two claimed to be exempt from the E.O.

In terms of training, Advocacy has held 55 training sessions at 45 different agencies. Agency attorneys, economists, policymakers, and other employees involved in the regulatory writing process have attended the hands-on sessions to learn how to comply with the RFA in a regulatory setting. Advocacy's current efforts are focused on rolling out an interactive electronic training module so that agencies can engage in periodic training and train new employees. Like the classroom setting, the online training program explains the steps rule writers should follow to make RFA decisions accurately.

Advocacy's training is having a noticeable impact on the way agencies develop rules. Agencies that have been through training tend to notify Advocacy earlier in the process, submit draft documents, and seek Advocacy's assistance in finding small entity data. For example, when Congress enacted the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (Act), it authorized the Food and Drug Administration (FDA) to promulgate rules in an expedited timeframe to protect the nation's food supply. In response to the Act, FDA published four final rules, each preceded by a notice of proposed rulemaking: prior notice of imported food shipments,

[1] E.O. 13272 can be found on the Office of Advocacy's website at http://www.sba.gov/advo/laws/eo13272.pdf.

registration of food facilities, establishment and maintenance of records, and administrative detention. The Act required FDA to publish the first three rules within 18 months or by December 12, 2003. FDA contacted Advocacy about the rules' impact on small businesses well before the proposed rules were published in the *Federal Register*. This allowed Advocacy to work closely with the FDA to reduce the economic effects of the rules on small businesses. As a result of the involvement of Advocacy and interested small businesses, FDA made several adjustments to the rules including the creation of the new automated commercial environment (ACE) database and a far less onerous notice requirement (twenty-four hours notice was reduced to two hours if the food is arriving by road, four hours if the food is arriving by rail, and eight hours if the food is arriving by sea); extending the registration update requirement from 30 days to 60 days; allowing those importers subject to the rule to check a food category titled "most or all" rather than requiring them to individually list food product categories that had been previously identified in the registration form; and exempting the food packaging industry, which consists primarily of small businesses, from the FDA registration and prior notice requirements. The FDA also gave small businesses more time to comply with the requirements.

Impact of the RFA, SBREFA and E.O. 13272

The SBREFA amendments to the RFA have been successful. In general, agencies are paying closer attention to their RFA obligations. As a result, they are implementing less costly regulations. Some agencies submit their draft regulations to Advocacy early in the process to obtain feedback on their RFA compliance and small business impact. Early intervention by Advocacy and improved agency compliance with the RFA have led to less burdensome regulations. For example, in FY 2001, involvement by the Office of Advocacy in agency rulemakings helped save small businesses an estimated $4.4 billion in new regulatory compliance costs. [2] Similarly, in FY 2002, the Office of Advocacy's efforts to improve agency compliance with the RFA on behalf of small entities secured more than $21 billion in first-year cost savings, with an additional $10 billion in annually recurring cost savings. [3] In FY 2003, Advocacy achieved more than $6.3 billion in regulatory cost savings and more than $5.7 billion in recurring annual savings on behalf of small entities. Moreover, in 2004, Advocacy helped save small entities more than $17 billion.[4] Most recently, in FY 2005, Advocacy's intervention resulted in $6.6 billion in small business cost savings for a total of $71 billion in cost savings during the course of this Administration.

Although the RFA is achieving cost savings for small entities, the RFA is needed now more than ever. In 2005, Mark Crain prepared a study on *The Impact of Regulatory Costs*

[2] The annual reports on the RFA can be found on the Office of Advocacy's website at http://www.sba.gov/advo/laws/flex.

[3] It should be noted that revisions made by the Environmental Protection Agency (EPA) to its Cross Media Electronic Reporting and Record-Keeping rule produced an estimated savings of $18 billion. Without that rule the cost savings for FY 2002 resulted in more than $3 billion.

[4] It should be noted that the withdrawal of the Department of Housing and Urban Development's rule on the Real Estate Settlement Procedures Act (RESPA) produced an estimated savings of $10.3 billion. Without that rule, the cost savings for FY 2004 would have been approximately $6 billion.

on Small Firms. It indicated that the overall cost of federal regulation totals $1.1 trillion; the cost per employee for firms with fewer than 20 employees is $7,647, 45 percent higher than their larger counterparts with 500 or more employees.[5] Legislative action is the necessary to continue to lower regulatory costs and level the playing field for small entities.

H.R. 682 and other Suggestions for Modifying the Regulatory Process to Reduce Burdens on Small Entities

The 109th Congress has the opportunity to amend the RFA and SBREFA to improve the regulatory climate for small entities. Even though the last few years have yielded a number of successes, there are certain loopholes in the RFA that were not addressed through SBREFA. The Office of Advocacy has pursued a legislative agenda during the 109th Congress with the intention of plugging some of the major holes in the RFA and improving the overall regulatory environment for small entities. H.R. 682 is a truly comprehensive bill to address problem areas in the RFA. The Office of Advocacy supports the goals of H.R. 682 and other measures that will increase the overall effectiveness of the RFA and SBREFA. While there are many important aspects of HR 682, Advocacy believes that the following issues are the most crucial:

Foreseeable Indirect Economic Impacts

The biggest loophole in the RFA is that it does not require agencies to analyze indirect impacts. Pursuant to sections 603, 604 and 605(b) of the RFA, agencies are required to consider the economic impact of a regulatory action on small entities. Although the RFA does not define economic impact, the committee report for the RFA suggests that agencies should consider direct and indirect impacts of the proposed regulation. The courts, however, have interpreted the RFA otherwise.

The primary case on the consideration of direct versus indirect impacts for RFA purposes in promulgating regulations is Mid-Tex Electric Co-op Inc. v. Federal Energy Regulatory Commission, 249 U.S. App. D.C. 64, 773 F.2d 327 (1985) (hereinafter Mid-Tex). Mid-Tex addressed a Federal Energy Regulatory Commission (FERC) rule which stated that electric utility companies could include amounts equal to 50 percent of their investments in construction work in progress (CWIP) in their rates. In promulgating the rule, FERC certified that the rule would not have a significant economic impact on a substantial number of small entities. The basis of the certification was that virtually all of the utilities did not fall within the meaning of the term "small entities" as defined by the RFA. Plaintiffs argued that FERC's certification was insufficient because it should have considered the impact on wholesale customers of the utilities as well as the regulated utilities. The court dismissed the plaintiffs' argument. The court concluded that the

[5] The Crain report is located at http://www.sba.gov/advo/research/rs207tot.264.pdf.

agency did not have to consider the economic impact of the rule on small entities that did not have to directly comply with the requirements of the rule.[6]

Post-SBREFA, the U.S. Court of Appeals for the District of Columbia applied the holding of the Mid-Tex case to American Trucking Associations, Inc. v. U.S. Environmental Protection Agency, 175 F.3d 1027, 336 U.S.App.D.C.16 (D.C.Cir., May 14, 1999) (hereinafter ATA). In the ATA case, Environmental Protection Agency (EPA) established primary national ambient air quality standards (NAAQS) for ozone and particulate matter. At the time of the rulemaking, EPA certified the rule pursuant to section 605(b). The basis of the certification was that small entities were not subject to the rule because the NAAQS regulated small entities indirectly through state implementation plans (SIPs). Although the court remanded the rule to the agency, the court found that EPA had complied with the requirements of the RFA. Specifically, the court found that since the states, not EPA, had the direct authority to impose the burden on small entities, EPA's regulation did not directly impact small entities.[7] The court also found that since the states would have broad discretion in obtaining compliance with the NAAQS, small entities were only indirectly affected by the standards.[8]

In Mid-Tex, compliance with FERC's regulation by the utilities was expected to have a ripple effect on customers of the small utilities. There were several unknown factors in the decision-making process that were beyond FERC's control such as whether utility companies had investments, the number of investments, costs of the investments, the decision of what would be recouped, to whom the utilities would pass the investment costs, etc. Unfortunately, the idea of the RFA not applying to indirect economic impacts is now being used by agencies even in cases where the impact is reasonably foreseeable, which undermines the spirit of the RFA.

One of the most compelling examples of the importance of considering indirect impacts on small entities can be found in 2002 Immigration and Naturalization Service's (INS) rule on B-2 tourist visas. This rulemaking illustrates the importance of having reasonably foreseeable indirect impacts analyzed under the RFA in the rulemaking process. On April 12, 2002, the Immigration and Naturalization Service (INS) published a proposed rule on *Limiting the Period of Admission for B Nonimmigrant Aliens.* The proposal eliminated the minimum six-month admission period of B-2 visitors for pleasure and placed the onus of explaining the amount of time for the length of stay on the foreign visitor. If the length of stay could not be determined, the INS agent would issue a visa for only thirty (30) days. Although it was foreseeable that small businesses in the travel industry could lose approximately $2 billion as a result of the proposal, INS certified that the proposal would not have a significant economic impact on a substantial number of small entities. The basis for the certification was that the proposal applied only to nonimmigrant aliens visiting the United States as visitors for business or pleasure. Because the courts have interpreted the RFA as only requiring agencies to consider the economic impact of the proposal on the entities that the proposal will directly impact, the certification was not

[6] Id. at 342.
[7] Id.
[8] Id.

technically erroneous. Advocacy asserted that from the standpoint of good public policy, the agency had a duty to perform a regulatory flexibility analysis and to consider less burdensome alternatives for achieving their goal when the potential impact of a regulation was foreseeable and economically devastating to a particular industry.[9] Advocacy reiterated this position at a hearing before House Committee on Small Business in June 2002.[10] Representatives from the travel industry also testified at that hearing about the potential economic impacts that their businesses would have experienced as a result of INS's actions. The rule was eventually withdrawn.

In addition, if the federal regulation is something that must be implemented by the states[11], as in the ATA case, the federal agencies are not required to perform the detailed analysis of economic impacts and alternatives required by the RFA. The duty of regulating is passed on to the states without any corresponding analysis or requirements for states to consider less burdensome alternatives for small business. Moreover, states with RFA-type laws on the books must perform the economic analysis, even though the states have fewer resources to conduct small business impact analysis than the federal government. This amounts to an unfunded mandate. Amending the RFA to require federal agencies to consider indirect impacts will help state officials craft less burdensome regulatory alternatives.

Because of the potentially devastating effect that not considering indirect impacts may have on small entities, Advocacy strongly supports section 3(b) of H.R. 682, which defines economic impact to include foreseeable indirect economic impacts. Requiring agencies to perform a regulatory flexibility analysis would provide the public with

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[9] The Office of Advocacy's comment letter is located at http://www.sba.gov/advo/laws/comments/ins02_0513.html.
[10] The Office of Advocacy's testimony before the U.S. House of Representatives, Committee on Small Business is located at http://www.sba.gov/advo/laws/test02_0619.html.

[11] The ATA case is also an example of why the need for flexibility is not limited to federal regulations. At least 92 percent of businesses in every state are small businesses. Those businesses bear a disproportionate share of regulatory costs and burdens. Recognizing that state and local governments can be a source of burdensome regulations on small business, Advocacy drafted model regulatory flexibility legislation for the states based on the federal RFA. Many states have some form of regulatory flexibility laws on the books. However, many of the laws do not contain the five critical elements addressed in Advocacy's model legislation. Advocacy's state model legislation recommends that successful state-level regulatory flexibility laws should address the following: 1) a small business definition that is consistent with state practices and permitting authorities; 2) a requirement that state agencies perform an economic impact analysis on the effect of a rule on small businesses before they regulate; 3) a requirement that state agencies consider alternatives that are less burdensome for small businesses while still meeting the agency's regulatory goals; 4) a provision that requires state governments to review existing regulations periodically; and 5) judicial review to give the law "teeth." Since 2002, 19 states have implemented regulatory flexibility via Executive Order or legislation based on Advocacy's model legislation. Those states are Alaska, Arkansas, Colorado, Connecticut, Georgia, Indiana, Kentucky, Massachusetts, Missouri, New Mexico, North Dakota, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Virginia, West Virginia, and Wisconsin.

information about the potential economic impact of an agency's proposed action and, hopefully, encourage agencies to consider less burdensome alternatives.

Section 610 Review of Existing Regulations

Small businesses often complain about the difficulties in dealing with the layers of regulations that agencies issue over time. Although a single proposed rule may not impose much of a regulatory burden, that rule, when added to numerous existing rules, imposes a crippling cumulative burden. Section 610 of the RFA requires agencies to periodically review their existing rules that may have a significant economic impact on a substantial number of small entities. The purpose of the review is to determine whether such rules should be continued without change, or should be amended or rescinded, consistent with the stated objectives of applicable statutes. Unfortunately, agency compliance with section 610 has historically been poor at best.

Small entities are limited in what they can do with burdensome regulations on the books. Although there are legal avenues that can be pursued to have burdensome rules reviewed, legal recourse is costly and time consuming. The automatic review of regulations afforded through section 610 not only results in the removal of burdensome regulations, it also saves small entities and federal agencies the hassle of having to resort to the legal system to obtain relief. However, limiting the review to only those regulations that the agency deemed to have a significant economic impact at the time of promulgation is problematic. As noted above, the Crain study on *The Impact of Regulatory Costs on Small Firms* indicates that the overall cost of federal regulation totals $1.1 trillion; the cost per employee for firms with fewer than 20 employees is $7,647, 45 percent higher than their larger counterparts with 500 or more employees.[12] Since new regulations are promulgated each year, the cumulative impact of regulations on small entities can be staggering, even if individually the regulations may not have a significant economic impact.

Section 7 of H.R. 682 only refers to the periodic review of rules that the agency determines to have a significant economic impact on a substantial number of small entities. Advocacy recommends that the RFA be amended to review all rules periodically. This change would encourage agencies to revise their rules to ensure that regulations reflect current conditions and needs.

Section 7 also amends the RFA to require an agency to submit an annual report on the result of its plan to Congress and Office of Information and Regulatory Affairs. Advocacy recommends that H.R. 682 be amended to include the Chief Counsel for Advocacy as a recipient of the agencies' reports at the same time they are submitted to Congress.

[12] The Crain report is located at http://www.sba.gov/advo/research/rs207tot.264.pdf.

Codification of E.O. 13272

E.O. 13272 has increased agency knowledge of and compliance with the RFA. One of the most important elements of E.O. 13272 is Section 3. Section 3 requires agencies to notify the Office of Advocacy of draft rules that will have a significant economic impact on a substantial number of small entities. It also requires agencies to give appropriate consideration to Advocacy's comments and address the comments in final rules. Small entities would benefit by amending the RFA to codify the requirements of E.O. 13272, ensuring that independent agencies are covered and creating long-term certainty for small entities.

Advocacy recognizes that section 4(b)(3) of H.R. 682 requires agencies to respond to Advocacy's comments if an agency prepares a FRFA. However, it does not provide for Advocacy's comments to be addressed if the agency certifies the rule at the final stage of the rulemaking. This is particularly important since in FY 2005, 12 percent of Advocacy comments were on improper certifications and 17 percent of Advocacy comments were on inadequate or missing IRFAs. Under H.R. 682, anywhere from 12 percent to 29 percent of Advocacy's comments could go unaddressed, if agencies decide to certify final rules in lieu of preparing a FRFA. Advocacy suggests that H.R. 682 be amended to require agencies to provide written responses to all comments submitted by Advocacy, regardless of whether the agency prepares a FRFA or a certification for the final rule. Amending the RFA in this way sets into law a key component of E.O. 13272 and would provide further assurance that small entities have a legitimate voice in the rulemaking process.

Panel Process

In addition to having concerns over requiring SBREFA panels for all agencies, Advocacy is concerned about the changes that H.R. 682 makes to the current panel process. The panel process described in section 6 of H.R. 682 provides Advocacy with responsibility for drafting the panel report. The current process produces a consensus report negotiated between Advocacy, OMB, and EPA or Occupational Safety and Health Administration (OSHA). Because it is a consensus document, agencies typically follow the recommendations.

Establishment and Approval of Small Business Size Standards by Chief Counsel for Advocacy

Currently, section 601(3) of the RFA provides that the term "small business" has the same meaning as the term "small business concern" under section 3 of the Small Business Act, unless an agency, after consulting with the Office of Advocacy of the Small Business Administration and after an opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes the definition in the *Federal Register*. The law assumes that the SBA size standard is appropriate unless the agency pursues a different one.

Section 9 of H.R. 682 amends the Small Business Act to allow the Chief Counsel for Advocacy to specify small business size definitions or standards for the purposes of any Act other than the Small Business Act or the Small Business Investment Act of 1958. The SBA's Office of Size Standards has the necessary expertise and resources to make appropriate decisions regarding industry size determinations. I do not believe that the proposed section 9 of H.R. 682 will benefit small entities. It may be more beneficial to amend the RFA and SBA regulations to require agencies to consult with Advocacy if the agency is interested in changing the size standard for RFA purposes rather than requiring the approval of the Administrator. This would not impact SBA's authority to establish size standards for SBA loan and other programs. This change to H.R. 682 may eliminate some of the confusion that currently exists over which office determines size standards for RFA purposes only.

Compliance Guides

Section 212 of SBREFA, which is a stand-alone section and not part of the RFA, requires agencies to provide plain English compliance guides to clearly explain each final rule that has a significant economic impact on a substantial number of small entities. The intent of section 212 of SBREFA was to ensure that small businesses had a way to understand complex and technical federal regulations. Unfortunately, this is not being done and small businesses continue to be frustrated with rules that are published without adequate compliance information. SBREFA should be amended to require agencies to publish plain language small business compliance guides whenever a final rule requires a FRFA. In addition, agencies should be required to report annually on their efforts to comply with this section. H.R. 682 does not include this needed change.

Conclusion

The Office of Advocacy believes that the RFA and SBREFA can be improved legislatively and commends this Committee for examining legislation that will help small business. Thank you for allowing me to present these views. I would be happy to answer any questions.

Mr. CANNON. Thank you, Mr. Sullivan.
Mr. Mihm?

TESTIMONY OF J. CHRISTOPHER MIHM, MANAGING DIRECTOR FOR STRATEGIC ISSUES, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Mr. MIHM. Thank you, Mr. Chairman, Mr. Watt. It is, again, a great honor to appear before you again today and to contribute to your review of the Regulatory Flexibility Act and your continuing broad examination of administrative law processes and procedures.

My written statement provides an overview of the basic purpose and requirements of the RFA, the main impediments to the act's implementation and the elements of RFA that Congress might consider amending to improve the effectiveness of the act. In the interest of brevity, this afternoon I will just hit the highlights of those issues.

As Mr. Sullivan mentioned in his opening statement, RFA was enacted in response to concerns about the effect Federal regulations can have on small entities. Among other things, RFA prompts regulatory agencies to analyze the potential effects of the rules on those entities, consider alternatives to reduce the burden of those rules and ensure that small entities have an opportunity to participate in the rule-making process.

As you mentioned in your opening statement, Mr. Chairman, in response to congressional requests, we have reviewed RFA's implementation on many occasions over many years, going back to the early 1990's. My bottom line today is that our prior reports have illustrated both the promise and the problems associated with RFA, with the recurring theme being the varying interpretations of RFA's requirements by Federal agencies. Although some progress has undoubtedly been made to address issues we identified, the full promise of the Regulatory Flexibility Act may never be realized until Congress either clarifies terms and definitions in the act or provides an agency with the clear authority and the responsibility to do so.

It is also important to keep in mind the domino effect that an agency's initial determination of whether the Regulatory Flexibility Act is applicable to rule-making has on other statutory requirements. These other requirements can include, for example, preparing compliance guides for small entities and periodically reviewing existing regulations.

More specifically, unclear terms and definitions can affect the applicability and effectiveness of regulatory reform requirements. We have frequently cited the need to clarify key terms in RFA, particularly—and this is the 800-pound gorilla, as it were—"the significant economic impact on a substantial number of small entities." RFA's requirements do not apply, as Mr. Sullivan mentioned, if an agency head certifies that a rule will not have that significant economic impact on a substantial number of small entities.

However, RFA neither defines this key phrase, nor places responsibility on any party to determine it consistently across the Government. It is therefore not surprising that compliance with RFA has varied from one agency to another and that agencies have had different interpretations of the act's requirements.

We have examined 12 years of annual reports from the Office of Advocacy, basically Tom's shop, and that these reports showed that compliance with RFA varied across agencies, within agencies and over time, a conclusion obviously shared by the Office of Advocacy in its own reports.

We noted that some agencies have been repeatedly characterized as satisfying the requirements, but other agencies have been viewed as less compliant over time.

One of the reasons for the agencies' lack of compliance with the Regulatory Flexibility Act requirements is that the act did not expressly authorize the SBA to interpret key provisions and did not require SBA to develop criteria for agencies to follow in reviewing their rules.

It is important to note at this point that the Office of Advocacy's 2003 RFA compliance guide, while reiterating that the RFA does not define certain terms, nevertheless provides some suggestions for agencies on the subject.

While the guidance and the associated training for agencies appear to have been very helpful, the key will be the degree to which agencies effectively and consistently apply that guidance and that training. In that regard, none of us know whether or not yet the extent or if the guidance and training has really made a substantive improvement in agencies' efforts to clarify some of the longstanding confusion about RFA requirements. We believe additional scrutiny and congressional monitoring of the RFA compliance may help to answer that question.

Well, let me just conclude there and say once again that I appreciate the opportunity to testify on these important issues and obviously would be pleased to take any questions you or Mr. Watt might have.

[The prepared statement of Mr. Mihm follows:]

PREPARED STATEMENT OF J. CHRISTOPHER MIHM

United States Government Accountability Office

GAO

Testimony

Before the Subcommitte on Commercial and Administrative Law, Committee on the Judiciary, House of Representatives

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REGULATORY FLEXIBILITY ACT

Congress Should Revisit and Clarify Elements of the Act to Improve Its Effectiveness

Statement of J. Christopher Mihm
Managing Director, Strategic Issues

GAO-06-998T

July 20, 2006

GAO
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Highlights

Highlights of GAO-06-998T, a testimony before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, House of Representatives

REGULATORY FLEXIBILITY ACT

Congress Should Revisit and Clarify Elements of the Act to Improve Its Effectiveness

Why GAO Did This Study

Federal regulation is one of the basic tools of government used to implement public policy. In 1980, the Regulatory Flexibility Act (RFA) was enacted in response to concerns about the effect that regulations can have on small entities, including small businesses, small governmental jurisdictions, and certain small not-for-profit organizations. Congress amended RFA in 1996, and the President issued Executive Order 13272 in 2002, to strengthen requirements for agencies to consider the impact of their proposed rules on small entities. However, concerns about the regulatory burden on small entities persist, prompting legislative proposals such as H.R. 682, the Regulatory Flexibility Improvements Act, which would amend RFA.

At the request of Congress, GAO has prepared many reports and testimonies reviewing the implementation of RFA and related policies. On the basis of that body of work, this testimony (1) provides an overview of the basic purpose and requirements of RFA, (2) highlights the main impediments to the Act's implementation that GAO's reports identified, and (3) suggests elements of RFA that Congress might consider amending to improve the effectiveness of the Act. GAO's prior reports and testimonies contain recommendations to improve the implementation of RFA and related regulatory process requirements.

www.gao.gov/cgi-bin/getrpt?GAO-06-998T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

What GAO Found

RFA established a principle that agencies should endeavor to fit their regulatory requirements to the scale of small entities. Among other things, RFA requires regulatory agencies to assess the impact of proposed rules on small entities, consider regulatory alternatives that will accomplish the agencies' objectives while minimizing the impacts on small entities, and ensure that small entities have an opportunity to participate in the rulemaking process. Further, RFA requires agencies to review existing rules within 10 years of promulgation that have or will have a significant impact on small entities to determine whether they should be continued without change or amended or rescinded to minimize their impact on small entities. RFA also requires the Chief Counsel for Advocacy of the Small Business Administration (Office of Advocacy) to monitor agencies' compliance. In response to Executive Order 13272, the Office of Advocacy published guidance in 2003 on how to comply with RFA.

In response to congressional requests, GAO reviewed agencies' implementation of RFA and related requirements on many occasions, with topics ranging from specific statutory provisions to the overall implementation of RFA. Generally, GAO found that the Act's results and effectiveness have been mixed; its reports illustrated both the promise and the problems associated with RFA. On one hand, RFA and related requirements clearly affected how federal agencies regulate and produced benefits, such as raising expectations regarding the analytical support for proposed rules. However, GAO also found that compliance with RFA varied across agencies, within agencies, and over time. A recurring finding was that uncertainties about RFA's requirements and key terms, and varying interpretations by federal agencies, limited the Act's application and effectiveness.

GAO's past work suggests that Congress might wish to review the procedures, definitions, exemptions, and other provisions of RFA to determine whether changes are needed to better achieve the purposes Congress intended. In particular, GAO's reports indicate that the full promise of RFA may never be realized until Congress revisits and clarifies elements of the Act, especially its key terms, or provides an agency or office with the clear authority and responsibility to do so. Attention should also be paid to the domino effect that an agency's initial determination of whether RFA is applicable to a rulemaking has on other statutory requirements, such as preparing compliance guides for small entities and periodically reviewing existing regulations. GAO also believes that Congress should reexamine not just RFA but how all of the various regulatory reform initiatives fit together and influence agencies' regulatory actions. Recent developments, such as the Office of Advocacy's RFA guidance, may help address some of these long-standing issues and merit continued monitoring by Congress.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to contribute to your review of H.R. 682, the Regulatory Flexibility Improvements Act, and your continuing general agenda to review administrative law, process, and procedure issues. In my statement today, I will summarize findings from our past body of work on the Regulatory Flexibility Act (RFA),[1] which H.R. 682 would amend, and related policies. Specifically, I will provide an overview of the basic purpose and requirements of RFA, highlight the main impediments to the Act's implementation that our work identified, and suggest elements of RFA that Congress might consider amending to improve the effectiveness of the Act.

In brief, RFA was enacted in response to concerns about the effect that federal regulations can have on small entities. Among other things, RFA prompts regulatory agencies to analyze the potential effects of their rules on small entities, consider alternatives to reduce the burden of those rules, and ensure that small entities have an opportunity to participate in the rulemaking process. In response to congressional requests, we have reviewed RFA's implementation on many occasions over the years. Our reports illustrated both the promise and the problems associated with the Act, with a recurring theme being the varying interpretations of RFA's requirements by federal agencies. Although some progress has been made to address issues we identified, the full promise of RFA may never be realized until Congress clarifies key terms and definitions in the Act, such as "a substantial number of small entities," or provides an agency or office with the clear authority and responsibility to do so. It is also important to keep in mind the domino effect that an agency's initial determination of whether RFA is applicable to a rulemaking has on other statutory requirements, such as preparing compliance guides for small entities and periodically reviewing existing regulations.

[1] 5 U.S.C. §§ 601-612.

RFA and Related Requirements Are Intended to Promote Attention to Regulations' Effects on Small Entities

Federal regulation is one of the basic tools of government. Agencies issue thousands of rules and regulations each year to implement statutes enacted by Congress. The public policy goals and benefits of regulations include, among other things, ensuring that workplaces, air travel, foods, and drugs are safe; that the nation's air, water, and land are not polluted; and that the appropriate amount of tax is collected. The costs of these regulations are estimated to be in the hundreds of billions of dollars, and the benefits estimates are much higher.[2] Given the size and impact of federal regulation, Congresses and Presidents have taken a number of actions to refine and reform the regulatory process within the past 25 years.[3]

In September 1980, RFA was enacted in response to concerns about the effect that federal regulations can have on "small entities," defined by the Act as including small businesses, small governmental jurisdictions, and certain small not-for-profit organizations. As we have previously noted, small businesses are a significant part of the nation's economy, and small governments make up the vast majority of local governments in the United States.[4] However, there have been concerns that these small entities may be disproportionately affected by federal agencies' regulatory requirements. RFA established the principle that agencies should endeavor, consistent with the objectives of applicable statutes, to fit regulatory and informational requirements to the scale of these small entities.

RFA requires regulatory agencies—including the independent regulatory agencies—to assess the potential impact of their rules on small entities. Under RFA, an agency must prepare an initial regulatory flexibility analysis at the time a proposed rule is issued unless the head of the agency determines that the proposed rule would not have a "significant economic

[2]The Office of Management and Budget reported that the estimated quantified and monetized annual benefits of the major federal regulations it reviewed from October 1995 through September 2005 range from $94 billion to $449 billion, while estimated annual costs range from $37 billion to $44 billion. See Office of Management and Budget, *Draft 2006 Report to Congress on the Costs and Benefits of Federal Regulations* (Washington, D.C.: April 2006).

[3]See GAO, *Regulatory Reform: Prior Reviews of Federal Regulatory Process Initiatives Reveal Opportunities for* Improvements, GAO-05-939T (Washington, D.C.: July 27, 2005) for summary descriptions of major regulatory reform initiatives implemented since 1980.

[4]GAO, *Regulatory Reform: Implementation of the Small Business Advocacy Review Panel Requirements*, GAO/GGD-98-36 (Washington, D.C.: Mar. 18, 1998).

impact upon a substantial number of small entities."[5] Further, agencies must consider alternatives to their proposed rules that will accomplish the agencies' objectives while minimizing the impacts on small entities. The Act also requires agencies to ensure that small entities have an opportunity to participate in the rulemaking process and requires the Chief Counsel for Advocacy of the Small Business Administration (Office of Advocacy) to monitor agencies' compliance. Among other things, RFA also requires regulatory agencies to review, within 10 years of promulgation, existing rules that have or will have a significant impact on small entities to determine whether they should be continued without change or amended or rescinded to minimize their impact on small entities.

Congress amended RFA with the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).[6] SBREFA made certain agency actions under RFA judicially reviewable. Other provisions in SBREFA added new requirements. For example, SBREFA requires agencies to develop one or more compliance guides for each final rule or group of related final rules for which the agency is required to prepare a regulatory flexibility analysis, and it requires agencies to provide small entities with some form of relief from civil monetary penalties. SBREFA also requires the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration to convene advocacy review panels before publishing an initial regulatory flexibility analysis.

More recently, in August 2002, President George W. Bush issued Executive Order 13272, which requires federal agencies to establish written procedures and policies on how they would measure the impact of their regulatory proposals on small entities and to vet those policies with the Office of Advocacy. The order also requires agencies to notify the Office of Advocacy before publishing draft rules expected to have a significant small business impact, to consider its written comments on proposed rules, and to publish a response with the final rule. The order requires the Office of Advocacy to provide notification of the requirements of the Act and training to all agencies on how to comply with RFA. The Office of

[5]RFA generally applies only where notice and comment rulemaking under the Administrative Procedure Act (APA) is required. When promulgating a final rule, agencies must also prepare a final regulatory flexibility analysis unless the agency finds that the rule will not have a significant economic impact on a substantial number of small entities.

[6]5 U.S.C. § 601 note.

Advocacy published guidance on the Act in 2003 and reported training more than 20 agencies on RFA compliance in fiscal year 2005.[7]

GAO Reviews Found that Varying Interpretations of RFA Requirements Hampered Effective Implementation of the Act

In response to congressional requests, we have reviewed agencies' implementation of RFA and related requirements on many occasions over the years, with topics ranging from specific statutory provisions to the overall implementation of RFA.[8] Generally, we found that the Act's overall results and effectiveness have been mixed. This is not unique to RFA; we found similar results when reviewing other regulatory reform initiatives, such as the Unfunded Mandates Reform Act of 1995.[9] Our past reports illustrated both the promise and the problems associated with RFA. RFA and related requirements have clearly affected how federal agencies regulate, and we identified important benefits of these initiatives, such as increasing attention on the potential impacts of rules and raising expectations regarding the analytical support for proposed rules. However, a recurring theme in our findings was that uncertainties about RFA's requirements and varying interpretations of those requirements by federal agencies limited the Act's application and effectiveness.

Some of the topics we reviewed, and our main findings regarding impediments to RFA's implementation, are illustrated in the following examples:

- We examined 12 years of annual reports from the Office of Advocacy and concluded that the reports indicated variable compliance with RFA across agencies, within agencies, and over time—a conclusion that the Office of Advocacy also reached in subsequent reports on implementation of RFA (on the 20th and 25th anniversaries of RFA's enactment).[10] We noted that some agencies had been repeatedly characterized as satisfying RFA requirements, but other agencies were

[7]See U.S. Small Business Administration, Office of Advocacy, *A Guide for Government Agencies: How to Comply with the Regulatory Flexibility Act* (Washington, D.C.: May 2003).

[8]A list of related GAO products appears at the end of this statement.

[9]2 U.S.C. §§ 658-658(g), 1501-1571. See GAO, *Federal Rulemaking: Past Reviews and Emerging Trends Suggest Issues That Merit Congressional Attention*, GAO-06-225T (Washington, D.C.: Nov. 1, 2005) and GAO-05-939T.

[10]See GAO, *Regulatory Flexibility Act: Status of Agencies' Compliance*, GAO/GGD-94-105 (Washington, D.C.: Apr. 27, 1994).

consistently viewed as recalcitrant. Agencies' performance also varied over time or varied by offices within the agencies. We said that one reason for agencies' lack of compliance with RFA requirements was that the Act did not expressly authorize the Small Business Administration (SBA) to interpret key provisions and did not require SBA to develop criteria for agencies to follow in reviewing their rules.

- We examined RFA implementation with regard to small governments and concluded that agencies were not conducting as many regulatory flexibility analyses for small governments as they might, largely because of weaknesses in the Act.[11] Specifically, we found that each agency we reviewed had a different interpretation of key RFA provisions. We also pointed out that RFA allowed agencies to interpret whether their proposed rules affected small governments and did not provide sufficiently specific criteria or definitions to guide agencies in deciding whether and how to assess the impact of proposed rules on small governments.

- We reviewed implementation of small business advocacy review panel requirements under SBREFA and found that the panels that had been convened were generally well received.[12] However, we also said that implementation was hindered—specifically, that there was uncertainty over whether panels should have been convened for some proposed rules—by the lack of agreed-upon governmentwide criteria as to whether a rule has a significant impact.

- We examined other related requirements regarding agencies' policies for the reduction and/or waiver of civil penalties on small entities and the publication of small entity compliance guides.[13] Again, we found that implementation varied across and within agencies, with some of the ineffectiveness and inconsistency traceable to definitional problems in RFA. All of the agencies' penalty relief policies that we reviewed were within the discretion that Congress provided, but the

[11]See GAO, *Regulatory Flexibility Act: Inherent Weaknesses May Limit Its Usefulness for Small Governments*, GAO/HRD-91-16 (Washington, D.C.: Jan. 11, 1991).

[12]See GAO, *Regulatory Reform: Implementation of the Small Business Advocacy Review Panel Requirements*, GAO/GGD-98-36 (Washington, D.C.: Mar. 18, 1998).

[13]See GAO, *Regulatory Reform: Implementation of Selected Agencies' Civil Penalty Relief Policies for Small Entities*, GAO-01-280 (Washington, D.C.: Feb. 20, 2001), and *Regulatory Reform: Compliance Guide Requirement Has Had Little Effect on Agency Practices*, GAO-02-172 (Washington, D.C.: Dec. 28, 2001).

policies varied considerably. Some policies covered only a portion of agencies' civil penalty enforcement actions, and some provided small entities with no greater penalty relief than large entities. The agencies varied in how key terms were defined. Similarly, we concluded that the requirement for small entity compliance guides did not have much of an impact, and its implementation also varied across, and sometimes within, agencies.

- RFA is unique among statutory requirements with general applicability in having a provision, under section 610, for the periodic review of existing rules. However, it is not clear that this look-back provision in RFA has been consistently and effectively implemented. In a series of reports on agencies' compliance with section 610, we found that the required reviews were not being conducted.[14] Meetings with agencies to identify why compliance was so limited revealed significant differences of opinion regarding key terms in RFA and confusion about what was required to determine compliance with RFA. At the request of the House Committee on Energy and Commerce, we have begun new work examining the subject of regulatory agencies' retrospective reviews of their existing regulations, including those undertaken in response to Section 610, and will report on the results of this engagement in the future.

We have not yet examined the effect of Executive Order 13272 and the Office of Advocacy's subsequent guidance and training for agencies on implementing RFA. Therefore, we have not done any evaluations that would indicate whether or not those developments are helping to address some of our concerns about the effectiveness of RFA.

Key Terms and Provisions of RFA Should Be Revisited and Clarified

While RFA has helped to influence how agencies regulate small entities, we believe that the full promise of the Act has not been realized. The results from our past work suggest that the Subcommittee might wish to review the procedures, definitions, exemptions, and other provisions of RFA, and related statutory requirements, to determine whether changes are needed to better achieve the purposes Congress intended. The central theme of our prior findings and recommendations on RFA has been the need to revisit and clarify elements of the Act, particularly its key terms. Although more recent developments, such as the Office of Advocacy's

[14] See, for example, GAO, *Regulatory Flexibility Act: Agencies' Interpretations of Review Requirements Vary*, GAO/GGD-99-55 (Washington, D.C.: Apr. 2, 1999).

detailed guidance to agencies on RFA compliance, may help address some of these long-standing issues, current legislative proposals, such as H.R. 682, make it clear that concerns remain about RFA's effectiveness—for example, that agencies are not assessing the impacts of their rules or identifying less costly regulatory approaches as expected under RFA—and the impact of federal regulations on small entities.

Unclear terms and definitions can affect the applicability and effectiveness of regulatory reform requirements. We have frequently cited the need to clarify the key terms in RFA, particularly "significant economic impact on a substantial number of small entities." RFA's requirements do not apply if an agency head certifies that a rule will not have a "significant economic impact on a substantial number of small entities." However, RFA neither defines this key phrase nor places clear responsibility on any party to define it consistently across the government. It is therefore not surprising, as I mentioned earlier, that we found compliance with RFA varied from one agency to another and that agencies had different interpretations of RFA's requirements.

We have recommended several times that Congress provide greater clarity concerning the key terms and provisions of RFA and related requirements, but to date Congress has not acted on many of these recommendations. The questions that remain unresolved on this topic are numerous and varied, including:

- Does Congress believe that the economic impact of a rule should be measured in terms of compliance costs as a percentage of businesses' annual revenues, the percentage of work hours available to the firms, or other metrics?
- If so, what percentage or other measure would be an appropriate definition of "significant?"
- Should agencies take into account the cumulative impact of their rules on small entities, even within a particular program area?
- Should agencies count the impact of the underlying statutes when determining whether their rules have a significant impact?
- What should be considered a "rule" for purposes of the requirement in RFA that agencies review rules with a significant impact within 10 years of their promulgation?

- Should agencies review rules that had a significant impact at the time they were originally published, or only those that currently have that effect?

- Should agencies conduct regulatory flexibility analyses for rules that have a positive economic impact on small entities, or only for rules with a negative impact?

It is worth noting that the Office of Advocacy's 2003 RFA compliance guide, while reiterating that RFA does not define certain key terms, nevertheless provides some suggestions on the subject. Citing parts of RFA's legislative history, the guidance indicates that exact standards for such definitions may not be possible or desirable, and that the definitions should vary depending on the context of each rule and preliminary assessments of the rule's impact. For example, the guidance points out that "significance" can be seen as relative to the size of a business and its competitors, among other things. However, the guidance does identify factors that agencies might want to consider when making RFA determinations. In some ways, this mirrors other aspects of RFA, such as section 610, where Congress did not explicitly define a threshold for an agency to determine whether an existing regulation should be maintained, amended, or eliminated but rather identified the factors that an agency must consider in its reviews.[18] We do not yet know whether or to what extent the guidance and associated training has helped agencies to clarify some of the long-standing confusion about RFA requirements and terms. Additional monitoring of RFA compliance may help to answer that question. Congress might also want to consider whether the factors that the Office of Advocacy suggested to help agencies define key terms and requirements are consistent with congressional intent or would benefit from having a statutory basis.

I also want to point out the potential domino effect of agencies' determinations of whether or not RFA applies to their rules. This is related to the lack of clarity on key terms mentioned above, the potential for agencies to waive or delay analysis under RFA, and the limitation of RFA's

[18]In conducting their reviews of existing rules under section 610, agencies are to consider the following factors: (1) the continuing need for the rule; (2) the nature of complaints or comments received concerning the rule from the public; (3) the complexity of the rule; (4) the extent to which the rule overlaps, duplicates, or conflicts with other federal rules and, to the extent feasible, with state and local government rules; and (5) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed since adoption of the rule.

applicability to only rules for which there was a notice of proposed rulemaking. The impact of an agency head's determination that RFA is not applicable is not only that the initial and final regulatory flexibility analyses envisioned by the Act would not be done, but also that other related requirements would not apply. These requirements include, for example, the need for agencies to prepare small entity compliance guides, convene SBREFA advocacy panels, and conduct periodic reviews of certain existing regulations. While we recognize, as provided by the Administrative Procedure Act, that notices of proposed rulemaking are not always practical, necessary, or in the public interest, this still raises the question of whether such exemptions from notice and comment rulemaking should preclude future opportunities for public participation and other related procedural and analytical requirements. Our prior work has shown that substantial numbers of rules, including major rules (for example, those with an impact of $100 million or more), are promulgated without going through a notice of proposed rulemaking.[16]

We also believe it is important for Congress to reexamine, not just RFA, but how all of the various regulatory reform initiatives fit together and influence agencies' regulatory actions. As I previously testified before this Subcommittee, we have found the effectiveness of most regulatory reform initiatives to be limited and that they merit congressional attention.[17] In addition, we have stated that this is a particularly timely point to reexamine the federal regulatory framework, because significant trends and challenges establish the case for change and the need to reexamine the base of federal government and all of its existing programs, policies, functions, and activities.[18]

Our September 2000 report on EPA's implementation of RFA illustrated the importance of considering the bigger picture and interrelationships between regulatory reform initiatives.[19] On the one hand, we reported about concerns regarding the methodologies EPA used in its analyses and

[16]See, for example, GAO, *Federal Rulemaking: Agencies Often Published Final Actions Without Proposed Rules*, GAO/GGD-98-126 (Washington, D.C.: Aug. 31, 1998).

[17]GAO-06-228T.

[18]See GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005) and GAO-05-399T.

[19]See GAO, *Regulatory Flexibility Act: Implementation in EPA Program Offices and Proposed Lead Rule*, GAO/GGD-00-193 (Washington, D.C.: Sept. 20, 2000).

its conclusions about the impact on small businesses of a proposed rule to lower certain reporting thresholds for lead and lead compounds.[20] The bigger picture, though, was our finding that after SBREFA took effect EPA's four major program offices certified that almost all (96 percent) of their proposed rules would not have a significant impact on a substantial number of small entities. EPA officials told us this was because of a change in EPA's RFA guidance prompted by the SBREFA requirement to convene an advocacy review panel for any proposed rule that was not certified. Prior to SBREFA, EPA's policy was to prepare a regulatory flexibility analysis for any rule that the agency expected to have any impact on small entities. According to EPA officials, the SBREFA panel requirement made continuation of the agency's more inclusive RFA policy too costly and impractical. In other words, a statute Congress enacted to strengthen RFA caused the agency to use the discretion permitted in RFA to conduct fewer regulatory flexibility analyses.[21]

In closing, I would reiterate that we believe Congress should revisit aspects of RFA and that our prior reports have indicated ample opportunities to refine the Act. Despite some progress in implementing RFA and other regulatory reform initiatives since 1980, it is clear from the introduction of H.R. 682 and related bills that Members of Congress remain concerned about the impact of regulations on small entities and the extent to which the rulemaking process encourages agencies to consider ways to reduce the burdens of new and existing rules, while still achieving the objectives of the underlying statutes.

Mr. Chairman, this concludes my prepared statement. Once again, I appreciate the opportunity to testify on these important issues. I would be pleased to address any questions you or other Members of the Subcommittee might have at this time.

[20]EPA had certified that the proposed rule would not have a significant impact and, therefore, did not trigger RFA's analytical and procedural requirements. Although we raised questions, we concluded that the analytic methods that EPA's program office used in its original and revised economic analysis, as well as the conclusions the office drew as a result of those analyses, were within the discretion provided by both RFA and EPA guidance.

[21]We made no new recommendations in GAO/GGD-00-193, but we referred to our prior recommendations, noting that clarifying what Congress intends the term "significant economic impact on a substantial number of small entities" to mean would make the implementation of RFA more consistent and help to prevent concerns about how agencies are implementing the Act.

Contact and Acknowledgements

If additional information is needed regarding this testimony, please contact J. Christopher Mihm, Managing Director, Strategic Issues, on (202) 512-6806 or at mihmj@gao.gov. Tim Bober, Jason Dorn, Andrea Levine, Latesha Love, Joseph Santiago, and Michael Volpe contributed to this statement.

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Mr. CANNON. Thank you, Mr. Mihm. We are actually sort of on a roll here. We had two people finish before the yellow light.

Mr. MIHM. We take your guidance, sir.

Mr. CANNON. I think you did this before, Mr. Mihm. Welcome back.

Mr. Shull, you are recognized for 5 minutes.

TESTIMONY OF J. ROBERT SHULL, DIRECTOR OF REGULATORY POLICY, OMB WATCH, WASHINGTON, DC

Mr. SHULL. Thank you very much, and thank you, Mr. Chairman and Mr. Watt, for having me before you to talk about this really important issue.

I want to start from the simple proposition that no agency is in the business of producing regulations for the sake of producing regulations. We ask our agencies to produce regulations to protect the public, to protect all of us who are breathing the air, drinking the water, all of the men and women of America who have to work for a living and go to a job where they want to be safe and healthy.

And small businesses, like all businesses, contribute to the hazards that we face, when we are breathing the air, drinking the water, going on the job, driving on the highways. And it really doesn't matter to all of us, to someone who is breathing dirty air or drinking poisoned water, whether the hazards that we are suddenly experiencing have been put there into our environment by small businesses or large businesses.

But I also want to start from the proposition that small businesses want to be good corporate citizens, and that the best intention for helping small businesses and recognizing the fact that small businesses do face a different kind of hurdle than their larger counterparts when trying to comply with regulations, might need some assistance. But that the answer isn't to give them a free pass in any way, that the answer isn't to burden the agencies whose job it is to protect the public, but rather to help small businesses comply.

We did hear that regulations have produced some costs for the economy and for the businesses who have to comply with them, but I think we also have to recognize that the benefits of regulation have been extraordinary. I mean, you can even look and measure in terms of I.Q. points when we took out lead from gasoline and now that kids aren't breathing that lead in from the air. You can see the measurable benefits, and that is one of many, many examples.

I also want to recognize that, although the Reg Flex Improvements Act that we are looking at today has a lot of concerns about regulation and whether or not they are hindering the competitiveness of American business in the global marketplace, that the economics literature out there just doesn't support the case that in America our regulations are somehow hindering our businesses from competing.

You can look at evidence of, say, plant location decisions. When we have environmental regulations, do plants that manufacture goods suddenly move to areas where there are less stringent environmental regulations? Or you can look at the trade flows: when environmental regulations become more stringent, do pollution-in-

tensive goods start coming in from developing nations to developed nations? And that link just hasn't been shown.

And because of that concern, we really think that there is no basis for the Reg Flex Improvements Act that we are looking at today. And I am concerned that it will really hinder the agencies from doing the good job that they are doing of protecting the people. I am concerned that the analysis itself that agencies have to perform under the Reg Flex Act will become more burdensome.

I mean, already, there is a signal in the bill that a succinct statement is not enough, that we have to have a very detailed explanation. The burden will increase through the scope of it. It would no longer apply just to rule makings that go through the APA notice and comment process, but now it would also apply to guidance documents, general policy statements, interpretive rules, and land management plans, that the periodic re-reviews of rules under the Reg Flex Act, which were for 10-year reviews of rules found to have a SEISNOSE, a significant economic impact on a substantial number of small entities. Since the Regulatory Flexibility Act went into effect, that those now go back to all the rules on the books, even the rules that we know, like the ban on lead in gasoline, just are incredibly important, proven protections.

We are also concerned about SBREFA panels now applying not just to EPA and OSHA rules, which we think were bad enough—it is giving business interests a first bite at the apple for those rules, but also applying to a significant number of other rules. We are also concerned about the SBA Office of Advocacy being put in a compromised position: if it is given regulatory authority over implementing the new requirements of the Reg Flex Improvements Act, that will compromise their role as an independent voice of small business.

And we think that there is a better way. We have outlined some in our prepared statement, and I would like to offer a more complete version of that statement for the record after this hearing.

[The prepared statement of Mr. Shull follows:]

PREPARED STATEMENT OF J. ROBERT SHULL

Testimony of
J. Robert Shull
Director of Regulatory Policy
OMB Watch

Before the
Subcommittee on Administrative Law
Committee on the Judiciary
U.S. House of Representatives

July 20, 2006

Thank you for the opportunity to testify before you today. I am Robert Shull, Director of Regulatory Policy for OMB Watch. OMB Watch is a nonprofit, nonpartisan research and advocacy center promoting an open, accountable government responsive to the public's needs. Founded in 1983 to remove the veil of secrecy from the White House Office of Management and Budget, OMB Watch has since then expanded its focus beyond monitoring OMB itself. We currently address four issue areas: right to know and access to government information; advocacy rights of nonprofits; effective budget and tax policies; and the use of regulatory policy to protect the public.

We are very concerned about the bill being discussed here today, H.R. 682, 'The Regulatory Flexibility Improvements Act.' While H.R. 682 purports to address the burdens faced by small businesses, the bill will only serve to further drown regulatory agencies in needless analysis, preventing them from promulgating and enforcing the regulations created to protect working families. More effective avenues exist to help alleviate the burden on small businesses while ensuring that workplace, environmental, and civil rights protections stay intact.

I. The Regulatory Flexibility Improvements Act is overly broad and will result in wasted public resources and reduced public protections.

The Regulatory Flexibility Improvements Act amends the Regulatory Flexibility Act by requiring federal agencies to conduct comprehensive analyses of the impacts of federal rules on small businesses. The bill would effect substantial changes from current law, by

1. Expanding the RFA's coverage to include all regulations on the books, even long-proven safeguards such as the ban on lead in gasoline;
2. Inviting paralysis by analysis, by requiring agencies to examine both direct *and indirect* effects of the regulations;
3. Expanding the scope of the RFA to include agency guidance documents, human services rules and land management plans; and
4. Dramatically expanding the scope of rules subject to SBREFA panels.

This far-reaching proposal could have devastating effects, calling into question longstanding health, safety and environmental protections while needlessly burdening agencies and squandering agency resources. Specifically, the bill will do the following:

A. Wastes agency resources on highly speculative assessments.

The bill requires agencies to examine not only direct effects, which are currently assessed under the RFA, but also indirect effects. Agencies face substantial difficulties in attempting to calculate indirect effects. In fact, agency representatives at a recent Senate roundtable suggested this analysis would be so speculative as to be useless for policymakers. The courts have consistently held that RFA does not impose an obligation on agencies to analyze indirect economic effects on entities it does not regulate. Requiring consideration of indirect economic effects would drown agencies in burdensome and highly speculative analyses and paperwork that would impede their ability to promulgate needed protections, such as protections for workers against exposure to deadly chemicals, like crystalline silica.

B. **Burdens agencies with redundant and unnecessary analysis.**

The bill also requires reviews of all existing 10-year old rules affecting small business. These look-back studies needlessly spend staff time and money to re-justify important and proven health and environmental safeguards, such as airbag safety standards in cars or food safety inspections that prevent against foodborne pathogens like e-coli or listeria. These look-back studies would add to the lengthy regimen of regulatory assessments already performed by agencies, including those required under Executive Order 12866, the Paperwork Reduction Act, the Unfunded Mandates Reform Act, and the National Environmental Policy Act, among others. The bill also expands the scope of rules subject to the Regulatory Flexibility Act by including amendments to land management plans, rules affecting Indian tribes, IRS recordkeeping requirements, and regulations governing grants to state and local governments, as well as *agency guidance documents*.

C. **Threatens valuable protections.**

Expanding RFA analysis to include look-backs and indirect effects could put longstanding protections in jeopardy. Agencies would be forced to re-justify proven regulatory safeguards such as lead in gasoline or arsenic in the drinking water. Industry advocates have already singled out EPA's ambient air quality standards for life-threatening soot and smog as a primary reason for expanding regulatory flexibility analysis to include indirect effects. H.R. 682 also extends analytical burdens to a whole new universe of public protections — human services rules, such as those protecting abused and neglected children in federally-funded child welfare programs — by including nonprofits in the definition of small entities and expanding the scope of the RFA to regulations governing grants to state and local governments.

D. Puts corporate special interests ahead of the public interest.

H.R. 682 gives corporate interests an even greater advantage in the regulatory process by giving the head of the Small Business Administration's Office of Advocacy a preview of proposed rules before they are published in the *Federal Register* and increased opportunities to intervene in the process. Current law requires EPA and OSHA to submit draft rules to panels of business lobbyists, and a section of this bill would expand these preview opportunities to all agencies. An additional section would actually give SBA's Office of Advocacy the power to write regulations governing all agencies' compliance with the Regulatory Flexibility Act. Given that Advocacy is a taxpayer-funded voice for business interests, this provision is particularly troubling.

II. Regulation does not always harm U.S. competitiveness and may actually improve it.

Burdensome anti-regulatory measures like H.R. 682 are born out of the idea that regulation will drive small American companies out of business. The real scholarly evidence, however, refutes this claim. While the business community may be hampered in competing in global trade, regulation is not at fault. The business community, however, has nothing to gain by publicizing the real reasons for its difficulties, such as lower wages paid in other countries with which we now have self-destructive free trade agreements. The idea that regulation causes competitive decline is the product not of careful scholarship but, rather, of a multi-million dollar public relations campaign.

These criticisms of regulation are insufficient for four reasons:

(A) *Regulatory safeguards produce significant benefits for the public.* Citations to the high cost of regulation do not establish that regulation is unwarranted because they completely ignore what we gain from these expenditures. Protecting people and the environment may cost a lot of money, but it also produces far larger benefits. In fact, even the Office of Management and Budget, which is a main proponent of the idea that regulations are too costly, nonetheless reports every year that regulation in the United States generates aggregate benefits that greatly exceed the cost of the federal regulations.[1]

(B) *Not all costs have the same moral or ethical value.* Some regulatory costs represent the cost to industry of doing what it should have done as a good corporate citizen in the absence of regulation. For example, stunning new evidence reveals that U.S. automakers misled the government and the public for years by claiming that the strength of vehicle roofs is unrelated to the serious injuries sustained when vehicles crash and roll over. According to industry documents, Ford denied this link even though its Volvo subsidiary had conducted research demonstrating that strengthening

1. *See* 2006 Draft Report on the Costs and Benefits of Federal Regulation, (available on-line at <http://www.whitehouse.gov/OMB/inforeg/reports/2006_draft_cost_benefit_report.pdf> Previous reports on the costs and benefits of regulation available at <http://www.whitehouse.gov/OMB/inforeg/regpol-reports_congress.html>).

car roofs and other improvements are the key to preventing injuries and saving lives in rollover crashes.[2] If and when the National Highway Traffic Safety Administration issues a rule to safeguard against vehicle roofs caving in during rollover crashes, the cost to the automakers of complying will mean little if it is not offset by the profits earned during the period that the automakers knew of the need for stronger roofs but failed to do anything about it.

(C) *Cost estimates are overblown.* Moreover, many claims about regulatory costs are suspicious because they rely on cost estimates that come from industry sources that have an incentive to overstate the costs for regulatory and public relation purposes. According to a recent influential study,

> *ex ante* cost estimates have usually been high, sometimes by orders of magnitude, when compared to actual costs incurred. This conclusion is not at all surprising in light of the strategic environment in which the predictions are generated. In preparing regulatory impact assessments for proposed rules, agencies are heavily dependent upon the regulated entities for information about compliance costs. Knowing that the agencies are less likely to impose regulatory options with high price tags (or to support them during the review process), the regulatees have every incentive to err on the high side.[3]

One particular estimate of costs, the discredited Crain and Hopkins study commissioned by the Small Business Administration, is significantly overblown.[4] For example, the familiar estimates that the manufacturing sector in 2000 "shouldered $147 billion of the $497 billion onus of environmental, economic, workplace, and tax-compliance regulation"[5] suffer the same problems just discussed and actually magnify those errors significantly, based on the assumption that regulatory compliance costs should be doubled to account for industry's public relations campaign against regulatory protections and the expenses of lobbying this very Congress.[6]

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2. *See* Press Release, Public Citizen, "New Report on Auto Industry Data Shows Automakers Misled NHTSA and Public When Denying Link Between Roof Strength and Injuries" (Mar. 30, 2005) (available on-line at <http://www.citizen.org/pressroom/release.cfm?ID=1909>).

3. Thomas O. McGarity & Ruth Ruttenberg, *Counting the Cost of Health, Safety & Environmental Regulation*, 80 TEX. L. REV. 1997, 1998 (2002).

4. *See* W. MARK CRAIN & THOMAS D. HOPKINS, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS (Office of Advocacy, Small Business Admin. RFP No. SBAHQ-00-R-0027) (2001).

5. Testimony of National Assoc'n of Manufs.*Hearing on Impact of Regulations on U.S. Manufacturing Before the House Subcomm. on Reg. Affairs, House Comm. on Gov't Reform*, 109th Cong. (April 12, 2005), at 5 (citing CRAIN & HOPKINS, *supra* note 11, at 27 Tbl.9A).

6. *See* CRAIN & HOPKINS, *supra* note 11, at 10.

(D) *Compliance costs are so minuscule that they have minor competitive consequences.* Finally, and most importantly for these purposes, regulation cannot be blamed for a decline in competitiveness or other economic ills because compliance costs are only a very small percentage of total value of the shipments made by manufacturers. On the basis of data from the World Bank, Professor Kevin Gallagher of Boston University finds the "sum of all marginal pollution abatement costs in the United States is less than one percent of value added production." [7] Department of Commerce data confirm this estimate. This information indicates abatement expenditures are an average of 0.62 percent of the value of shipments of all industries. Industry sectors with high abatement costs only pay between 1.27 and 1.51 percent of the value of shipments.[8] Indirect costs are derivative of direct compliance costs; since low direct costs generally will produce low indirect costs, regulation overall should have a minor competitive and labor impacts.

The scholarly evidence backs up this claim. Economists have considered the impact of environmental regulations on plant location decisions (do pollution-intensive industries build disproportionate number of new factories in countries or areas of the United States where there is weak environmental regulation?) and on trade flows (do exports from developing to developed countries show an increasing percentage of pollution-intensive goods?). Neither type of study supports a regulation-competitiveness link. I recommend a recent literature review by Professor Sidney Shapiro, which synthesizes the major research on the questions and comes to the following conclusions:

- The leading meta-study of plant location and trade flow studies found that "studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location-decisions have produced estimates that are either small, statistically insignificant, or not a robust to test of model specification." These authors concluded that there is "[o]verall … relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness, however that elusive term is defined."[9]

- According to another survey of the literature, "The vast majority of studies have found no systematic evidence that the share of developing country exports and production is becoming more pollution-intensive. In addition, no studies have indicated that there is substantial evidence

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7. Testimony of Prof. Sidney A. Shapiro, *Hearing on Impact of Regulations on U.S. Manufacturing*, 109th Cong. (April 12, 2005), at 5 text accompanying note 5.

8. *Id.* at 5 (citing Adam B. Jaffe, Steven R. Peterson, Paul R. Portney, & Robert N. Stavins, *Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?*, 33 J. ECON. LIT. 132, 141 Tbl.5 (1995)).

9. *Id.* at 5-6 (citing Jaffe et al., *supra* note 15, at 141).

> that pollution-intensive industries flee developed countries with relatively high (and costly) environmental standards)."[10]

III. The Regulatory Flexibility Improvements Act Will Not Meet the Need of Small Businesses.

H.R. 682 was put forward under the banner of relieving regulatory burden to small business, but this legislation puts public protections at stake while failing to get at the heart of what ails small business. The small business community is a major source of innovation and employment in this country. Like their larger counterparts, however, small businesses are also responsible for social ills addressed by regulations, ranging from workplace health and safety problems to environmental pollution.[11] Thus, we cannot simply give small businesses a free pass from regulation. At the same time, it can be relatively more expensive for small business to comply with regulations than large companies. Small businesses want to do their part and be responsible; real reforms, then, must help small businesses comply with regulations in order to level the playing field with large businesses while giving the public the protection it needs and deserves.

We already have these reforms. Small firms receive direct government subsidies such as outright and government-guaranteed loans from the Small Business Administration (SBA) as well as indirect preferential treatment through federal procurement requirements and tax provisions. Additionally, small business is treated to many exemptions or special treatment in the area of regulation. For example, employers with fewer than 15 employees are exempt from the Equal Employment Opportunity Act,[12] and OSHA levies lighter penalties for smaller firms, exempts businesses with fewer than 10 workers from recordkeeping requirements, and provides free on-site compliance consultations.[13]

Small business concerns are inscribed in law. The Small Business Regulatory Enforcement Fairness Act (SBREFA) requires agencies to give special consideration and voice to small business as part of the rulemaking process as well as expanded judicial review for small businesses wishing to challenge agency decisions.[14] Likewise, the Equal Access to Justice Act gives small businesses special privileges when litigating against agencies: small businesses can recover attorney's fees if they prevail

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10. *Id.* at 6 (citing KEVIN O. GALLAGHER, FREE TRADE AND THE ENVIRONMENT: MEXICO, NAFTA, AND BEYOND 26 (2004)).

11. *See* Richard J. Pierce, Jr., *Small is Not Beautiful: The Case Against Special Regulatory Treatment of Small Firms*, 50 ADMIN. L. REV. 537 (1998).

12. *See* 42 U.S.C. § 2000e(b).

13. *See* OSHA, *OSHA Small Business Assistance: OSHA Benefits for Small Business* (available on-line at <http://www.osha.gov/dcsp/smallbusiness/benefits.html>).

14. *See* 5 U.S.C. §§ 601 *et seq.*

in court against a federal agency.[15]

Real reforms for small businesses would make these benefits meaningful by clamping down on the ways that large businesses game the rules and claim the status of "small business." Real reform would consider the role of small business in contributing to pollution and other harms to the public and would respond by adequately funding compliance assistance offices in every congressional district, which would be given the resources they need to give small businesses the help that they, in turn, need to be good corporate citizens and comply with the law. This bill does not come close to being real reform; it is a shameful giveaway of the protections we need, and it shamelessly exploits the real needs of small businesses in order to justify this dangerous exercise.

IV. There Is a Better Way.

A. National Business Regulatory Assistance Act

There are better ways to help small business without sacrificing longstanding public protections. The National Small Business Regulatory Assistance Act (S. 1411) would be the first step to strengthening Small Business Development Centers (SBDCs) around the country by launching a pilot in which SBDCs would provide compliance assistance to small businesses. This bill would help level the playing field for small businesses by giving them specialized assistance with understanding and complying with federal regulations, without compromising the public's protections, directly or indirectly; instead, it would actually help some businesses to comply with the regulations that are in place to protect the public.

B. Strengthening Petitions for Rulemaking

Processes already exist that allow both businesses and the public interest to ask federal agencies to address particular regulatory problems. Small businesses are already well aware of the regulations that are particularly burdensome or obsolete. Rather than expanding the Regulatory Flexibility Act to review all federal regulations on the books, small businesses already have the power to petition agencies to revisit specific regulations. Strengthening the petition process by making agencies more responsive to requests from the public would use existing mechanisms to open the door to reforms without drowning agencies in reviews of existing regulations. Moreover, rather than serving a particular constituency, strengthening petitions for rulemaking would benefit all members of the public. It can be used to identify both gaps in public protections as well as areas where reform may be needed.

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15. *See id.* § 504.

Problems of H.R. 682

Regulatory Flexibility Act	Regulatory Flexibility Improvements Act (H.R. 682)
• Applies only to rules with direct effects on small businesses	• Applies to rules, policy statements and guidance documents, land management plans, revisions or amendments to land management plans, recordkeeping requirements and formal rulemakings with direct and indirect effects to small businesses.
• Includes regulations impacting small businesses and local governments	• Includes regulations impacting small businesses, local governments, Tribal organizations, local labor organizations and professional and trade associations
• Requires agencies to prepare a regulatory flexibility analysis for all proposed rules and for all final rules, summarizing why the action is being taken and description of how small entities will be impacted.	• Regulatory flexibility analysis must contain all provisions of original regulatory flexibility analysis, but must also include a description of alternatives that might maximize benefits and an estimate of "the additional cumulative economic impact of the proposed rule on small entities beyond that already imposed on the class of small entities." Final analysis is no longer required to be "succinct," and explanations are amended to be "detailed explanations."
• The agency is required to respond to public comments.	• The agency is required to specifically respond to comments filed by the Chief Counsel of Advocacy, including details of any changes made as a result of the comments.
• Allows analysis to be either quantified or general.	• If agency gives a general description instead of a quantified analysis, it must include detailed explanation of why quantification is not "practicable or reliable."
	• Eliminates procedures for agency heads to delay the analysis before promulgating proposed or final rule.
• Requires small business panel to review all rules by EPA and OSHA with a significant impact on small entities.	• Requires small business panel to review all rules that result in "an annual effect on the economy of $100,000,000 or more," "a major increase in costs or prices," "significant adverse effects" on a variety of economic factors, "a significant impact on a substantial number of small entities."
• Periodic review of all rules, "which have or will have a significant adverse impact on a substantial number of small entities," going back to ten years before the enactment of the RFA.	• Periodic review of all rules, regardless of whether they have had or will have a significant impact on a substantial number of small entities. Agencies will submit a report to Congress regarding their findings. The review must include comments by the Regulatory Enforcement Ombudsman and the Chief Counsel of the Office of Advocacy and "the contribution of the rule to the cumulative economic impact of all Federal rules on the class of small entities affected by the rule."

Mr. CANNON. Thank you. Let us just ask unanimous consent that you have 5 additional days to submit that. Would that be sufficient?

Mr. SHULL. Thank you very much.

Mr. CANNON. Without objection, so ordered. And, frankly, we understand that you were drawn into this late. That was a compelling statement given what apparently was a short time to prepare, and we thank you for being here.

Mr. Frulla, you are recognized for 5 minutes. Thank you.

TESTIMONY OF DAVID FRULLA, ESQUIRE, KELLEY DRYE COLLIER SHANNON, WASHINGTON, DC

Mr. FRULLA. Thank you, Mr. Chairman, Mr. Ranking Member.

My perspective on the Regulatory Flexibility Act is as a 10-year litigant. I have had over a dozen cases regarding six different agencies, rule-making proceedings, and we have prevailed about half the time. And we have gotten some substantive results. These aren't always things that are high profile, above-the-radar issues. In one case, we ended up with a settlement that involved a scientific re-review of a 67 percent reduction in a quota for sharks that were caught in the Gulf and Atlantic.

That review showed there was no scientific basis for that quota cut. Again, not every regulation is lead in gasoline. There is a lot that the Government does. Sometimes it goes awry. There needs to be checks and balances there. The Regulatory Flexibility Act is an important tool.

And I would also note that a Regulatory Flexibility Act victory is only a first step. It is often a long haul to get an agency to change course. And I also have to tell you, and it is probably not a news flash to anybody here, that Federal agencies don't always listen to Federal judges.

So SBREFA was a step in the right direction and this new legislation, H.R. 682, and equally importantly, the congressional attention that is being paid to the RFA, are right on point. Litigation does impose discipline. We get to see after 10 years weaknesses in the law that litigation shows in the same way as cross examination, but on the legal side.

I would like to applaud especially H.R. 682's efforts to clarify jurisdictional issues and timing issues. We lay this out extensively in my written testimony. To address the foreseeable indirect effects, let me give you one example. A couple of years ago, I think it was, Congress wanted to impose cost-containment standards on what they call WIC-only vendors in the Women, Infant and Children Food and Nutrition Program.

And it was clear that there were to be stores that are WIC-only vendors, that essentially service that community, that were to be regulated and were to have their costs contained. However, the States regulated that level and the directive was for the States to make these changes.

That is outside the Regulatory Flexibility Act as it currently stands, even though these small businesses were clearly the target, and the intended target. We also think it is going to be important to crystallize the Office of Advocacy's role in establishing how other agencies do reg-flex analyses. We had a case with the EPA at one

point, and the EPA's reg flex guidance asks the question in terms of determining economic impact as what the impact of the regulation is on a business's gross revenues.

They say, we don't need to look at profitability, and they said, well, you know, a 1 percent hit on gross revenues, that is not much. Well, it is a lot if you only have a 4 percent profit margin. But the court said the EPA had the discretion to use its own standards. That is something else that needs to be looked at, and that is something that the SBA has issued guidance on.

Other issues we note, the standard of review. Normally, there is essentially what they call a good-faith standard. It is kind of backing up from an arbitrary and capricious standard. That is starting to get pretty toothless in many cases.

I have addressed that in the testimony, some good results and some bad results. We submit that the arbitrary and capricious standard ought to apply to the no significant impact determinations. Clearly in the law, it is in the legislative history, and the same when the final regulatory flexibility analyses are reviewed.

It also should be stated that application of the Reg Flex Act to a particular rule ought to be handled under the *de novo* standard, as should the question of whether an agency has flexibility under a given law. Another case we had, one page of law ended up with 47 pages of regulations and the agency said that they had no flexibility, and it was all required. That doesn't seem to make sense.

Three other points I would like to mention quickly, expedition. Questions of whether the Regulatory Flexibility Act applies should be expedited. We are waiting 6 years for a final decision, when we know the answer from the D.C. circuit that the Reg Flex Act applies to nationwide permitting under the Clean Water Act. Attorneys' fees, got to put a plug in for that. If a small business prevails, they should be able to be awarded attorneys' fees. A victory on reg flex is only the start, and it shouldn't be a war of attrition. And, finally, make sure the Office of Advocacy has the resources they need.

Thank you very much.

[The prepared statement of Mr. Frulla follows:]

PREPARED STATEMENT OF DAVID E. FRULLA

KELLEY DRYE
COLLIER SHANNON

H.R. 682:
Regulatory Flexibility Improvements Act

Testimony Before the U.S. House Judiciary Subcommittee
on Commercial and Administrative Law

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July 20, 2006

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Testimony of David E. Frulla
Before the Subcommittee on Commercial and Administrative Law
House of Representatives Committee on the Judiciary

July 20, 2006

Mr. Chairman and Members of the Subcommittee on Commercial and Administrative Law, I appreciate the opportunity to testify before the Subcommittee's July 20, 2006, legislative hearing on H.R. 682, the Regulatory Flexibility Improvements Act. This legislation should help ensure that the Regulatory Flexibility Act ("RFA"), as amended in 1996 by the Small Business Regulatory Enforcement and Fairness Act ("SBREFA"), is an effective and enforceable tool to require Federal agencies tailor their regulations to the scope and scale of small businesses and other small entities. H.R. 682 shows that its sponsors have been listening to the needs and concerns of small entities, with respect to RFA compliance.

EXECUTIVE SUMMARY

SBREFA made many salutary changes to the RFA, not the least of which are its judicial review provisions. As the Subcommittee knows, SBREFA added these judicial review provisions, at 5 U. S. C. § 611, to ensure federal agencies do more than pay "lip service" to the RFA. *See* 142 CONG. REC. S3242, S3245 (*daily ed.*, Mar. 29, 1996).

We have extensive experience litigating SBREFA cases.[1] That said, I am appearing before the Subcommittee today in my personal capacity, and not on behalf of

[1] In fact, I believe that I may have litigated as many RFA cases as anyone in the country since SBREFA was enacted. I have been involved in over a dozen RFA cases against six different agencies: the Department of Commerce (regarding various fisheries regulations), the Department of Health and Human Services (regarding the "interim payment" system for home health agency Medicare reimbursement), the Army Corps of Engineers (regarding modification of its Clean Water Act Nationwide Permit System), the Environmental Protection Agency (regarding its Lead Rule), the Federal Communications Commission (regarding its intermodal telephone number porting requirements), and the Food and Nutrition Service (as a friend of the court, regarding its cost-reduction program for so-called "WIC-only" vendors).

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any client. In summary, the decade-long crucible of the litigation process has demonstrated both strengths and weaknesses in the RFA's structure and processes. Congress should now use this experience to improve the RFA and ensure it serves its intended purposes. H.R. 682 addresses many important issues but more needs to be done.

I will first address important changes to the RFA that H.R. 682 would make. Then I will identify an important situation where H.R. 682 addressed an issue, but may not have gone far enough. Finally, I will identify a few issues that H.R. 682 did not address, but that Congress should address, whether in this legislation or elsewhere (for instance, in the appropriations process).

I. H.R. 682 ADDRESSES CERTAIN CHRONIC RFA/SBREFA IMPLEMENTATION PROBLEMS VERY WELL

First, Section 8 of H.R. 682 would clarify a jurisdictional and timing issue that we confronted in *Nat'l Ass'n of Homebuilders v. U.S. Army Corps of Engineers*, 417 F.3d 1272 (D.C. Cir. 2005), *reversing* 297 F. Supp. 2d 74 (D.D.C. 2003). I represented the National Federation of Independent Business Legal Foundation and a small business homebuilder in their RFA challenge to a major Army Corps of Engineers Clean Water Act rulemaking that implemented new nationwide permits and supporting terms and conditions. The Army Corps had completely and, as the D.C. Circuit held, erroneously disclaimed its obligation to comply with the RFA, by baldly claiming that it was not issuing "regulations." More specifically, *NAHB* reversed a lower court decision which had dismissed RFA and APA claims on the ground that the Army Corps' issuance of these nationwide permits and their terms and conditions did not represent "final agency action." The RFA uses the term "final agency action" in its jurisdictional provisions, 5 U.S.C. § 611(a).

We were able to argue successfully at the appellate level in *NAHB* that the Army Corps' actions relating to the RFA were complete when the agency concluded its rulemaking proceedings and that no set of facts (such as the application of the nationwide permit standards in the context of an actual permit application), could or would make the RFA claim any more ready for review. By changing the finality standard in Section 611 from "final agency action" to "publication of the final rule," Section 8(c) of H.R. 682 would remove this point of confusion on jurisdiction and the timing of judicial review.

The clarity H.R. 682 would provide represents a real benefit to the small business community. We filed suit in *NAHB* in 2000, and it was not until 2005 that the appeals court made its decision. And we are still awaiting a final order from the district court effecting the settlement of the case that followed from the D.C. Circuit ruling. Meanwhile, the Army Corps is gearing up for a new permit rulemaking as these nationwide permits are only valid for five years.

Second, H.R. 682 would significantly enhance the Small Business Administration Office of Advocacy's coordinating role for Federal Government-wide RFA compliance. For instance, Section 10(a) of H.R. 682, proposing to enact a new RFA section, 5 U.S.C. § 613, would authorize the Office of Advocacy to develop omnibus RFA implementing regulations that all other agencies would be required to follow, absent approval from the Office of Advocacy. Currently, there are almost as many sets of agency RFA implementing regulations as there are Federal agencies. This is not constructive.

For instance, the Environmental Protection Agency's RFA implementing guidelines authorize the agency to conduct RFA economic impact analyses based on small businesses' revenues, rather than their profitability. While any fair assessment of a

regulation's economic impact ought to be measured against profits (and thus the entity's ability to pay for the regulation), a district court in Washington, D.C. recently deferred to the EPA guidelines. *Ad Hoc Metals Coalition v. Johnson*, 1:01cv0766 (PLF) (D.D.C., Jan. 20, 2006), *slip op.*, at 12-13.[2] Uniform Office of Advocacy regulations consistent with its Guide for Government Agencies would have changed the deference calculus.

More generally, the caselaw is mixed regarding the level of deference accorded to the Office of Advocacy in its efforts to ensure RFA compliance. Certain cases are very respectful of positions and submissions from the Chief Counsel. *See, e.g., Southern Offshore Fishing Ass'n v. Daley*, 995 F. Supp. 1411, 1435 (M.D. Fla. 1998) (*SOFA I*) (terming the Office of Advocacy as the Federal Government's RFA "watch dog"). However, other cases are not deferential. *American Trucking Ass'ns v. EPA*, 175 F.3d 1027, 1044 (D.C. Cir. 1999) (no deference owed to either EPA's or SBA's RFA interpretations), *modified on other grounds*, 195 F.3d 4 (D.C. Cir. 1999), *aff'd in part and rev'd in part on other grounds, sub nom., Whitman v. American Trucking Ass'ns*, 531 U.S. 457 (2001).

Deference ought to be accorded to the Office of Advocacy. The Chief Counsel and his experienced staff have a detailed familiarity with the RFA and its requirements, small entities' ability to accommodate regulations, and the benefit of an overall perspective on the many and varied ways that rulemaking agencies attempt to avoid or defeat their RFA obligations. By law and Executive Order, the Office of Advocacy has been an RFA teacher. In granting the Office of Advocacy an explicit regulation-writing

[2] The court explained, "The RFA does not define 'significant impact on a substantial number of small entities,' grants neither authority nor responsibility to any entity to develop a uniform definition of SEISNSE, and provides no guidance as to how certification decisions are made. Instead, the RFA grants federal agencies broad discretion regarding how key terms in the act should be defined and how certification decisions should be made." *Id., slip op.*, at 12.

role, H.R. 682 should not only promote more consistent RFA application and compliance across the government, but also confirm that the primacy of the expert Chief Counsel for Advocacy on the RFA issues within his ken. In addition, by extending the Chief Counsel's authority to comment and intervene to Administrative Procedure Act issues more generally (*see* H.R. 682, § 10(c)), the legislation recognizes the integral links between RFA compliance and APA standards.[3]

Section 4(b)(3) of H.R. 682 also requires rulemaking agencies to address specifically to Office of Advocacy comments in response to a proposed rule. This measure should help the small business community, and the courts, identify when rulemaking agencies are acting in the face of, or even inconsistent with, conclusions and guidance from expert agency.

For its part, Section 8(d) of H.R. 682 constructively clarifies the Chief Counsel's authority to intervene in actions under the RFA against Federal agencies, by specifically delineating that authority as coextensive with the scope of RFA judicial review. The SBA can have a unique role to play in RFA litigation, especially given the RFA's unique and tailored remedial provisions.

For instance, in *United States Telecom Ass'n v. FCC*, 400 F.3d 29 (D.C. Cir. 2005), in my prior law firm, we represented small, generally rural wireline telephone carriers in their challenge to a Federal Communications Commission order requiring all wireline carriers to develop and maintain the infrastructure to permit their customers to transfer, or "port," their phone numbers to their wireless phones even if these customers moved from one physical location to another. In that case, the FCC had disclaimed its

[3] For instance, the RFA's applicability is principally tied to the APA's standards for notice and comment rulemaking under 5 U.S.C. § 553. See 5 U.S.C. §§ 601(2) (defining a "rule" under the RFA); 604 (initial regulatory flexibility analysis standards); and 605 (final regulatory flexibility analysis standards).

RFA obligations, arguing that it had merely issued an interpretative ruling in response to a petition for rulemaking, which it also likened to adjudication. The D.C. Circuit disagreed, and held the agency had developed a "legislative rule" requiring RFA compliance. 400 F.3d at 40-41. The court enjoined the FCC from enforcing the rule against small entities until the agency had complied with the RFA. *Id.* at 43-44. While the injunction came approximately fifteen months after the rulemaking, with the SBA Office of Advocacy's assistance, our clients were still able to preserve enough of the *status quo* for the injunction to be effective.

More specifically, during the pendency of the case, state utility commissions had employed their limited authority to grant "waivers" to petitioning companies that were subject to the FCC's porting order. The FCC Bureau that developed the rule had preemptively informed these state commissions that they should not grant any of the waiver requests. Whether or not these state commissions would have complied with the bureau's edict, FCC Chairman Michael Powell ultimately countermanded it. He did so as part of a settlement with the SBA Office of Advocacy to resolve the SBA's intervention in our case, on the eve of the SBA's filing its *amicus* brief supporting our position. SBA's litigation role, even stopping short of briefing and argument, served an important and creative function in the overall arc of the litigation.

Third, H.R. 682 addresses another long-standing problem relating to what are called "indirect" regulatory impacts. More specifically, agencies often claim, based on a long-standing line of cases, that the impacts of their regulations should not be counted for RFA purposes if they do not directly impact small entities, or else they design their regulatory schemes to impact indirectly small entities, perhaps in part to avoid or limit

RFA requirements. *See, e.g., Nat'l Women, Infants, and Children Grocers Ass'n v. Food and Nutrition Svc.*, 416 F. Supp.2d 92, 109-10 (D.D.C. 2006) (rejecting RFA challenge because the interim final rule imposed its requirements on state agencies administering the WIC program even though small business WIC-only grocery stores were the professed "targets" of the rule). This case relied on *Cement Kiln Recycling Coalition v. EPA*, 255 F.3d 855, 869 (D.C. Cir. 2001), which held that "application of the RFA does not turn on whether particular entities are the 'targets' of a given rule." The origins of this narrowing construction of the RFA's scope are sketchy, and non-statutory, and H.R. 682 should correct this matter.[4]

Section 3(b) of H.R. 682 would constructively address this situation by extending the term "economic impact" under the RFA to "any indirect economic effect on small entities which is reasonably foreseeable and results from such rule . . . "

II. H.R. 682 COULD DO MORE TO ENSURE COURTS RECOGNIZE THEIR AUTHORITY TO REQUIRE THAT AGENCIES UNDERTAKE DETAILED, CAREFUL RFA ANALYSES

H.R. 682's findings, set forth in Section 2, state clearly that rulemaking agencies need to do more to understand the impacts their proposed regulations have on small entities, undertake outreach to small entities in the regulated community, and develop ameliorative alternatives.[5] To address these shortcomings in agency RFA analyses, the

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[4] These RFA "indirect regulation" cases stem from *Mid-Tex Elec. Coop. v. FERC*, 773 F.2d 327, 432 (D.C. Cir. 1985). *See, e.g., Cement Kiln*, 255 F.3d at 869. For its part, *Mid-Tex* derived the standard from the RFA's preamble, rather than its operative terms. *See* 773 F.2d at 341. A statute's operative terms should control over its preamble, *Ass'n of American Railroads v. Costle*, 562 F.2d 1310, 1316 (D.C. Cir. 1977); *Yazoo and Miss. Valley R.R. Co. v. Thomas*, 132 U.S. 174, 188 (1889), particularly when the operative language establishes a specific "definition which declares what a term 'means' [and] is binding upon the court," *Nat'l City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122, 1133-34 (8th Cir. 1982), *relying on Colautti v. Franklin*, 439 U.S. 379, 392-93 n.10 (1979).

[5] RFA applicability and Section 605(b) certifications have been the subject of much SBREFA litigation to date, but they are only threshold issues; ultimately, to be truly effective, as the findings

bill, in the main, imposes more detailed analytical requirements on agencies in Section 4. Section 4(a) also constructively requires agencies to affirmatively collect information to estimate the number and type of small entities to which a proposed rule would apply, rather than allowing an agency to excuse shoddy outreach and investigation based on 5 U.S.C. § 603(b)(4)'s current "feasib[ility]" limitation.[6] The legislation would also promote more relevant RFA analyses by requiring an agency to consider the cumulative impacts of its regulations on small businesses, by adding a new sub-section (b)(6) to Section 603.

Simply requiring agencies to undertake more analyses may not, however, solve the problem that H.R. 682's Findings correctly identify. H.R. 682 does not, but should, ensure adequate enforcement authority for these new requirements. We have had success in RFA litigation when a court carefully considers an agency RFA's analyses under the APA's "arbitrary and capricious" standard. But in our experience, not all courts conduct sufficiently careful reviews of agencies' RFA analyses.

On the positive side of the ledger, in *SOFA I*, the Federal court in Tampa, Florida was able to recognize from personal, real world experience that a 50% shark fishing quota reduction would have a significant economic impact on a substantial number of small business shark fishermen, 995 F. Supp. at 1436, notwithstanding the Commerce

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recognize, RFA requirements and attendant litigation must evolve to address whether agencies are conducting adequate regulatory flexibility analyses and effectively developing ameliorative alternatives.

[6] Such an obligation has been created in certain contexts under the National Environmental Policy Act. "In general, NEPA imposes a duty on federal agencies to gather information and do independent research when missing information is 'important,' 'significant,' or 'essential' to a reasoned choice among alternatives." *Oregon Environmental Council v. Kunzman*, 817 F.2d 484,495 (9th Cir. 1987) (citations omitted). Certain courts have already found that NEPA's substantive requirements are analogous to duties imposed on resource agencies under the RFA. *See Associated Fisheries of Maine, Inc. v. Daley*, 127 F.3d 104, 114 (1st Cir. 1997).

Department's repeated rationalizations and diversionary arguments to support its flawed Section 605(b) no significant impact certification. *Id.* at 1433-37. *See also Nat'l Ass'n of Psychiatric Health Sys. v. Shalala*, 120 F. Supp.2d 32, 43-44 (D.D.C. 2000) (carefully reviewing cursory, hedged, and contradictory Section 605(b) certification and granting relief).

In so doing, *SOFA I* applied the APA's "arbitrary and capricious standard" and rejected application of the more deferential "without observance of procedure" standard of review. 995 F. Supp. at 1425.[7] This decision is consistent with SBREFA's legislative history[8]; for its part, the RFA currently states more generally that courts are to review agency RFA compliance under Administrative Procedure Act standards. *See* 5 U.S.C. § 611(a)(1). The SBA Chief Counsel for Advocacy had intervened in *SOFA I* on this point, recognizing the hollowness of the "without observance of procedure" standard of review.

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[7] The court's commitment to ensuring the Commerce Department complied with the RFA made *SOFA* a seminal case – and one that provided effective relief. In November 2000, after repeated, failed agency efforts to rationalize its original Section 605(b) "no significant impact" certification, two stern reported decisions and a special master finding that the agency had acted in bad faith with respect to the plaintiffs' RFA claims, the shark fishermen and the Department of Commerce settled the case. *See Southern Offshore Fishing Ass'n v. Mineta*, 2000 WL 33171005 (M.D. Fla., Dec. 7, 2000) (prior proceedings reported sub nom. at *SOFA I, supra,* and *Southern Offshore Fishing Ass'n v. Daley*, 55 F. Supp.2d 1336 (M.D. Fla. 1999) (*SOFA II*)). As part of the settlement, the parties agreed to an independent scientific review of the scientific data and analyses used by the Government to set these quotas. That independent review did not support the Commerce Department's scientific justifications for the quota reductions. The Committee should note that the Court lacked the expertise (and maybe the authority under the APA) to address the flaws in relevant agency scientific analyses that were so evident to the scientific review panel convened as a result of the settlement. *See SOFA I*, 995 F. Supp. at 1432-33.

[8] According to SBREFA's legislative history: "[I]f the court finds that a final agency action was arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law, the court may set aside the rule or order the agency to take other corrective action." 142 CONG. REC. S3245 (daily ed. Mar. 29, 1996) (statement of Sen. Bond). Similarly, SBREFA's main drafter confirmed sub-section 611(a)(1) & (2)'s express terms, stating:

> ... Review under these sections is not limited to the agency's compliance with the procedural aspects of the RFA; final agency actions under these sections will be subject to the normal judicial review standards of Chapter 7 of Title 5.

142 CONG. REC. E571-01, E574 (daily ed. Apr. 19, 1996) (remarks of Rep. Hyde). Chairman Hyde further specifically stated that the "normal" standards include the "arbitrary and capricious" standard. *Id.*

However, the standard of review for RFA analyses in certain cases is verging on this latter-referenced, essentially toothless standard. For instance, *Nat'l Women, Infants, and Children Grocers Ass'n* concluded that, "Agencies need only engage in a 'reasonable' and 'good faith effort' to carry out the mandate of the RFA . . . . Further, the RFA is a purely procedural, as opposed to a substantive, mandate; RFA 'requires nothing more than that the agency file a final regulatory flexibility analysis demonstrating a reasonable good-faith effort to carry out the RFA's mandate." 416 F. Supp.2d at 108 (*quoting Alenco Communs. Inc. v. FCC*, 201 F.3d 608, 625 (5th Cir. 2000), and *United Cellular Corp. v. FCC*, 254 F.3d 78, 88 (D.C. Cir. 2001)) (citations omitted).

I am concerned that, under these latter cases, especially with the new provisions in Section 4 of H.R. 682, if it is enacted, an agency would be tempted to substitute bulk for quality in its analyses, expecting a court would consider the development of voluminous analyses to equate with a good faith effort, notwithstanding the quality of conclusions contained in the analyses. Recognizing courts are loath to tackle reams of data and analyses, some agencies are already on occasion, if not as a *modus operandi*, filling the RFA decision-making record with impenetrable layers of economic information, but failing to take the important, subsequent step of distilling and analyzing this information, so as to assist the decision-makers and the public to develop flexible regulatory alternatives.

H.R. 682 should thus amend Section 611 of the RFA to clarify the applicable standard of review: Agency decisions regarding whether the RFA applies and whether a an agency's authority to promulgate a rule under a statute permits regulatory flexibility[9]

[9] Agencies often claim (sometimes, we believe, inappropriately) that their general statutory grants of authority do not accord them any flexibility regarding small entities as to the voluminous details of the

represent questions of law that a reviewing court should consider *de novo*. Subsequent agency analyses contained in Section 605(b) certifications and regulatory flexibility analyses should be subject to the APA's "arbitrary and capricious" standard of review.

Congress should also consider clarifying the RFA to state that agencies need to complete a full RFA analysis if there is a doubt. The RFA's legislative history makes this point. After reviewing the RFA's legislative history, a district court has explained "that '[t]he legislation is intended to be as inclusive as possible, and doubts about its applicability should be resolved in favor of complying with the provisions of the Act.'" *NAHC*, 135 F. Supp. 2d at 168 (*quoting* 126 CONG. REC. H24589 (Sep. 8, 1980) (House Statement of RFA Issues) (alteration in original)). Accordingly, "[t]he statement's context clearly shows that Congress intended that agencies err on the side of caution in determining whether to perform regulatory flexibility analyses." *Id.* However, the import of this important section of legislative history can be blunted, if not negated entirely, by the good faith review standard, under which certain agencies are back-stopping questionable Section 605(b) certification with cursory and flimsy regulatory flexibility analyses.

III. ADDITIONAL MATTERS THAT CONGRESS SHOULD ADDRESS

I would now like to offer some constructive, discrete steps that Congress can take to provide tools for those of us who sometimes need to secure agency RFA compliance through litigation.

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regulations they implement. For instance, in *National Association for Home Care v. Shalala*, 135 F. Supp.2d 161(D.D.C. 2001) (*NAHC*), the Health Care Financing Administration claimed that one page of statutory language in the Balanced Budget Act of 1997 accorded it essentially no flexibility in how it developed and implemented forty-seven Federal Register pages of regulatory analyses and requirements imposed on small home health care providers. *See also Greater Dallas Home Care Alliance v. United States*, 36 F. Supp.2d 765 (N.D. Tex. 1999).

First, Congress should explicitly provide for expedited judicial review regarding whether the RFA applies. Agencies are still claiming that binding, widely-applicable actions are not legislative rules subject to the RFA. *USTA* and *NAHB*, discussed above, are notable examples. In fact, in *NAHB*, we have been alternatively litigating and waiting since we filed suit in June 2000 for a final decision that the Army Corps should have applied the RFA. Indeed, we waited for well over three years for the district court to (erroneously) dismiss the case for lack of jurisdiction.

Second, the RFA's judicial review provisions should be amended to provide for attorneys' fees under the EAJA whenever a small entity prevails on an RFA/SBREFA claim. Small entities and associations representing them often lack the funds to sustain RFA litigation, pa rticularly once it reaches the often-protracted remedy phase. RFA litigation and compliance efforts should not become a war of attrition for these often economically marginal entities and associations representing them. *See, e.g.*, *United States Telecom Ass'n v. FCC*, 2005 U.S. App. LEXIS 18599 (D.C. Cir., Aug. 25, 2005) (denying EAJA award to prevailing small business associations).

Finally, Congress should recognize that the Office of Advocacy will likely require more resources, especially if H.R. 682 is to expand its regulatory and oversight role. Such a public investment in RFA compliance pays dividends in terms of "more just application of the laws and more equitable distribution of economic costs, which will ultimately serve both the society's and the government's best interests." *See* 126 Cong. Rec. H24589 (Sep. 8, 1980).

* * *

I appreciate the opportunity to testify before the Subcommittee on Commercial and Administrative Law, and hope that the Committee on Judiciary and the Congress as a whole will act promptly and decisively to make the SBREFA-improved RFA even stronger and better.

Mr. CANNON. Thank you, Mr. Frulla.

I appreciate all your testimony, and I recognize myself for 5 minutes to ask some questions.

It sounds like there is consensus that there are some improvements we can make and we need to try and achieve that in addressing this bill.

Mr. Shull, recognizing you didn't have time to prepare, and you have heard what the other witnesses have said, I don't want to put you on the spot in this regard, but do you either have things that you would like to propose that we do better in the Regulatory Flexibility Act, or things that you have heard today—do things come to mind that you would oppose as you consider what has been said today?

Mr. SHULL. Yes, sir. I actually think that if the goal is to serve small businesses, that there are better ways other than the Reg Flex to go about serving that need. And, actually, something that would be in the jurisdiction of this Committee—and that would serve not just small businesses but really all of us—might be to look at the petitions for rule-making under the APA.

Because it can take a really long time for either public interest groups who have identified a need for new protections or more increased protections, or for business groups that have identified a standard that is out of date and they have a new way, a better way, of going about it.

With the petition for rule-making process, what we can do is bring to the agencies a specific rule that needs to be improved and call for specific improvements. But the agencies can take a really long time to respond to the petitions or to do anything about it once they have recognized the need for improvement. I mean, it took over 10 years, and I don't know how many court battles, to get OSHA, after it recognized the need for improving the standard on hexavalent chromium, to actually get about the work of doing it, of protecting workers.

So I think that that would be a better approach, something that is evenhanded that applies to business groups and public interest groups as well, and anybody else out there who sees a need for improvement, and it is more targeted. It doesn't drain the agencies' resources into going back and reopening the case for rules that we already know need to stay on the books and for just really sort of this meat ax approach, a clumsy approach, as opposed to a focused, targeted approach, where small businesses can bring up the rules they think need to be fixed, other groups can pull up needs that need to be met.

I mean, there are other approaches as well, and there I think things outside of this Committee's jurisdiction that might also be very helpful for small businesses, that would help businesses comply without burdening agencies or without giving them a free pass from regulatory compliance. And one of them would be compliance assistance and making sure that there are compliance assistance offices in every congressional district, that can go about the work of helping small businesses understand what regulations they need to comply with and to help them figure out how to go about doing it.

Plain language in regulation—if it is easier for businesses or anybody else to read the regulations and understand them. There was a bipartisan bill that Mrs. Miller and Mr. Lynch over on the Government Reform Committee proposed that would not do a thing about weakening regulatory standards, but just change the language in which they are written so that they are easier to comply with.

I think that is another way for reducing cost without reducing the level of protection. And there are other ideas—for example, the small business gateway I have heard proposed—basically, informational resources, helping small businesses get the information they need in order to go about the work of being a good corporate citizen, which I think that we all agree they want to be.

Mr. CANNON. Thank you. Have you been involved at all with our APA review process?

Mr. SHULL. Actually, I haven't, but I have followed it from afar and I look forward to getting more involved.

Mr. CANNON. It has been a little bit arcane in the sense of hidden away, boxed up in an ark with some very, very smart people working on it. I am hoping that we can move that at some phase into a Wikipedia format so that it is online and people can contribute. I think that might be an easy way for you to get engaged and see what academics and others are looking at and bring it down to the real world of advocacy that you are thinking of.

And we would invite you and you may want to talk to staff about how you can be engaged prior to that if you are interested. We appreciate your ideas.

Mr. SHULL. I appreciate that.

Mr. CANNON. I don't know if you know, we have a hearing next week on the 60th anniversary of the APA.

Mr. SHULL. I will be here.

Mr. CANNON. An arcane area of the law, but really actually, in the end, the most important. Thank you. My time has expired.

Mr. Watt, you are recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman, and I thank the witnesses for being here, apologize for being a little late.

At the end of the day, I guess this is about a bill that is before us and whether it is supportable as written. I think I heard Mr. Shull's opinion on that. I am not sure I heard anybody else's.

Mr. Sullivan, do you support H.R. 682 as written, or, if not, is there another, better bill? I understand there is a bill pending on the Senate side, S. 1388. Which one of those is better?

Mr. SULLIVAN. Both bills improve the Regulatory Flexibility Act. A little bit of a dilemma in H.R. 682, if it were passed into law tomorrow or next week, my office does not have the resources to implement it effectively.

The Senate bill that you refer to is a more targeted approach and contains many of the needed reforms of 682.

Mr. WATT. Mr. Mihm, does the Administration support this 682? Can you speak for the Administration?

Mr. MIHM. GAO, the Government Accountability Office. I was actually hoping Mr. Sullivan would take the whole 5 minutes, but since he didn't, I will have to answer your question.

As a congressional support agency, we don't typically support legislation——

Mr. WATT. I am sorry, and I am not trying to put you on the spot.

Mr. MIHM. But I will say, sir, that many of the types of concerns that our work has identified in the past about the lack of standardization and clarity in the RFA are, is what the bill is designed to address. In that sense, those types of legislative actions would be a step forward.

Mr. WATT. Mr. Sullivan, you have mentioned secondary and tertiary indirect impacts on small business. I was kind of shuddering to think if the current law requires an assessment of direct impact, I can't even think of anything that wouldn't have some secondary, tertiary, indirect impact on small business and whether we are setting Government agencies up to spend all their time evaluating secondary, tertiary, indirect impacts. It seems to me burdensome enough to require them, expect them to do an assessment of what is foreseeable, not an academic exercise of what may be some possible impact.

Talk to me about the cost of secondary, tertiary, indirect impact analysis, if you would.

Mr. SULLIVAN. Thank you, Congressman Watt. H.R. 682 actually balances that very question that you asked, and it does so by, I believe, expecting or mandating agencies to do impact analysis on those impacts that are reasonably foreseeable.

Let me use an actual case example of how this works, because the words secondary and tertiary I think do——

Mr. WATT. And that compares with what is the current standard?

Mr. SULLIVAN. Currently, when an agency regulates, they look at who must comply directly with a regulation. After September 11th, when the then-referenced agency, INS, decided to limit visitor visas, they were limiting foreign visitors who come to the United States the time allowed to stay in the United States. Those were the direct impact of an INS-proposed rule.

Now, how it should work, and what H.R. 682 would require INS to do, is to say, all right, is border security important? Yes. Let us look at how long we know visitors in the United States, foreign visitors, are legally in the United States, do the analysis.

Now, who is impacted by limiting that length of stay? Tourism, high-end vacation homes, pouring millions of dollars into many destination spots, millions of dollars for Canadians crossing the border and going to destination spots in the United States. That type of analysis, the analysis of looking, well, if we limit their stay to 15 days, this is the economic impact, if we limit their stay to 30 days, here is the economic impact—that type of analysis, which actually is not very difficult, is all secondary impact analysis.

And my office——

Mr. WATT. So you are talking about foreseeable under this——

Mr. SULLIVAN. Reasonably.

Mr. WATT. Reasonably foreseeable under this bill. What is the language in the current——

Mr. SULLIVAN. The language is silent on that, and, in fact, the courts have interpreted it only to require direct impact. So INS did

not violate the letter of the law as it has been interpreted in courts, and David Frulla's testimony mentions those court decisions, as well as my testimony.

But, when you step back, you have got to think, shouldn't INS have informed the public through the notice and comment process that you are more familiar with your understanding of the Administrative Procedure Act to say, we are thinking of limiting visitor stay. And we are thinking of limiting those foreign visitors for about 15 days, as opposed to the current 30-day period. This is how we believe it will impact travel agencies, tourist destinations, white water rafting and outfitting companies, and we want you, the public, to comment on that type of analysis.

That does not happen now under the Reg Flex Act, but it should happen, because it informs the regulatory process, and it informs agencies like INS on how to have a better, more well-informed regulation that is finalized. That is the need for the secondary impact analysis.

Mr. WATT. There is nothing in the bill that really requires a tertiary impact? You are just talking about reasonably foreseeable?

Mr. SULLIVAN. Reasonably foreseeable. And, again, it gets at what should agencies be doing that is responsible to inform the rule-making process? All over the country, we have States who are left in the position through delegated laws, whether that be environmental laws, safety and health laws, that passed these enormous mandates by the Federal Government that says protect the environment and you figure it out. Comply with the Clean Air Act standards, but you figure out how you regulate your own State.

And these folks don't have chief counsels for advocacy. They don't have reams of chief economists. They need help in the Federal Government to actually lay out, here is how it may impact when you choose these different decisions. So there is a responsibility, I think, to help the State regulators figure out what should they be doing that is both cost effective and protective through the regulatory regimen that they are faced with.

Mr. WATT. I am way out of time, but if the Chairman will indulge me, and I would like to get——

Mr. CANNON. I can't see the red light.

Mr. WATT. Mr. Mihm said he doesn't want to comment on which one of these bills is better. I did want to get Mr. Frulla on the record about whether he prefers the Senate bill or this bill, and even in light of Mr. Shull's disposition not to be doing any of this, I guess, even in that context, whether just kind of a straightforward one or two sentences on which one of these bills you would prefer. Just for the record.

Mr. FRULLA. I will be intensely practical. I think that the Senate bill is a little more targeted. This is obviously a little more thoroughgoing a bill. The most important thing is for folks to start to get to the business of reconciling these bills so that we can get the law fixed in a constructive way that everybody can agree on and work together on.

I think the bills ought to come together, same place as Mr. Sullivan, essentially, and I think it is an important thing to do. And I don't want a little bit of disagreement on the margins to be some-

thing that holds this up because this is important to a lot of small businesses.

Mr. WATT. Mr. Shull?

Mr. SHULL. I think maybe the way I can say it is by saying that although we object to the core elements that are there in both bills, it is worth noting that the Senate version of this bill does not have the sections that would give new regulatory authorities to the SBA Office of Advocacy, which we find a particularly additional problematic element of the bill. Because the voice of small business, we think, shouldn't be in the business of telling agencies how to comply with the law.

Mr. WATT. Rather than telling them what is too burdensome.

Mr. SHULL. Right.

Mr. WATT. Okay, thank you, Mr. Chairman.

I thank the witnesses. That was very informative.

Mr. CANNON. The gentleman yields back.

Let me also thank the witnesses.

I ask unanimous consent that the record be left open for 10 days for follow-up questions by Members of the panel. Without objection, so ordered.

Thank you for coming. This has been actually quite insightful, very interesting.

And I know, Mr. Shull in particular, the idea of speedy decisions, we are plagued today with a number of cases where agencies are just not deciding, and that is in some cases bad for business. Often, it is bad for consumers, and so we look forward to your suggestions if we ever get to a public forum with our APA review, which I think would be helpful.

Because I that, I think, is really the key to business. Industry moves so quickly, things happen so quickly in America today, a danger that didn't exist yesterday is here today and devastating.

Perhaps tomorrow, the opportunity for business to significantly improve the quality of their products by having standards like the FDA's good manufacturing practices for nutritional supplements, we are just waiting for them. It doesn't really matter much what they are. They just need to be there and then consumers will have an idea of what they are getting, what the quality is of what they are getting.

So the opportunity to improve how we regulate ourselves I think is significant. So we thank you for being here today.

And, with that, we will adjourn.

[Whereupon, at 1:06 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

REVISED PREPARED STATEMENT OF J. ROBERT SHULL, DIRECTOR OF REGULATORY POLICY, OMB WATCH, WASHINGTON, DC

Testimony of
J. Robert Shull
Director of Regulatory Policy
OMB Watch

Before the
Subcommittee on Administrative Law
Committee on the Judiciary
U.S. House of Representatives

July 20, 2006

Thank you for the opportunity to testify before you today. I am Robert Shull, Director of Regulatory Policy for OMB Watch. OMB Watch is a nonprofit, nonpartisan research and advocacy center promoting an open, accountable government responsive to the public's needs. Founded in 1983 to remove the veil of secrecy from the White House Office of Management and Budget, OMB Watch has since then expanded its focus beyond monitoring OMB itself. We currently address four issue areas: right to know and access to government information; advocacy rights of nonprofits; effective budget and tax policies; and the use of regulatory policy to protect the public.

We are very concerned about the bill being discussed here today, H.R. 682, "The Regulatory Flexibility Improvements Act." While H.R. 682 purports to address the burdens faced by small businesses, the bill will only serve to further drown regulatory agencies in needless analysis, preventing them from promulgating and enforcing the regulations created to protect working families. More effective avenues exist to help alleviate the burden on small businesses while ensuring that workplace, environmental, and civil rights protections stay intact.

I. The Regulatory Flexibility Improvements Act is overly broad and will result in wasted public resources and reduced public protections.

The Regulatory Flexibility Improvements Act amends the Regulatory Flexibility Act by requiring federal agencies to conduct comprehensive analyses of the impacts of federal rules on small businesses. The bill would effect substantial changes from current law, by

1. Expanding the RFA's coverage to include all regulations on the books, even long-proven safeguards such as the ban on lead in gasoline;
2. Inviting paralysis by analysis, by requiring agencies to examine both direct *and indirect* effects of the regulations;
3. Expanding the scope of the RFA to include agency guidance documents, human services rules and land management plans; and
4. Dramatically expanding the scope of rules subject to SBREFA panels.

This far-reaching proposal could have devastating effects, calling into question longstanding health, safety and environmental protections while needlessly burdening agencies and squandering agency resources. Specifically, the bill will do the following:

A. Waste agency resources on highly speculative assessments.

The bill requires agencies to examine not only direct effects, which are currently assessed under the RFA, but also indirect effects. Agencies face substantial difficulties in attempting to calculate indirect effects. In fact, agency representatives at a recent Senate roundtable suggested this analysis would be so speculative as to be useless for policymakers. The courts have consistently held that RFA does not impose an obligation on agencies to analyze indirect economic effects on entities it does not regulate. Requiring consideration of indirect economic effects would drown agencies in burdensome and highly speculative analyses and paperwork that would impede their ability to promulgate needed protections, such as protections for workers against exposure to deadly chemicals, like crystalline silica.

B. **Burden agencies with redundant and unnecessary analysis.**

The bill also requires reviews of all existing 10-year old rules affecting small business. These look-back studies needlessly spend staff time and money to re-justify important and proven health and environmental safeguards, such as airbag safety standards in cars or food safety inspections that prevent against foodborne pathogens like e-coli or listeria. These look-back studies would add to the lengthy regimen of regulatory assessments already performed by agencies, including those required under Executive Order 12866, the Paperwork Reduction Act, the Unfunded Mandates Reform Act, and the National Environmental Policy Act, among others.

The bill also uses a more expansive definition of "rule" than used in the original Regulatory Flexibility Act. H.R. 682 amends the definition of rule to refer to 5 USC 551(4), which defines a rule as "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." This expanded definition means that regulatory flexibility analysis will also apply to guidance documents and policy statements as well as proposed and final rules. The bill also expands the scope of rules subject to the Regulatory Flexibility Act by including amendments to land management plans, rules affecting Indian tribes, IRS recordkeeping requirements, and regulations governing grants to state and local governments. These changes drastically expand the scope of the Regulatory Flexibility analysis requirements and will needlessly drown agencies in burdensome analysis every time the agency seeks to act in any way.

Moreover, the Regulatory Flexibility Improvements Act has made this analysis more onerous by requiring that the analysis to be more detailed and quantitative than it was previously. Not only will agencies have to perform Reg Flex analyses more often, they will have to spend more time doing each analysis. While the current law gives equal weight to narrative rather and quantitative explanations of the burden of regulations on small entities, H.R. 682 would compel agencies to

perform quantitative analysis of burden by requiring agencies seeking to do non-quantitative analysis to explain why a quantitative analysis was not possible.

C. Threaten valuable protections.

Expanding RFA analysis to include look-backs and indirect effects could put longstanding protections in jeopardy. Agencies would be forced to re-justify proven regulatory safeguards such as lead in gasoline or arsenic in the drinking water. Industry advocates have already singled out EPA's ambient air quality standards for life-threatening soot and smog as a primary reason for expanding regulatory flexibility analysis to include indirect effects. H.R. 682 also extends analytical burdens to a whole new universe of public protections — human services rules, such as those protecting abused and neglected children in federally-funded child welfare programs — by including nonprofits in the definition of small entities and expanding the scope of the RFA to regulations governing grants to state and local governments.

The bill also ties the hands of agencies by eliminating procedures for delaying analysis. Under current law, the agency can continue to promulgate a regulation before it has finished the regulatory flexibility analysis, if the agency head believes it is necessary to do so. H.R. 682 eliminates these commonsense procedures, instead forcing agencies to delay needed protections until the analysis is finished. Imagine if emergency regulations to protect miners after the Sago incident, for instance, had to be delayed until the agency could finish this onerous and highly speculative analysis. Even when the need for the regulation has been clearly proven, the agency would have to wait for the regulatory flexibility analysis before it could proceed.

D. Put corporate special interests ahead of the public interest.

H.R. 682 gives corporate interests an even greater advantage in the regulatory process by giving the head of the Small Business Administration's Office of Advocacy a preview of proposed rules before they are published in the *Federal Register* and increased opportunities to intervene in the process. Current law requires EPA and OSHA to submit draft rules to panels of business lobbyists, and a section of this bill would expand these preview opportunities to all agencies. The bill would also expand the regulations that would require SBREFA panels by including all rules that result in "an annual effect on the economy of $100,000,000 or more," "a major increase in costs or prices," "significant adverse effects" on a variety of economic factors, "a significant impact on a substantial number of small entities." An additional section would actually give SBA's Office of Advocacy the power to write regulations governing all agencies' compliance with the Regulatory Flexibility Act. Given that Advocacy is a taxpayer-funded voice for business interests, this provision is particularly troubling.

In another corporate giveaway, the bill would allow trade associations to be considered small businesses despite their net worth. This change to the current law would allow huge trade associations to masquerade as small businesses and seek the same protections and considerations as other small businesses.

II. Regulation does not always harm U.S. competitiveness and may actually improve it.

Burdensome anti-regulatory measures like H.R. 682 are born out of the idea that regulation will drive small American companies out of business. The real scholarly evidence, however, refutes this claim. While the business community may be hampered in competing in global trade, regulation is not at fault. The business community, however, has nothing to gain by publicizing the real reasons for its difficulties, such as lower wages paid in other countries with which we now have self-destructive free trade agreements. The idea that regulation causes competitive decline is the product not of careful scholarship but, rather, of a multi-million dollar public relations campaign.

These criticisms of regulation are insufficient for four reasons:

(A) *Regulatory safeguards produce significant benefits for the public.* Citations of the high cost of regulation do not establish that regulation is unwarranted because they completely ignore what we gain from these expenditures. Protecting people and the environment may cost a lot of money, but it also produces far larger benefits. In fact, even the Office of Management and Budget, which is a main proponent of the idea that regulations are too costly, nonetheless reports every year that regulation in the United States generates aggregate benefits that greatly exceed the cost of the federal regulations.[1]

(B) *Not all costs have the same moral or ethical value.* Some regulatory costs represent the cost to industry of doing what it should have done as a good corporate citizen in the absence of regulation. For example, stunning new evidence reveals that U.S. automakers misled the government and the public for years by claiming that the strength of vehicle roofs is unrelated to the serious injuries sustained when vehicles crash and roll over. According to industry documents, Ford denied this link even though its Volvo subsidiary had conducted research demonstrating that strengthening car roofs and other improvements are the key to preventing injuries and saving lives in rollover crashes.[2] If and when the National Highway Traffic Safety Administration issues a rule to safeguard against vehicle roofs caving in during rollover crashes, the cost to the automakers of complying will mean little if it is not offset by the profits earned during the period that the automakers knew of the need for stronger roofs but failed to do anything about it.

(C) *Cost estimates are overblown.* Moreover, many claims about regulatory costs are

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1. *See* 2006 Draft Report on the Costs and Benefits of Federal Regulation, (available on-line at <http://www.whitehouse.gov/OMB/inforeg/reports/2006_draft_cost_benefit_report.pdf> Previous reports on the costs and benefits of regulation available at <http://www.whitehouse.gov/OMB/inforeg/regpol-reports_congress.html>).

2. *See* Press Release, Public Citizen, "New Report on Auto Industry Data Shows Automakers Misled NHTSA and Public When Denying Link Between Roof Strength and Injuries" (Mar. 30, 2005) (available on-line at <http://www.citizen.org/pressroom/release.cfm?ID=1909>).

suspicious because they rely on cost estimates that come from industry sources that have an incentive to overstate the costs for regulatory and public relation purposes. According to a recent influential study,

> *ex ante* cost estimates have usually been high, sometimes by orders of magnitude, when compared to actual costs incurred. This conclusion is not at all surprising in light of the strategic environment in which the predictions are generated. In preparing regulatory impact assessments for proposed rules, agencies are heavily dependent upon the regulated entities for information about compliance costs. Knowing that the agencies are less likely to impose regulatory options with high price tags (or to support them during the review process), the regulatees have every incentive to err on the high side.[3]

One particular estimate of costs, the discredited Crain and Hopkins study commissioned by the Small Business Administration, is significantly overblown.[4] For example, the familiar estimates that the manufacturing sector in 2000 "shouldered $147 billion of the $497 billion onus of environmental, economic, workplace, and tax-compliance regulation"[5] suffer the same problems just discussed and actually magnify those errors significantly, based on the assumption that regulatory compliance costs should be doubled to account for industry's public relations campaign against regulatory protections and the expenses of lobbying this very Congress.[6]

(D) <u>*Compliance costs are so minuscule that they have minor competitive consequences.*</u> Finally, and most importantly for these purposes, regulation cannot be blamed for a decline in competitiveness or other economic ills because compliance costs are only a very small percentage of total value of the shipments made by manufacturers. On the basis of data from the World Bank, Professor Kevin Gallagher of Boston University finds the "sum of all marginal pollution abatement costs in the United States is less than one percent of value added production."[7] Department of Commerce data confirm this estimate. This information indicates abatement expenditures are an

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3. Thomas O. McGarity & Ruth Ruttenberg, *Counting the Cost of Health, Safety & Environmental Regulation*, 80 TEX. L. REV. 1997, 1998 (2002).

4. *See* W. MARK CRAIN & THOMAS D. HOPKINS, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS (Office of Advocacy, Small Business Admin. RFP No. SBAHQ-00-R-0027) (2001).

5. Testimony of National Assoc'n of Manufs.*Hearing on Impact of Regulations on U.S. Manufacturing Before the House Subcomm. on Reg. Affairs, House Comm. on Gov't Reform* , 109th Cong. (April 12, 2005), at 5 (citing CRAIN & HOPKINS, *supra* note 11, at 27 Tbl.9A).

6. *See* CRAIN & HOPKINS, *supra* note 11, at 10.

7. Testimony of Prof. Sidney A. Shapiro, *Hearing on Impact of Regulations on U.S. Manufacturing*, 109th Cong. (April 12, 2005), at 5 text accompanying note 5.

average of 0.62 percent of the value of shipments of all industries. Industry sectors with high abatement costs only pay between 1.27 and 1.51 percent of the value of shipments.[8] Indirect costs are derivative of direct compliance costs; since low direct costs generally will produce low indirect costs, regulation overall should have a minor competitive and labor impacts.

The scholarly evidence backs up this claim. Economists have considered the impact of environmental regulations on plant location decisions (do pollution-intensive industries build disproportionate number of new factories in countries or areas of the United States where there is weak environmental regulation?) and on trade flows (do exports from developing to developed countries show an increasing percentage of pollution-intensive goods?). Neither type of study supports a regulation-competitiveness link. I recommend a recent literature review by Professor Sidney Shapiro, which synthesizes the major research on the questions and comes to the following conclusions:

- The leading meta-study of plant location and trade flow studies found that "studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location-decisions have produced estimates that are either small, statistically insignificant, or not a robust to test of model specification." These authors concluded that there is "[o]verall … relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness, however that elusive term is defined."[9]

- According to another survey of the literature, "The vast majority of studies have found no systematic evidence that the share of developing country exports and production is becoming more pollution-intensive. In addition, no studies have indicated that there is substantial evidence that pollution-intensive industries flee developed countries with relatively high (and costly) environmental standards)."[10]

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8. *Id.* at 5 (citing Adam B. Jaffe, Steven R. Peterson, Paul R. Portney, & Robert N. Stavins, *Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?*, 33 J. ECON. LIT. 132, 141 Tbl.5 (1995)).

9. *Id.* at 5-6 (citing Jaffe et al., *supra* note 15, at 141).

10. *Id.* at 6 (citing KEVIN O. GALLAGHER, FREE TRADE AND THE ENVIRONMENT: MEXICO, NAFTA, AND BEYOND 26 (2004)).

III. The Regulatory Flexibility Improvements Act will not meet the needs of small businesses.

H.R. 682 was put forward under the banner of relieving regulatory burden to small business, but this legislation puts public protections at stake while failing to get at the heart of what ails small business. The small business community is a major source of innovation and employment in this country. Like their larger counterparts, however, small businesses are also responsible for social ills addressed by regulations, ranging from workplace health and safety problems to environmental pollution.[11] Thus, we cannot simply give small businesses a free pass from regulation. At the same time, it can be relatively more expensive for small business to comply with regulations than large companies. Small businesses want to do their part and be responsible; real reforms, then, must help small businesses comply with regulations in order to level the playing field with large businesses while giving the public the protection it needs and deserves.

We already have these reforms. Small firms receive direct government subsidies such as outright and government-guaranteed loans from the Small Business Administration (SBA) as well as indirect preferential treatment through federal procurement requirements and tax provisions. Additionally, small business is treated to many exemptions or special treatment in the area of regulation. For example, employers with fewer than 15 employees are exempt from the Equal Employment Opportunity Act,[12] and OSHA levies lighter penalties for smaller firms, exempts businesses with fewer than 10 workers from recordkeeping requirements, and provides free on-site compliance consultations.[13]

Small business concerns are inscribed in law. The Small Business Regulatory Enforcement Fairness Act (SBREFA) requires agencies to give special consideration and voice to small business as part of the rulemaking process as well as expanded judicial review for small businesses wishing to challenge agency decisions.[14] Likewise, the Equal Access to Justice Act gives small businesses special privileges when litigating against agencies: small businesses can recover attorney's fees if they prevail in court against a federal agency.[15]

Real reforms for small businesses would make these benefits meaningful by clamping down on the ways that large businesses game the rules and claim the status of "small business." Real reform would consider the role of small business in contributing to pollution and other harms to the public and would respond by adequately funding compliance assistance offices in every congressional district,

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11. *See* Richard J. Pierce, Jr., *Small is Not Beautiful: The Case Against Special Regulatory Treatment of Small Firms*, 50 ADMIN. L. REV. 537 (1998).

12. *See* 42 U.S.C. § 2000e(b).

13. *See* OSHA, *OSHA Small Business Assistance: OSHA Benefits for Small Business* (available on-line at <http://www.osha.gov/dcsp/smallbusiness/benefits.html>).

14. *See* 5 U.S.C. §§ 601 *et seq.*

15. *See id.* § 504.

which would be given the resources they need to give small businesses the help that they, in turn, need to be good corporate citizens and comply with the law. This bill does not come close to being real reform; it is a shameful giveaway of the protections we need, and it shamelessly exploits the real needs of small businesses in order to justify this dangerous exercise.

IV. There is a better way.

A. National Business Regulatory Assistance Act

There are better ways to help small business without sacrificing longstanding public protections. The National Small Business Regulatory Assistance Act (S. 1411) would be the first step to strengthening Small Business Development Centers (SBDCs) around the country by launching a pilot in which SBDCs would provide compliance assistance to small businesses. This bill would help level the playing field for small businesses by giving them specialized assistance with understanding and complying with federal regulations, without compromising the public's protections, directly or indirectly; instead, it would actually help some businesses to comply with the regulations that are in place to protect the public.

B. Strengthening Petitions for Rulemaking

Processes already exist that allow both businesses and the public interest to ask federal agencies to address particular regulatory problems. Small businesses are already well aware of the regulations that are particularly burdensome or obsolete. Rather than expanding the Regulatory Flexibility Act to review all federal regulations on the books, small businesses already have the power to petition agencies to revisit specific regulations. Strengthening the petition process by making agencies more responsive to requests from the public would use existing mechanisms to open the door to reforms without drowning agencies in reviews of existing regulations. Moreover, rather than serving a particular constituency, strengthening petitions for rulemaking would benefit all members of the public. It can be used to identify both gaps in public protections as well as areas where reform may be needed.

Problems of H.R. 682

Regulatory Flexibility Act	Regulatory Flexibility Improvements Act (H.R. 682)
• Applies only to rules with direct effects on small businesses	• Applies to rules, policy statements and guidance documents, land management plans, revisions or amendments to land management plans, recordkeeping requirements and formal rulemakings with direct and indirect effects to small businesses.
• Includes regulations impacting small businesses and local governments	• Includes regulations impacting small businesses, local governments, Tribal organizations, local labor organizations and professional and trade associations
• Requires agencies to prepare a regulatory flexibility analysis for all proposed rules and for all final rules, summarizing why the action is being taken and description of how small entities will be impacted.	• Regulatory flexibility analysis must contain all provisions of original regulatory flexibility analysis, but must also include a description of alternatives that might maximize benefits and an estimate of "the additional cumulative economic impact of the proposed rule on small entities beyond that already imposed on the class of small entities." Final analysis is no longer required to be "succinct," and explanations are amended to be "detailed explanations."
• The agency is required to respond to public comments.	• The agency is required to specifically respond to comments filed by the Chief Counsel of Advocacy, including details of any changes made as a result of the comments.
• Allows analysis to be either quantified or general.	• If agency gives a general description instead of a quantified analysis, it must include detailed explanation of why quantification is not "practicable or reliable."
	• Eliminates procedures for agency heads to delay the analysis before promulgating proposed or final rule.
• Requires small business panel to review all rules by EPA and OSHA with a significant impact on small entities.	• Requires small business panel to review all rules that result in "an annual effect on the economy of $100,000,000 or more," "a major increase in costs or prices," "significant adverse effects" on a variety of economic factors, "a significant impact on a substantial number of small entities."
• Periodic review of all rules, "which have or will have a significant adverse impact on a substantial number of small entities," going back to ten years before the enactment of the RFA.	• Periodic review of all rules, regardless of whether they have had or will have a significant impact on a substantial number of small entities. Agencies will submit a report to Congress regarding their findings. The review must include comments by the Regulatory Enforcement Ombudsman and the Chief Counsel of the Office of Advocacy and "the contribution of the rule to the cumulative economic impact of all Federal rules on the class of small entities affected by the rule."

PREPARED STATEMENT OF THE HONORABLE DONALD A. MANZULLO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
109th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Statement for the Record of the Hon. Donald A. Manzullo
Chairman, Committee on Small Business
Before the Subcommittee on Commercial and Administrative Law
of the Committee on the Judiciary
United States House of Representatives
Washington, DC
July 20, 2005

New small businesses open every year. Buffeted by a variety of economic and financial gusts, these businesses struggle mightily against the prevailing winds in an effort to reach their destination of profitability. One very strong gale through which small businesses must navigate is unnecessary and overly burdensome federal regulation. Small businesses, according to a study by the Office of Advocacy of the United States Small Business Administration, pay $2,000 per employee per year more than large businesses to comply with the tornado of federal regulation. In some sectors, such as manufacturing, the per-employee cost is even higher than that average. Thus, it is not surprising to learn that nearly 500,000 businesses fall to the regulatory winds buffeting them.

More than 25 years ago, Congress recognized that the gusts of regulation were transforming into a hurricane. Congress reacted with a brilliant idea; force federal regulators to examine the impact that their rules will have on small business before the winds of regulation destroy the small business. That brilliant idea was the Regulatory Flexibility Act. Passed in 1980, it not only was supposed to force federal agencies to think before they regulated but it was to direct their thinking to consider specifically the effect that the regulatory storms have on small business.

Enactment of the RFA forced a small but perceptible shift in the tack of federal regulation. Some agencies used enactment to focus their thinking and develop less burdensome regulation. To many other agencies, though, the RFA was a gentle breeze wafting by, barely ruffling them on their course for more and more burdensome, overlapping, and unnecessary regulation.

Congress tried to strengthen the winds of change in 1996 with the enactment of the Small Business Regulatory Enforcement Fairness Act or SBREFA. That act made agency compliance with the procedural requirements of the RFA judicially reviewable independent of any challenge to the underlying agency rule. With the threat of litigation hanging over them, federal agencies began paying more attention to the RFA.

The added attention did not result in a significant change in wind direction for many agencies. President Bush noted the importance of the RFA as a means to reduce the regulatory storms lashing small business in a March 19, 2002. He also said that federal agencies were ignoring the law. The President went on to state that federal regulators "will care that the law is on the books." The small business owners in attendance at that speech wildly applauded. The President ultimately assigned the task to Dr. John Graham, the former head of the Office of Information and Regulatory Affairs at the Office of Management and Budget and Thomas Sullivan, the Chief Counsel for Advocacy at the United States Small Business Administration. Fearlessly flying into the eye of the regulatory storm, they tried to tame the winds of the federal bureaucracy. While they eliminated many of the gusts, the prevailing winds have not dramatically changed. Small businesses remain buffeted by regulation.

The efforts of Dr. Graham and Chief Counsel Sullivan have been hampered by the inadequacy of the RFA. Plagued by undefined terms and vague parameters, the RFA is far from an ideal statute. Loopholes exist that permit agencies to fly their regulatory proposals to fruition without much more than an occasional bout of turbulence. Some agencies go so far as to interpret their statutory mandate and the RFA in a way as to avoid any semblance of compliance.

The absence of uniform interpretation of the RFA among federal agencies is best demonstrated by a proposed rule published in the Federal Register on July 18, 2006. Six federal agencies that regulate financial institutions and debt collection proposed a joint rule to implement certain sections of the Fair and Accurate Credit Transaction Act (FACT). Each agency's implementation of the RFA was dramatically different. For example, the Federal Reserve and the Federal Trade Commission provided detailed analyses and requested comments on significant alternatives. 71 Fed. Reg. at 40,803, 40,805. In contrast, the National Credit Union Administration had one paragraph that simply stated the proposal would not have a significant economic impact on a substantial number of small entities – a statement that does not even comply with existing requirements to provide a factual basis for the certification.

H.R. 682 significantly strengthens the RFA so that agencies, as President Bush stated, "will care that the law is on the books." The bill makes numerous technical improvements to the RFA, eliminates loopholes, and significantly empowers the Chief Counsel to do more than simply cajole and report on agency compliance with the RFA. The primary objective of H.R. 682 is to avoid the type of ad hoc implementation of the RFA evidenced by the joint proposed rule implementing FACT.

One of the original purposes of the RFA was to create an economic impact statement that was akin to an environmental impact statement that agencies must prepare pursuant to the National Environmental Policy Act (NEPA). Court decisions, however, determined that while parallels exist between the RFA and NEPA, those parallels could only go so far since the level of detail required by NEPA exceeds that required by the RFA. The Small Business Committee regularly sees the impact that regulations have on small businesses struggling to survive and grow. Detailed analysis of the impact of regulations on small businesses is necessary to ensure that regulators are not making irreversible decisions that will reduce the competitive ability of small businesses, prevent them from expanding, and harm the growth of the American economy. After all, even

NEPA recognizes that a major federal action affecting the environment also will have socio-economic consequences that must be measured and assessed before going forward with a major federal action. Yet, the most pervasive and far-reaching federal action – the issuance of a legislative regulation – only need have a modicum of explanation and analysis. That makes no sense, undermines the concept of rational decisionmaking, and leaves small businesses exposed to significant costs and burdens that might otherwise be alleviated without any diminution in the ability of federal agencies to meet their statutory and regulatory mandates.

The other major change relates to the Office of Advocacy and its role under the RFA. Currently, the Chief Counsel's power is quite limited. He can use the power of persuasion, enlist the assistance of Dr. Graham at OIRA, embarrass agency officials in his annual report to Congress, and threaten agencies with the prospect of filing an amicus brief in federal court. But that is all of the Chief Counsel's power. Even though the Chief Counsel is required to instruct agencies in RFA compliance and monitor such compliance, the United States Court of Appeals for the District of Columbia Circuit determined that the interpretations of the RFA by the Chief Counsel do not deserve any deference except to the extent that the comments are like any other comments – persuasive to the agency. This stands in stark contrast to the interpretations of NEPA offered by the Council on Environmental Quality (CEQ). The Supreme Court, on more than one occasion, held that CEQ's regulations implementing NEPA should be given substantial deference.

The significance of the deference paid federal agency interpretation of statutes may be an esoteric point, but it is important nonetheless. The Supreme Court grants substantial deference to federal agency interpretations of ambiguous statutes. The Chief Counsel does not get that deference because he is not considered to be implementing the RFA. By granting the Chief Counsel the authority to write regulations for implementing the RFA, the Chief Counsel's interpretations will be accorded the same deference that courts grant to CEQ's interpretation of NEPA. This will force agencies to work even more closely with the Chief Counsel to ensure that the agency's interpretation of the RFA comports with that of the Chief Counsel.

The bill does not provide bright-line definitions for the two primary parameters in the RFA – "significant economic impact" and "substantial number of small entities." That oversight was purposeful. Given the stunning breadth of the federal bureaucracy, it is not possible to define these terms by either percentages or number of businesses. For example, a statutory definition of significant economic impact that sets an impact as significant if it reduces net profits by five percent seems reasonable. Yet, for the retail food industry, whose gross margins average from 2 to 4 cents on the dollar, a bright-line statutory change amounts to an exemption from compliance with respect to food retailing. Regulations, such as country-of-origin labeling, would never meet that statutory threshold. If the primary purpose of H.R. 682 is to close the loopholes in the RFA, no rational purpose exists by creating new ones. As primary author of this legislation, I would expect the Office of Advocacy, when it drafts implementing regulations, to adopt the tactic used by CEQ when it was faced with defining the parallel amorphous terms of "major federal action" and "significantly affecting the environment."

H.R. 682 also will hold agencies accountable for analyzing both the direct and indirect impacts of their rulemaking decisions on small businesses. Current court decisions are most emphatic in stating that an agency need only analyze the impact of their rules on those entities directly regulated by their actions. An agency may certify that a rule does not substantially impact a significant number of entities by creating rules that state and local governments must implement. Although businesses may suffer harsh and burdensome effects (effects that might well be analyzed in an agency's environmental impact statement and regulatory impact analysis), the obvious impacts on small businesses in such circumstances are ignored by the agency. This practice ignores how Congress delegates responsibility to federal agencies, the real world effect of regulations, and runs contrary to the purpose of the RFA.

H.R. 682 represents a comprehensive fix to current weaknesses in the RFA. When the RFA was enacted, opponents said it would slow the promulgation of rules. A comparison of the size of the Federal Register in 1980 with that today will show that the RFA has done no such thing. During the debate over the amendments to the RFA made by SBREFA, opponents argued that judicial review would create a gust of wind that would blow down the courthouse door. Shockingly, the federal courthouse doors remain standing. Any arguments about the horrors of H.R. 682 that will be raised by opponents of the bill that the regulatory process will come to a grinding halt also have no basis in fact. Nothing in H.R. 682 changes the underlying statutory mandates of federal agencies and their responsibilities. H.R. 682 simply forces agencies to take procedural steps to understand what they are doing when they regulate and those steps will make them regulate more sensibly.

Ultimately, what is at stake is the ability of small businesses to stay in business -- based not on the whims and dictates of federal bureaucrats but on their capacities in the marketplace. Better, sounder rules will be beneficial to the regulatory objectives of the agencies through increased compliance and lower costs to small businesses. For example, if the Department of Justice completes its current rulemaking process for implementing the Americans with Disabilities Act in a manner that will force the closure of small businesses, those businesses will be unable to offer services to the disabled undermining the intent of Congress.

No good reason exists to oppose those goals and objectives that the sponsors of H.R. 682 have other than the fear of the unknown. But as President Roosevelt, paraphrasing Michel de Montaigne said: "The only thing we have to fear is fear itself." I stand ready to work with Subcommittee Chairman Cannon and others to ensure that H.R. 682 becomes law. Then the RFA really will be on the books and federal agencies will care that the law is on the books.

LETTER FROM ROBERT D. EVANS, DIRECTOR, GOVERNMENTAL AFFAIRS OFFICE, AMERICAN BAR ASSOCIATION (ABA)

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July 18, 2006

The Honorable Thad Cochran
Chairman
Committee on Appropriations
United States Senate
Washington, D.C. 20510

The Honorable Robert C. Byrd
Ranking Member
Committee on Appropriations
United States Senate
Washington, D.C. 20510

Re: Funding the Newly Reauthorized Administrative Conference of the United States for Fiscal Year 2007

Dear Chairman Cochran and Ranking Member Byrd:

On behalf of the American Bar Association ("ABA") and its more than 400,000 members nationwide, I write to express our strong support for funding the Administrative Conference of the United States ("ACUS") for fiscal year 2007 at the fully authorized level of $3.2 million. As your Committee prepares to mark up the Transportation, Treasury Appropriations Bill later this week, we urge you to provide full funding for ACUS, which was just reconstituted in the last Congress by the enactment of the "Federal Regulatory Improvement Act of 2004" (P.L. 108-401, formerly, H.R. 4917). Once it is provided with this modest funding, the agency will be able to restart its operations and then begin addressing the many important tasks that may be assigned to it by Congress, including, for example, assisting the Department of Homeland Security to consolidate the administrative processes from the more than 20 federal agencies that were included in the new Department.

ACUS was originally established in 1964 as a permanent body to serve as the federal government's in-house advisor on, and coordinator of, administrative procedural reform. It enjoyed bipartisan support for over 25 years and advised all three branches of government before being terminated in 1995. In 2004, Congress held several hearings on ACUS reauthorization, and during those hearings, all six witnesses, including Supreme Court Justices Antonin Scalia and Stephen Breyer, praised the work of the agency. The written testimony of Justices Scalia and Breyer is available on the ABA's website at http://www.abanet.org/poladv/ACUSreauthorization.html.

Following these hearings, H.R. 4917 was introduced by Rep. Chris Cannon (R-UT), Chairman of the House Judiciary Subcommittee on Commercial and Administrative Law, for the purpose of reauthorizing and resurrecting the agency. That bipartisan legislation ultimately garnered 34 cosponsors—including 18 Republicans and 16 Democrats—before being approved unanimously by the House and Senate at the end of the 108th Congress. President Bush then signed the measure into law on October 30, 2004.

At the request of Chairman Cannon, the Congressional Research Service ("CRS") prepared a short study describing the many benefits of ACUS, and a copy of the CRS Memorandum of October 7, 2004 is also available at http://www.abanet.org/poladv/ACUSreauthorization.html. As outlined by CRS, ACUS has many virtues, including the following:

•A newly-reconstituted ACUS would provide urgently needed resources and expertise to assist with difficult administrative process issues arising from the 9/11 terrorist attacks against the United States as well as other new administrative issues. The CRS Memorandum concludes that "[ACUS's] reactivation would fill the current urgent need for an expert independent entity to render relevant, cost-beneficial assistance with respect to complex and sensitive administrative process issues raised by 9/11 restructuring and reorganization efforts," including the creation of the Department of Homeland Security by consolidating parts of 22 existing agencies and the 9/11 Commission's recommendations to establish a new intelligence structure. In addition, CRS noted that ACUS could provide valuable analysis and guidance on a host of other administrative issues, including public participation in electronic rulemaking, early challenges to the quality of scientific data used by agencies in the rulemaking process, and possible refinements to the Congressional Review Act. A fully-funded ACUS could effectively address these and myriad other issues involving administrative process, procedure, and practice at a cost that is minimal when compared to the benefits that are likely to result.

•ACUS enjoys strong bipartisan support and all observers agree that it has been extremely cost-effective. As CRS also noted in its Memorandum, all six of the witnesses who testified before the House Judiciary Subcommittee on Commercial and Administrative Law agreed that during the more than 25 years of its existence, "...the Conference was a valuable resource providing information and guidance on the efficiency, adequacy and fairness of the administrative procedures used by agencies in carrying out their missions." ACUS was unique in that it brought together senior representatives of the federal government with leading practitioners and scholars of the private sector to work together to improve how our government functions. That collaboration has been sorely missed in many ways, as was so clearly brought out in the hearings. As CRS explained, ACUS produced over 180 recommendations for agency, judicial, and congressional actions over the years, and approximately three-quarters of these reforms were adopted in whole or in part. Because ACUS achieved these impressive reforms with a budget of just a few million dollars per year, CRS noted that "all observers, both before and after the demise of ACUS in 1995, have acknowledged that the Conference was a cost-effective operation."

•Before it was terminated in 1995, ACUS brought about many significant achievements. In addition to providing a valuable source of expert and nonpartisan advice to the federal government, ACUS also played an important facilitative role for agencies in implementing changes or carrying out recommendations. In particular, Congress gave ACUS facilitative statutory responsibilities for implementing a number of statutes, including, for example, the Equal Access to Justice Act, the

Congressional Accountability Act, the Government in the Sunshine Act, the Administrative Dispute Resolution Act, and the Negotiated Rulemaking Act. In addition, ACUS' recommendations often resulted in huge monetary savings for agencies, private parties, and practitioners. For example, CRS cited testimony from the President of the American Arbitration Association which stated that "ACUS's encouragement of administrative dispute resolution had saved 'millions of dollars' that would otherwise have been spent for litigation costs." CRS also noted that in 1994, the FDIC estimated that "its pilot mediation program, modeled after an ACUS recommendation, had already saved it $9 million." The CRS Memorandum provides numerous additional examples of ACUS' prior successes as well.

• ACUS' role in the regulatory process is totally separate and distinct from that of OIRA. In the past, some have suggested that ACUS' activities perhaps may duplicate some of the activities of OMB's Office of Information and Regulatory Affairs ("OIRA"). This reflects a misunderstanding of ACUS' fundamental role in the regulatory process. By virtue of its history and institutional design, ACUS is uniquely in a position to achieve bi-partisan consensus on administrative and regulatory improvements; to provide a forum for executive and independent agencies to exchange "best practices" ideas; and to bring private sector lawyers and academics together with political and career government officials to address ways to improve government operations.

OIRA is a very different type of entity that is neither inclined nor equipped to address many of the issues that ACUS has focused on. For example, there is no way that OIRA could have devoted so much time and attention to developing the ADR techniques that so many government agencies adopted. Nor does OIRA play any role in agency adjudication or judicial review issues. OIRA's principal role is to represent the President in making sure that the Administration's regulatory policy is followed. ACUS's role, on the other hand, is to be an independent catalyst for seeking to reform and improve administrative and procedural issues that necessarily tend to receive less attention in Congress or the White House in the face of what are deemed more pressing day-to-day matters.

In sum, now that Congress has enacted bipartisan legislation reauthorizing ACUS, the agency should be provided with the very modest resources that it needs to restart its operations without unnecessary delay. To accomplish this goal, we urge you to provide $3.2 million in funding for ACUS for fiscal year 2007 during your Committee's mark up of the Transportation Treasury Appropriations Bill later this week.

Thank you for considering the views of the ABA on this important issue. If you would like to discuss the ABA's views in greater detail, please feel free to contact the ABA's senior legislative counsel for administrative law issues, Larson Frisby, at 202/662-1098, or the Chair of the ACUS Task Force of the ABA Administrative Law Section, Warren Belmar, at 202/586-6758.

Sincerely,

Robert D. Evans

Robert D. Evans

cc: The Honorable Christopher S. Bond
The Honorable Patty Murray
All other members of the Senate Committee on Appropriations
The Honorable Arlen Specter
The Honorable Orrin G. Hatch
The Honorable Patrick J. Leahy
The Honorable Jeff Sessions
The Honorable Charles E. Schumer
The Honorable Jerry Lewis
The Honorable David R. Obey
The Honorable Joseph Knollenberg
The Honorable John W. Olver
The Honorable Chris Cannon

RESPONSE TO POST-HEARING QUESTIONS FROM THE HONORABLE THOMAS M. SULLIVAN, CHIEF COUNSEL FOR ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Advocacy: the voice of small business in government

August 11, 2006

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Cannon:

Thank you for the opportunity to provide you with additional information related to my testimony on HR 682, the Regulatory Flexibility Improvements Act. This letter addresses the questions that you posed in your letter dated July 25, 2006.

Congress established the Office Advocacy pursuant to Public Law 94-305 to advocate the views of small business before Federal agencies and Congress. Because Advocacy is an independent office within the U.S. Small Business Administration (SBA), these views do not necessarily reflect the position of the Administration or the SBA. For the sake of clarity, I will repeat each of your questions, followed by our responses.

Q: ***What provisions of H.R. 682 stand out as the most constructive reforms?***

A: H.R. 682 is a comprehensive bill that is meant to close the loopholes in the RFA. While many of the reforms are important, the most important reforms for small entities are:

1) Consideration of foreseeable indirect impacts
2) Expansion of the requirements for Section 610 review
3) Consideration of cumulative impacts of regulations

4) Codification of Executive Order 13272 (i.e., a permanent mechanism to ensure that agencies respond to Advocacy's comments and provide early access to draft regulations when possible)

Q: ***Some critics of the Regulatory Flexibility Act have suggested that its implementation could be improved if certain terms were better defined. For example, they note that "significant economic impact on a substantial number of small entities" should be defined with some specificity. What is your reaction to this suggestion?***

A: When the RFA was initially drafted, the lawmakers intentionally left the term "significant economic impact on a substantial number of small entities" vague to allow the agencies some flexibility to define the terms in the manner that best suit the problem that needs to be addressed, the rule's requirements, and the preliminary assessment of the rule's impact. Some latitude is necessary to assure that agencies are able to perform the best analysis for the particular situation.

Q: ***In 2002, President Bush signed Executive Order 13272, which requires federal agencies to establish written procedures and policies on how they measure the impact of their regulatory proposals on small entities.***

What has been your Office's experience with Executive Order 13272?

A: Overall, Executive Order (E.O.) 13272 has been successful. With the exception of the Department of State, all Cabinet-level departments have developed written plans in compliance with E.O. 13272. The performance of the independent agencies, however, has not been as successful. Of the 75 independent regulatory agencies, only 16 responded to the requirements of the E.O. Of those 16, only eight have provided written procedures, while six claimed that they do not regulate small entities, and two claimed to be exempt from the E.O.

E.O. 13272 also requires that Advocacy provide training to the agencies on compliance with the RFA. Since the E.O. was signed, Advocacy has held 55 training sessions at 45 different agencies. Agency attorneys, economists, policymakers, and other employees involved in the regulatory writing process have attended the hands-on sessions to learn how to comply with the RFA in a regulatory setting. Advocacy's current efforts are focused on rolling out an interactive electronic training module so that agencies can engage in periodic training and train new

employees. Like the classroom setting, the online training program explains the steps rule writers should follow to make RFA decisions accurately. As a result of Advocacy's training and the implementation of agency rulemaking, agency compliance with the RFA has improved.

Moreover, E.O. 13272 requires agencies to provide Advocacy with a draft copy of rules that will have a significant economic impact on a substantial number of small entities when the rules are forwarded to Office of Information and Regulatory Affairs (OIRA) and to give appropriate consideration to Advocacy's comments and address the comments in final rules. As such, Advocacy is getting involved earlier in the rulemaking process. This allows Advocacy to achieve improved agency compliance and cost savings for small entities.

Q: ***Some have suggested that it should be codified. What is your reaction to that?***

A: E.O. 13272 has increased agency knowledge of and compliance with the RFA. Small entities would benefit by amending the RFA to codify the requirements of E.O. 13272, ensuring that independent agencies are covered and creating long-term certainty for small entities.

If it is codified, Advocacy would suggest that the requirements be expanded to require agencies to address Advocacy's comments if the agency certifies the rule at the final stage of the rulemaking. Currently, agencies must only address Advocacy's comments if a final regulatory flexibility analysis (FRFA) is prepared. In FY 2005, 12 percent of Advocacy comments addressed improper certifications and 17 percent of Advocacy comments addressed inadequate or missing initial regulatory flexibility analyses (IRFAs).

Q: ***Please explain whether current section 610-dealing with periodic review-is or is not working?***

A: Unfortunately, agency compliance with section 610 has historically been minimal. Agencies ignore the requirement altogether or simply issue boilerplate language to the effect that an existing rule has been reviewed, and that the rule remains useful. Small entities are limited in what they can do with burdensome regulations on the books. As noted in my testimony, the

Crain study, *The Impact of Regulatory Costs on Small Firms*, indicates that the overall cost of federal regulation totals $1.1 trillion; the cost per employee for firms with fewer than 20 employees is $7,647. This is 45 percent higher than their larger counterparts with 500 or more employees.[1] Since new regulations are promulgated each year, the cumulative impact of regulations on small entities can be staggering.

In addition, a number of agencies interpret section 610 as only requiring review for rules that the agency determined to have a significant economic impact on a substantial number of small entities at the time that the rule was promulgated. As such, many rules that may become costly to small business due to changes in circumstances or additional cumulative rules are not reviewed. Advocacy recommends that the RFA be amended to review all rules periodically. This change would encourage agencies to revise their rules to ensure that regulations reflect current conditions and needs.

Q: ***Some have suggested that a "plain English" summary of a final rule is beneficial. Please explain.***

A: Although SBREFA required compliance guides to explain small business regulatory requirements, the compliance guides are only required for rules that have a FRFA, not for final rules that are certified. Moreover, even though a compliance guide is required for rules with FRFAs, some agencies do not comply with that requirement.

A plain English summary of a final rule, in the form of a compliance guide, would be beneficial in terms of explaining the rule to small entities in an easily cognizable manner. Improving the current compliance guide requirement by establishing a date (prior to the implementation of the final rule) for the guide to be published, and establishing minimal criteria for drafting the guides (including a plain English requirement) would provide small entities with the information that they need to comply with new regulations and reduce the penalties that are incurred due to confusion about the requirements. In addition, it would prevent small entities

[1] The Crain report is located at http://www.sba.gov/advo/research/rs207tot.264.pdf.

from having to incur legal fees to understand the rules as well as losing valuable business time trying to decipher the new requirements.

Q: ***Under H.R. 682, your office would have expanded responsibilities. Would your Office have the resources to execute these additional duties?***

A: No, the Office of Advocacy would not have the resources to perform all of the duties in H.R. 682.

Q: ***Please explain how your office interfaces with OIRA at OMB?***

A: The Office of Advocacy and OIRA work together closely on regulations and paperwork reviews that have a small business impact. OIRA desk officers contact Advocacy's legal/policy team directly when they spot a problematic rule, and vice versa. Using our combined resources generally results in better, less burdensome regulations that still achieve the policy goals of the underlying legislative mandates.

I appreciate the opportunity to provide the requested information. If you have any questions, please contact my office. Thank you.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

RESPONSE TO POST-HEARING QUESTIONS FROM J. CHRISTOPHER MIHM, MANAGING DIRECTOR FOR STRATEGIC ISSUES, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

United States Government Accountability Office
Washington, DC 20548

August 4, 2006

The Honorable Christopher B. Cannon
Chairman
The Honorable Melvin L. Watt
Ranking Minority Member
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
House of Representatives

On July 25, 2006, you requested that we respond to questions for the official record regarding your Subcommittee's July 20, 2006, hearing on H.R. 682, the Regulatory Flexibility Improvements Act. Our responses are included in this correspondence.

Responses to Questions

1. On July 20, 2006, you testified about various recurring problems regarding the implementation of the Regulatory Flexibility Act (RFA). What role—if any—could a reconstituted Administrative Conference of the United States (ACUS) play with respect to the problems you have identified regarding the Regulatory Flexibility Act?

As we have noted previously, ACUS provided a valuable forum to advise the federal government on administrative procedural reform. ACUS drew on legal experts from across the spectrum to study problems affecting federal administrative procedures and provided nonpartisan advice and recommendations on how to improve the efficiency, adequacy, and fairness of those procedures. We would expect a reconstituted ACUS to provide the same benefits if asked to review issues associated with RFA. ACUS, if funded, could plan and direct empirical research to reexamine RFA and generate a range of practical options for addressing weaknesses of the Act.

2. As you noted in your written testimony, President Bush issued Executive Order 13272 in August 2002, which requires federal agencies to establish written procedures and policies on how they measure the impact of their regulatory proposals on small entities and to vet these policies with the Small Business Administration's (SBA) Office of Advocacy. You also note that GAO has not evaluated whether the Executive Order is helping to address some of the concerns GAO has raised regarding the Act's

effectiveness. Would such an evaluation be useful to have before further reforms to the Act are considered?

In our testimony, we advocated continued monitoring of the implementation of Executive Order 13272, as well as the Office of Advocacy's related RFA guidance and training for federal agencies. Together, the Executive Order and the Office of Advocacy's guidance and training have the potential to reduce agencies' confusion about RFA and promote more effective compliance with the Act's requirements. The Office of Advocacy has reported on its and other agencies' responses to the Executive Order, but a broader independent evaluation of the effectiveness of those actions has not been conducted. Such an evaluation could help Congress to focus proposed amendments of RFA on the aspects of the Act that are still proving most troublesome to implement. As indicated in our response to the first question, such research would also be an appropriate charge for ACUS.

3. With regard to the implementation issues you have highlighted regarding the Regulatory Flexibility Act—particularly with respect to the disparate performance by various agencies—could some of these issues be addressed by more active guidance or involvement by OMB?

We have previously recommended that OMB, in consultation with SBA, take more action regarding oversight and guidance to agencies on compliance with RFA requirements.[1] OMB acted on some of those recommendations, particularly regarding the RFA requirement for periodic reviews of existing regulations. Our reports have also documented the effects of active OMB involvement and oversight on agencies' rulemaking actions.[2] With regard to RFA, for example, we noted in February 2000 that the Federal Emergency Management Agency (FEMA) began additional analysis of the impact of its draft regulations on small entities in response to OMB's concerns about the agency's compliance with RFA.[3] However, there are limits to what OMB involvement could achieve. As we have pointed out in prior reports, OMB's Office of Information and Regulatory Affairs (OIRA), which has responsibility for handling a large volume of regulatory and paperwork reviews, is a relatively small office, so attention to RFA issues would compete with other priorities. Also, OIRA's oversight of rulemaking generally does not cover the rules of independent regulatory agencies.

4. Does the Office of Advocacy at the Small Business Administration provide sufficient guidance under the Regulatory Flexibility Act?

As noted in our testimony, the Office of Advocacy's 2003 RFA compliance guide appears to be helpful in addressing some of the issues we have raised regarding the Act. In particular, it discusses the interpretation of key terms in RFA and suggests factors that agencies might want to consider when making RFA determinations. The key, however, will be effective implementation, particularly the degree to which agencies successfully and consistently apply that guidance. We have not evaluated

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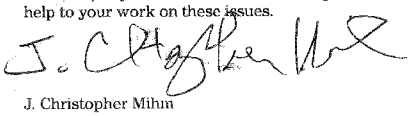
[1] For a summary of some of those recommendations, see GAO, *Regulatory Flexibility Act: Clarification of Key Terms Still Needed*, GAO-02-491T (Washington, D.C.: Mar. 6, 2002).
[2] See GAO, *Rulemaking: OMB's Role in Reviews of Agencies' Draft Rules and the Transparency of Those Reviews*, GAO-03-929 (Washington, D.C.: Sept. 22, 2003).
[3] GAO, *Disaster Assistance: Issues Related to the Development of FEMA's Insurance Requirements*, GAO/GGD/OGC-00-62 (Washington, D.C.: Feb. 25, 2000).

the implementation of the Office of Advocacy's 2003 guidance. Therefore, we have no basis to judge whether the guidance, on the whole, is sufficient.

5. Since 1996, judicial review has been available under the Regulatory Flexibility Act. What impact, if any, has judicial review had on the problems GAO has cited over the years about the Regulatory Flexibility Act?

We have only addressed the impact of judicial review indirectly; it has not been a primary objective of any of our RFA evaluations. For example, in a December 2001 report, we noted that some officials indicated that their agencies may prepare voluntary final regulatory flexibility analyses to help ensure that their rules will not be overturned via judicial review. In a September 2000 report, we outlined the development of changes in EPA's RFA guidance documents over time. We noted that an EPA official said the provision allowing judicial review of regulatory flexibility analyses meant that the agency would have to make sure that all of its initial regulatory flexibility analyses could withstand judicial scrutiny, and, therefore, EPA no longer had the option of doing a limited analysis on rules that it believed would have a minimal impact on small entities. We also pointed out that, in a report marking the 20th anniversary of RFA, the Office of Advocacy noted that the addition of judicial review had been an incentive for agencies to comply with the Act's requirements and that small entities were not hesitant to initiate court challenges in appropriate cases.

Please contact me at (202) 512-6806 or mihmj@gao.gov if you, other Subcommittee members, or your staffs have additional questions or if we can provide additional help to your work on these issues.



J. Christopher Mihm
Managing Director
Strategic Issues

(450524)

RESPONSE TO POST-HEARING QUESTIONS FROM J. ROBERT SHULL, DIRECTOR OF REGULATORY POLICY, OMB WATCH, WASHINGTON, DC

J. ROBERT SHULL
Director of Regulatory Policy

Responses to Subcommittee Follow-Up Questions

1. Does the current rulemaking process adequately address the needs of small businesses?

It is not at all surprising that proponents of the House and Senate bills to change the Regulatory Flexibility Act frame their initiative as a service to small business; the public believes that small businesses need some help in order to operate on a level playing field with big corporations. The small business community is a major source of innovation and employment in this country. Like their larger counterparts, however, small businesses are also responsible for social ills addressed by regulations, ranging from workplace health and safety problems to environmental pollution.[1] Thus, we cannot simply give small businesses a free pass from regulation. At the same time, it can be relatively more expensive for small business to comply with regulations than large companies. Small businesses want to do their part and be responsible; real reforms, then, must help small businesses comply with regulations in order to level the playing field with large businesses while giving the public the protection it needs and deserves.

We already have these reforms. Small firms receive direct government subsidies such as outright and government-guaranteed loans from the Small Business Administration (SBA) as well as indirect preferential treatment through federal procurement requirements and tax provisions. Additionally, small business is treated to many exemptions or special treatment in the area of regulation. For example, employers with fewer than 15 employees are exempt from the Equal Employment Opportunity Act,[2] and OSHA levies lighter penalties for smaller firms, exempts businesses with fewer than 10 workers from recordkeeping requirements, and provides free on-site compliance consultations.[3]

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1. *See* Richard J. Pierce, Jr., *Small is Not Beautiful: The Case Against Special Regulatory Treatment of Small Firms*, 50 ADMIN. L. REV. 537 (1998).

2. *See* 42 U.S.C. § 2000e(b).

3. *See* OSHA, *OSHA Small Business Assistance: OSHA Benefits for Small Business* (available on-line at <http://www.osha.gov/dcsp/smallbusiness/benefits.html>).

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Small business concerns are inscribed throughout the regulatory process. The Small Business Regulatory Enforcement Fairness Act (SBREFA) requires agencies to give special consideration and voice to small business as part of the rulemaking process as well as expanded judicial review for small businesses wishing to challenge agency decisions.[4] (Note that public interest advocates are not accorded similar privileges.) Likewise, the Equal Access to Justice Act gives small businesses special privileges when litigating against agencies: small businesses can recover attorney's fees if they prevail in court against a federal agency.[5]

Of course, these benefits accrue not just to the mom-and-pop storefront that we tend to think of when we talk about small business but also to very large multimillion dollar businesses that can game the rules and claim the status of "small business."[6]

Because of all these ways that the regulatory process already serves the special interests of small businesses, the real need is not for more burdens on that process — burdens which could put the public at risk. Real reform would consider the role of small business in contributing to pollution and other harms to the public and would respond by adequately funding compliance assistance offices in every congressional district, which would be given the resources they need to give small businesses the help that they, in turn, need to be good corporate citizens and comply with the law.

2. You question the value of requiring agencies to assess the indirect effects of regulations on small businesses. Consider, for example, a situation where the Department of Homeland Security issues a regulation restricting the number of flights that can land at an airport. Under current law, the DHS would probably only have to consider the impact of the regulation on the airlines themselves. Shouldn't the DHS also be required to at least consider the indirect impact that the regulation could have on all the small shop owners and other entrepreneurs at the airport that will undoubtedly lose business as a result of this regulation?

At the core of this question is a concern, which has been aggravated by the public relations machinery of corporate special interests and industry-funded think tanks, that regulatory protections for the public interest are a drag on the economy that impede the competitiveness of American businesses, large and small. The empirical literature tells us a much different story. I am attaching to this response an OMB Watch Issue Brief, *Regulation and Competitiveness*, which goes into more detail on this literature, as well as a more recent scholarly overview by economics professor Frank Ackerman, Ph.D. The short version of the story is that economic indicators fail to demonstrate a link between protective regulations and competitiveness, or any cost in jobs for American workers; in fact, consistent with the Porter "hypothesis," there are many cases in which regulation demonstrably *improved* business operations by inspiring companies to innovate and discover new efficiencies. Many of these cases are also briefly noted in another attached document, *The Going-Out-of-Business Myth*.

An additional driver of the concerns about the costs to small businesses of complying with regulations is a series of studies commissioned by the Small Business Administration's Office of

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4. *See* 5 U.S.C. §§ 601 *et seq.*

5. *See id.* § 504.

6. *See* OMB Watch, *Small Business Not So Small*, Apr. 17, 2002, available at <http://www.ombwatch.org/article/articleview/687/1/243?TopicID=3>.

Advocacy that purport to estimate the burden on small businesses. This series of studies, in all its iterations, is a deeply flawed enterprise. I am attaching an excerpt from OMB Watch's comments to OMB's 2005 draft report on the costs and benefits of regulations, in which we pointed out the deep flaws of the SBA study — and repeated OMB's own criticisms of the study. The SBA study is based on other deeply flawed estimates of industry compliance costs, which a recent Public Citizen report debunked as systematically biased in an upward direction.[7]

More specific to the question posed here: if agencies were required to assess indirect effects of regulation on small businesses, where would the inquiry ever end? The small businesses operating at the hypothetical airport (which, given the rents at major airports, are most likely not small at all but actually large chain establishments, or franchise operations of larger corporate enterprises) buy supplies from other possibly small businesses, and they may contract for janitorial services from yet more small businesses. Those small businesses, in turn, have relationships with yet more small businesses. All of these attendant effects are most certainly indirect. To assess them quantitatively would be unhelpfully speculative, and it is unclear whether the resulting estimates would be helpful in the already fraught and difficult task of priority setting for policies to protect the public.

3. Why do you cite as being particularly troubling those provisions in H.R. 682 allowing the Office for Advocacy to preview proposed rules before they are published in the Federal Register and giving that Office the power to write regulations governing agencies' compliance with the Regulatory Flexibility Act (RFA)?

SBA's Office of Advocacy is, as the name implies, an *advocate* for the interests of business. An advocate for business has no place dictating anything to agencies charged with protecting the public health, safety, civil rights, environment, or social welfare. Moreover, a voice for business should not be given the first bite at the apple in previewing draft regulations; business interests ought to be forced to play on a level playing field with the public interest.

4. What is your view of the value, if any, of Executive Order 13,272?

Corporate special interests, whether or not they count as "small" under SBA rules, have an acute interest in fighting regulations and organized resources that they can bring to bear in those fights. The public, meanwhile, has a diffuse interest in regulations, and its interests are organized, if at all, in the under-resourced nonprofit sector. Accordingly, business interests are always already better organized and better resourced in their opposition to regulation than the public interest sector can ever be in its support for new protective standards. An executive order extralegally distorting the regulatory process to allow a government-funded voice for business interests to preview draft regulations and enjoy other special privileges in the regulatory process is the last thing we need. Moreover, any other layers of review before regulations can be published are delays that endanger the public, which can count the cost in lives.

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7. *See* RUTH RUTTENBERG & ASSOCS., NOT TOO COSTLY, AFTER ALL: AN EXAMINATION OF THE INFLATED COST-ESTIMATES OF HEALTH, SAFETY, AND ENVIRONMENTAL PROTECTIONS (Public Citizen, Feb. 2004), *available at* <http://www.citizen.org/documents/ACF187.pdf>.

5. Do you think that some of the implementation issues which have been cited by the GAO and others regarding the RFA could be addressed by OMB?

OMB would undoubtedly do much to distort the process further in favor of corporate special interests, if given the excuse to do so and legal cover in the name of the Regulatory Flexibility Act. For reasons stated above, we do not support any such extraordinary efforts to use the Regulatory Flexibility Act to tilt the playing field any more than it already is. Additionally, OMB, through its Office of Information and Regulatory Affairs, has demonstrated an appalling willingness over the years to weaken or eliminate protective policies. For an overview of OMB's destructive legacy during the tenure of John Graham as administrator of OIRA, see our collection of web articles at www.OMBWatch.org/regs/grahamfiles. OMB should not be entrusted with any more legal authorities to disrupt protective policies.

6. Do you think the Administrative Conference of the United States — if it was reconstituted — could play a role in improving the implementation of the RFA?

ACUS is fondly remembered by many who follow regulatory policy. The general consensus is that the quality and utility of ACUS's work were dependent on the quality of the staffing and the resources allotted to ACUS. Because, however, we do not share the view that the RFA needs to become any more of a burden than it already is, I cannot address whether ACUS would or would not be effective in the job envisioned by RFA proponents.

Regulation and Competitiveness[1]

Anti-regulatory arguments claim that regulation is inherently a burden that weakens the competitiveness of American businesses in the global market. Yet a plethora of scholarly studies indicates that the opposite is true: regulation not only does not hinder U.S. competitiveness but actually may increase the competitive advantage of the United States. Overall, factors such as wages and trade agreements play a much larger role than regulation in determining U.S. competitiveness. Economists have been unable to find the strong negative correlation between regulation and competitiveness. This finding may run counter to intuition, but it suggests that protecting public health, safety and the environment can have real economic advantages; the United States does not have to sacrifice public protections in order to promote U.S. competitiveness.

1. Economic indicators fail to show an environment/competitiveness tradeoff.

Economists look at several economic indicators to determine the impact of regulation on competitiveness, such as plant location, industry imports and exports, and foreign direct investment (FDI). The argument that regulation harms U.S. competitiveness is based primarily on the theory that pollution-intensive industries will move to areas with more lax environmental regulations ("pollution havens") in order to avoid the costs of compliance with more stringent environmental protections. If the pollution haven theory holds, then firms will choose to open new plant locations in areas with less regulation. Similarly, if regulation impacts competitiveness, then there should be a positive correlation between regulation and net imports of an industry: as regulation increases, countries with more lax regulations will gain a great share of the import market. Further, if the pollution haven theory is to hold, then stringent regulation in the United States will induce high polluting firms to disproportionately invest overseas.

Though some economists have found a pollution haven effect, many economists have discovered that regulation has no negative impact on competitiveness, and some have even argued that regulation may increase competitiveness. Even in studies that have found that regulation hampers competitiveness, the effect tends to be insignificant or, at most, significant but relatively minor. A 1995 survey of economic studies by Jaffe et al., for instance, concludes that "overall, there is relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness, however that elusive term is defined."[2] Eban Goodstein not only corroborated

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1. February 2006. This issue brief was written by Genevieve Smith, Regulatory Policy Analyst.

2. Jaffe et al., *Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?*, 33 J. ECON. LIT. 132, 157 (1995).

Jaffe's conclusions but has also found that, between 1979-1989, the industries that spent more on regulation compliance actually exhibited superior performance compared to imports from developed and developing countries.[3] Those who claim that regulation is overly burdensome tend to ignore the divergent economic opinion on regulation and competitiveness and instead focus only on inapposite evidence mischaracterized as corroborating a deregulatory agenda.

Regulation does not negatively impact plan location decisions.

The Jaffe et al. study looked at all three indicators of competitiveness and found on all accounts that regulation was not a major factor in competitiveness. In the case of plant location decisions, Jaffe et al. found that there is little evidence to support the conclusion that stringent regulation is a major determinant in plant location decisions. This finding is corroborated by a host of other economists. Timothy J. Batrik studied the impacts of state government environmental regulation expenditures on plant location decisions and found that such expenditures had an insignificant effect on plant locations.[4] Kevin Gallagher found that plants moving to Mexico are not the ones with highest pollution abatement costs; overseas movement of industries is affected more by labor costs than by regulation.[5] A look at plant location within India found that increased government spending on environmental regulation not only did not deter plant location but actually had a positive impact.[6]

Clark, Marchese, and Zarrilli examined industry decisions to conduct offshore assembly in developing companies. Consistent with the findings on plant location, the authors found that pollution intensive industries were less likely to conduct offshore assembly. They argued that the U.S. has a comparative advantage in highly polluting industries, while developing countries have a comparative advantage in simple assembly industries. At the same time, "the cost of pollution control and abatement are too small to influence the competitive performance of location decision of these activities."[7]

Regulation does not increase dependence on imports.

Further, several economic studies have found that stringent regulations have not led to

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3. Eban Goodstein, *A New Look at Environmental Protection and Competitiveness*, Briefing Paper for the Economic Policy Institute, Washington, DC (1997).

4. Timothy J. Batrik, *The Effects of Environmental Regulation on Business Location in the United States*, 19 GROWTH CHANGE 22 (1988).

5. Kevin Gallagher, *Trade Liberalization and Industrial Pollution in Mexico: Lessons for the FTAA*, Working Paper for Global Development and Environment Institute (October 2000).

6. Muthukumara Mani, Sheoli Pargal & Mainul Huq, *Does Environmental Regulation Matter? Determinants of the Location of New Manufacturing Plants in India in 1994*, World Bank Working Paper, at 1-26.

7. Don P. Clark, Serafino Marchese & Simonetta Zarrilli, *Do Dirty Industries Conduct Offshore Assembly in Developing Countries?*, 14 INT'L ECON. J. 75, 86 (2000).

increases in imports. Jaffe et al. examined a number of studies on the impact of regulation on imports and exports and concluded once again that regulation has no significant impact. Grossman and Krueger, for instance, looked at the impacts of NAFTA on net imports and found greater imports in industries with the lowers pollution costs. Moreover, they found that "traditional determinants of trade and investment patterns" have a significant impact on net imports while environmental costs have a minor and insignificant impact.[8]

A 1997 briefing paper by Eban Goodstein confirmed the findings of Jaffe et al. Moreover, Goodstein's study also found that "over the 1979-89 period, *industries that spend more money complying with environmental regulations actually demonstrated superior performance against imports from developed countries.*"[9] Goodstein found the same relationship "for imports from developing countries, but the relationship was not as strong."[10] Goodstein expanded on existing research on the effect of regulation on net imports by exploiting the large dataset made available by the National Bureau of Economic Research (NBER). Again, he concluded from the data that environmental regulation does not harm U.S. competitiveness. A look at the top 20 industries that experienced growth of import share by less-developed countries (LDC) from 1973-79 and 1979-89 shows that industries with high environmental costs were not the industries experiencing growth in net imports. In fact, "only three of the top 20 in the early period were industries with higher-than-average environmental costs; only one in the latter. It seems, then that low-wage industries, not 'dirty' ones, dominate the list of LDC import leaders."[11]

Regulation does not send foreign investment abroad.

Despite predictions to the contrary, several economic studies have found foreign direct investment to increase with environmental stringency, implying that environmental regulation does not deter foreign investors. In a recently published article for the *International Trade Journal*, Elizabeth T. Cole and Prescott C. Ensign have found that U.S. FDI into Mexico is moving toward low polluting industries.[12] In fact, air pollution decreased in the United States at a time when foreign direct investment was increasing.[13]

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8. Gene M. Grossman & Alan B. Krueger, *Environmental Impacts of a North American Free Trade Agreement*, *in* THE US-MEXICO FREE TRADE AGREEMENT 13 (Peter Garber ed. 1993).

9. Goodstein, *supra* note 3, at 2.

10. *Id.*

11. *Id.* at 6

12. Elizabeth T. Cole & Prescott C. Ensign, *An Examination of U.S. FDI into Mexico and its Relation to NAFTA: Understanding the Effects of Environmental Regulation and the Factor Endowments that Affect Location Decision*, 19 INT'L TRADE J. 1 (2005).

13. DAVID WHEELER, RACING TO THE BOTTOM? FOREIGN INVESTMENT AND AIR POLLUTION IN DEVELOPING COUNTRIES (Development Research Group, World Bank, 2001), *available at* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632594>. Wheeler's study shows a correlation and not causation.

Thus, the bulk of the economic literature contradicts the claim that regulation seriously hampers U.S. competitiveness. As Jaffe et al. conclude, "studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location decisions have produced estimates that are either small, statistically insignificant, or not robust to tests of model specification."[14] Other economic factors, such as labor costs, play a much more significant role in the movement of industries. Concludes Goodstein, "Highly polluting industries are relocating to poor countries; but the reason, overwhelmingly, is low wages."[15]

Economic opinion on the existence of a pollution haven effect is by no means conclusive. Economic studies deviate broadly on the subject. According to one literature review, "much of the empirical literature that has attempted to test this assumption has arrived at differing conclusions, ranging from a modest deterrent effect of environmental regulatory stringency on economic activity to a counterintuitive modest attract effect."[16] Even in the most damning characterizations, regulation still is only said to have a modest impact on U.S. competitiveness[17]

Even if *some* evidence does point to a pollution haven effect, one cannot dismiss the wide range of divergent economic opinion on the subject. As Tim Jeppensen, John List and Henk Folmer conclude in a 2002 article for the *Journal of Regional Science*, "casual perusal of the literature [on regulation and competitiveness] indicates that construction of a consensus point is akin to finding a needle in a haystack."[18]

2. Regulation does not cost jobs.

Economists have also refuted the claim that increased regulation decreases jobs. Economist Eban Goodstein at the Economic Policy Institute has written substantially on the relationship of jobs and the environment. According to Goodstein, the jobs-environment trade-off is largely a myth. Goodstein's book *Jobs and the Environment: The Myth of a National Trade-Off* finds a small positive effect of environmental regulation on overall employment, especially in the area of manufacturing

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14. Jaffe et al., *supra* note 2, at 157-158.

15. EBAN GOODSTEIN, JOBS AND THE ENVIRONMENT: THE MYTH OF A NATIONAL TRADE-OFF 19(1994).

16. Smita B. Brunnermeier & Arik Levinson, *Examining the Evidence on Environmental Regulations and Industry Location*, 13 J. ENVT. & DEVEL. 6 (2004).

17. See Keller & Levinson, *Pollution Abatement Costs and Foreign Direct Investment Inflows to U.S. States*, 84 REV. ECON. & STATS. 691 (2002), in which they found that environmental regulation does have significant negative impact on FDI into the United States, but the magnitude is economically small. See also Arik Levinson, *Environmental Regulation and Manufacturers' Location Choices: Evidence from the Census of Manufacturers*, 62 J. PUB. ECON. 5 (1996), in which Levinson found that the manufacturing sector is sensitive to environmental regulation, but again the impact is small in magnitude. Though the sector was sensitive to regulation, "the degree of aversion to stringent states does not seem to increase for pollution-intensive industries."

18. Tim Jeppesen, John A. List, & Henk Folmer, *Environmental Regulations and New Plant Location Decisions: Evidence from a Meta-Analysis*, 42 J. REGIONAL SCI. 19, 36 (2002).

workers.[19] Goodstein also finds that environmental regulation does not lead to manufacturing plant shutdowns.

Regulation leads to job creation and innovation of new technologies that can then expand the economy. Government spending on environmental regulation includes "investments in pollution control equipment and personnel, scientific studies to test pesticides and chemicals, the clean-up of hazardous wastes at Superfund sites, and the bill paid to your local garbage collector."[20] All of these costs *create jobs*. Moreover, these jobs are overwhelmingly blue collar and, by nature, domestic.[21] According to Goodstein, "the one comprehensive estimate available suggests that, in 1992, just under 4 million jobs were directly or indirectly related to pollution abatement and environmental protection the United States."[22]

Even the more equivocal work of Richard D. Morgenstern, William A. Pizer, and Jhih-Shyang Shih cannot avoid the job-creating potential of environmental protection: they conclude that environmental regulation is *just as likely* to create jobs as to cause job losses. "While environmental spending clearly has consequences for business and labor, the hypothesis that such spending significantly reduces employment in heavily polluting industries is not supported by the data," they write.[23] Morgenstern et al. examined the pulp and paper, plastics, petroleum and steel sectors and found "that a million dollars of additional environmental expenditure is associated with an insignificant change in employment."[24]

They explain: "Most importantly, there are strong positive employment effects in industries where environmental activities are relatively labor intensive and where demand is relatively inelastic, such as plastics and petroleum. In others, where labor already represents a large share of production costs and where demand is more elasticity, such as steel and pulp and paper, there is little evidence of a significant employment consequence either way."[25]

Berman and Bui also found that regulation had no impact on labor demands. The authors examined the impact on labor demands of increased air pollution abatement in the Los Angeles area.

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19. *See generally* Goodstein, *supra* note 15.

20. Eban Goodstein, *Jobs or the Environment? No Trade-Off*, 38 CHALLENGE 41, 46 (1995).

21. Frank Ackerman & Rachel Massey, *Prospering with Precaution: Employment, Economics, and the Precautionary Principle* (Precautionary Principle Project, Aug. 2002), *available at* <http://www.healthytomorrow.org/pdf/prosper.pdf>.

22. *Id.* at 42.

23. RICHARD D. MORGENSTERN, WILLIAM A. PIZER, & JHIH-SHYANG SHIH, JOBS VERSUS THE ENVIRONMENT: AN INDUSTRY-LEVEL PERSPECTIVE (Resources for the Future Discussion Paper No. 99-01-REV, 2000) 25.

24. *Id.* at 24.

25. *Id.*

In looking at data from 1979 through 1992, a period that saw sharp increases in environmental regulation, they found that increased regulation had no effect on employment in refineries.[26]

3. Regulation can improve efficiency.

Those positing an anti-regulatory agenda are forced to dismiss entirely the Porter "hypothesis" that regulation can actually increase productivity by increasing the efficiency of operations. Porter's theory was developed in response to real-world observations, such as OSHA's Cotton Dust Rule, in which regulations to protect the public had indirect benefits of inducing technological innovations and improved efficiencies in business operations. Since Porter elaborated his argument, the real world examples have continued to multiply. His "hypothesis" is now backed by a robust body of empirical evidence:

- Though regulation certainly does result in some cost to industry, it can also spur economic growth and increased efficiency. Jaffe points to a 1990 Barbera and McConnell study that "found that lower production costs in the nonferrous metals industry were brought about by new environmental regulations that led to the introduction of new, low-polluting production practices that were also more efficient."[27] EPA itself has in fact argued that environmental regulations generate "more cost-effective processes that both reduce emissions and the overall cost of doing business."[28]

- A study of the impacts on food manufacturing of trade liberalization between Mexico and the U.S. found that free trade would benefit Mexican producers because of resulting productivity growth, not because of the country's more lax environmental regulation. In fact, increased environmental regulation actually stimulated greater productivity in Mexican food manufacturing. "Pollution abatement efforts encouraged by the Mexican Government's inspection program manifestly have stimulated improvements in food processing efficiency as well as in environmental quality."[29] The enhanced productivity offset any consequence for the profitability of Mexican food manufacturing in the aftermath of the new pollution controls. At the same time, the authors found "U.S. pollution regulations have had no impact on the

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26. Eli Berman & Linda T. M. Bui, *Environmental Regulation and Labor Demand: Evidence from the South Coast Air Basin*, 79 J. PUB. ECON. 265 (2001).

27. Jaffe et al., *supra* note 2, at 155.

28. Office of Air and Radiation, Environmental Protection Agency, *The Clean Air Marketplace: New Business Opportunities Created by the Clean Air Act Amendments–Summary of Conference Proceedings* (July 24, 1992).

29. Ebru Alpay, Steven Buccola, & Joe Kervilet, *Productivity Growth and Environmental Regulation in Mexican and U.S. Food Manufacturing*, 84 AMER. J. AGR. ECON. 887, 894 (2002).

profitability or productivity of U.S. food manufacturing."[30]

- Berman and Bui also found that in meeting more stringent environmental standards, oil refineries in the Los Angeles Air Basin actually increased their productivity and efficiency. Interviews with "plant managers and environmental engineers suggested that productivity increases were not accidental. They resulted from a careful redesign of production processes induced by the need to comply with environmental regulation."[31]

- Stephen Meyer compared regulation across states in the United States found that environmental regulation did impact economic prosperity. In fact, "states with stronger environmental regulations tended to have higher growth in the gross domestic products."[32] Though the correlation does not suggest causation, it does indicate that environmental regulation does not hinder state's economies. The correlation held true even during times of recession. In an update focusing on the 1990-91 recession, Meyer found states with stronger environmental regulation were not more likely to face economic decline during a period of recession than states with weaker environmental standards.[33]

Although the United States already has the least restrictive regulation in the world[34] and is third on the list of the world's top ten economies,[35] the business community has continued to assert that health, safety and environmental regulation is overly burdensome and must therefore be repealed. Yet the evidence shows that the cost to business of complying with regulation is negligible and that factors such as wages and trade agreements have a far greater impact on the competitiveness of U.S. business or the choice of an industry to move business overseas.

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30. *Id.* at 887.

31. Eli Berman & Linda T. M. Bui, *Environmental Regulation and Productivity: Evidence from Oil Refineries*, 83 REV. ECON. & STATS. 498, 508 (2001).

32. Stephen Meyer, *Environmentalism and Economic Prosperity: An Update* (Department of Political Science, Massachusetts Institute of Technology, Feb. 1993), at 2.

33. *Id.* at 9.

34. OFFICE OF INFO. & REG. AFFS., OMB, 2005 DRAFT ANN. REPT. TO CONG. ON COSTS & BENS. OF FED. REG. at 33 text accompanying note 22.

35. *Id.* at 30 text accompanying note 16.

OMB WATCH

July 2005

The Going-Out-of-Business Myth

The public needs regulatory safeguards to protect our health, safety, environment, civil rights, and welfare. Corporate special interests, however, have an interest in avoiding spending a single dime to improve their destructive behavior. Again and again, when new regulatory protections have been proposed, corporate lobbyists have argued that business would be bankrupted and forced to go out of business. Again and again, they have been proven wrong.

Case Study	*Ex ante*	*Ex post*
Asbestos	"When the Occupational Safety and Health Administration (OSHA) instituted regulations covering exposure to asbestos in the early 1970s, [it] hired a consulting firm to estimate the cost of compliance."[1]	"Two later studies found that the original prediction for the cost of compliance was more than double the actual cost, because of overly static assumptions."[2]
Benzene	"In the late 1970s, the chemical industry predicted that controlling benzene emissions would cost $350,000 per plant."[3]	"Shortly after these predictions were made, however, the plants developed a process that substituted other chemicals for benzene and virtually eliminated control costs."[4]
CFCs	"In 1988, reducing CFC production by 50 percent within 10 years was estimated by the EPA to cost $3.55 per kilogram. By 1993, the goal had become much more ambitious: complete elimination of CFC production, with the deadline moved up two years, to 1996."[5]	"Nevertheless, the estimated cost of compliance fell more than 30 percent, to $2.45 per kilogram. And where substitutes for certain CFCs had not been expected to be available for eight or nine years, industry was able to identify and adopt substitutes in as little as two years."[6] Additionally, regulated industry achieved substantial costs savings as a result of the CFC phase-out. For example, "when the international phase-out of ozone-destroying CFCs got underway, a company called Nortel began looking for substitutes. The company, which had used the chemicals as a cleaning agent, invested $1 million to purchase and employ new hardware. Once the redesigned system was in place, however, Nortel found that it actually saved $4 million in chemical waste-disposal costs and CFC purchases."[7]

CFCs in Automobile Air Conditioners	"In 1993 car manufacturers estimated that the price of a new car would increase by $650 to $1,200 due to new regulations limiting the use of CFCs."[8]	"In 1997 the actual cost was estimated to be $40 to $400 per car."[9]
Coke Ovens (1976/1987)	*OSHA Rule: Overall.* "The original OSHA estimate for the cost of complying with the 1976 coke oven standard was more than five times higher than estimates of actual costs. OSHA's contractor suggested that complying with the standard would cost from $200 million to more than $1 billion."[10]	"However, a Council on Wage-Price Stability study later estimated the actual cost of the standard to be $160 million. . . . Ultimately, firms were able to meet the standard without incurring all of the capital costs in the first year, and actual compliance costs were dramatically lower than originally predicted."[11]
	OSHA Rule: RIA Sample. "The OSHA consultant estimated that three steel firms in their sample would spend $93 million on capital equipment and $34 million in annual operating costs to comply with the regulations."[12]	"A later study by Arthur Andersen determined that the three firms actually spent between $5 million and $7 million in 1977 to comply with the standard, and only $1 million to $2 million on capital expenditures."[13]
	EPA Rule. "In the late 1980s, coke production again came under regulatory scrutiny, this time by the EPA. In 1987, the agency estimated that the cost of controlling hazardous air pollution from coke ovens would be roughly $4 billion."[14]	"By 1991 that estimate fell to between $250 million and $400 million."[15]
Cotton Dust (1978)	*Total Cost.* "OSHA's estimate in the Final Regulatory Impact Analysis placed the textile manufacturing sector's cost of compliance at $280.3 million annually (1982 dollars, for amortized capital spending, incremental operations and maintenance, and other new spending)."[16]	"However, actual spending is estimated to have been only about a third of this amount, $82.8 annually (also 1982 dollars), chiefly because of the advantageous economics of the plant modernization push that was widely undertaken across the sector."[17]

	Other Consequences. "Concern was expressed in the rulemaking that smaller textile firms could encounter substantial constraints in raising capital for compliance-related improvements, and that the standard would tilt the sector's competitive center toward newer and more modern plants. . . . . Also, control equipment suppliers argued during the rulemaking that serious bottlenecks would arise in trying to retrofit the industry's equipment in short order."[18]	"Nonetheless, the actual effects in all these respects proved to be modest and generally bearable."[19]
Ethylene Oxide (1984)	"There was little concern at the time of the rulemaking that the standard would entail substantial financial or economic consequences for the industry or the national economy, because average spending for compliance per hospital was estimated to total no more than $1,500 to $3,500 annually."[20]	"There is no evidence that the outcome differed from these expectations."[21]
Formaldehyde (1987)	"OSHA's final estimate placed the industry's compliance costs at $11.4 million annually (1987 dollars). (Cost savings of $1.7 million annually from avoided medical expenses also were identified.)"[22]	"Actual spending appears to have been about half this level, $6.0 million annually."[23]
Grain Handling Facilities (1987)	"OSHA estimated the sector's total compliance costs in the range of $41.4 million to $68.8 million annually (1985 dollars; spanning the incremental need for equipment and actions across the 13 separate provisions) and avoided property losses at $35.4 million annually (as compliance reduced the number of facility explosions and serious fires). These calculations yielded an estimated net cost of compliance in the range of $5.9 million to $33.4 million annually."[24]	"Now that nearly five years have passed since full compliance with the terms of the 1987 standard was mandated, the evidence is that few if any facilities have ceased operation as a result of the standard—an outcome contrary to the economic impact estimates the industry submitted to the rulemaking. (The sector has, however, been subject to substantial economic pressures over this period for reasons not related to OSHA actions.)"[25]

Occupational Lead Exposures (1978)	"OSHA did, however, outline an outer bound of about $91 million (1976 dollars) in total capital spending, based on a complete rebuilding of the industry using the Bergsoe smelter technology (then considered to be the most cost-effective option). In an early 1980s revision of the estimates, OSHA placed the cost of PEL compliance at a capital requirement of $125 million (1982 dollars), or 1.3 cents annually per pound of production ($150 million and 1.6 cents/lb, respectively, in 1992 dollars)."[26]	"Nevertheless, the industry's actual spending to date (through early 1994) has been far below these levels. Cumulative capital investment appears to total no more than $20 million (1992 dollars), and some of this overlaps with expenditures to meet the various environmental requirements to which the industry has also been subject. Annual compliance spending appears to be averaging 0.5 cent/lb to 1.0 cent/lb (1992 dollars), and perhaps as low as 0.3 cent/lb, i.e. well below OSHA's expectations at the time of the rulemaking and largely reflective of the industry's strategy of minimizing expenditures on engineering controls and relying much more heavily on respirator and hygiene programs to reduce exposures."[27]
Strip Mining (1978)	"Prior to the passage of the 1978 Surface Mining Control and Reclamation Act, estimates for compliance costs ranged from $6 to $12 per ton of coal."[28]	"Actual costs for eastern coal operations have been in the range of 50 cents to $1 per ton. After the regulations were adopted, the market switched away from coal deposits with high reclamation costs. Ready substitutes included surface-minable coal in flatter areas (with lower reclamation costs), and underground deposits."[29]
Vinyl Chloride (1974)	"The most credible figures put forth at the time were those of the agency's technical consultant, which estimated total costs at around $1 billion (1974 dollars), including capital expenses for new equipment, replacement of lost capacity, and incremental operating expenses."[30]	"According to the post-promulgation survey of industry members, however, actual spending amounted to only about a quarter of this estimate, $228 million to $278 million."[31]

NOTES

1. Eban Goodstein, *Polluted Data*, AMER. PROSPECT, Nov.-Dec. 1997, *available at* <http://www.prospect.org/web/page.ww?section=root&name= ViewPrint&articleId=4757>.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. OFFICE OF TECH. ASSESSMENT, U.S. CONG., GAUGING CONTROL TECHNOLOGY AND REGULATORY IMPACTS IN OCCUPATIONAL SAFETY AND HEALTH: AN APPRAISAL OF OSHA'S ANALYTICAL APPROACH 59 Tbl.3-3 (Rep. No. OTA-ENV-635, Sep. 1995), *available at* <http://www.wws.princeton.edu/~ota/disk1/1995/9531_n.html>.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 60 Tbl.3-3.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.* at 59 Tbl.3-3.

27. *Id.*

28. Goodstein, *supra* note 1.

29. *Id.*

30. OTA, *supra* note 16, at 59 Tbl.3-3.

31. *Id.*

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The Unbearable Lightness of Regulatory Costs

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The Unbearable Lightness of Regulatory Costs

Frank Ackerman[1]

Abstract

Will unbearable regulatory costs ruin the US economy? This specter haunts official Washington, just as fears of communism once did. Once again, the prevailing rhetoric suggests, an implacable enemy of free enterprise puts our prosperity at risk. Like anti-communism in its heyday, anti-command-and-control-ism serves to narrow debate, promoting the unregulated laissez-faire economy as the sole acceptable goal and standard for public policy. Fears of the purported costs of regulation have been used to justify a sweeping reorganization of regulatory practice, in which the Office of Management and Budget (OMB) is empowered to, and often enough does, reject regulations from other agencies on the basis of intricate, conjectural, economic calculations.

This article argues for a different perspective: what is remarkable about regulatory costs is not their heavy economic burden, but rather their lightness. Section 1 identifies two general reasons to doubt that there is a significant trade-off between prosperity and regulation: first, regulatory costs are frequently too small to matter; and second, even when the costs are larger, reducing them would not always improve economic outcomes.

The next three sections examine evidence on the size and impact of regulatory costs. Section 2 presents cost estimates for a particularly ambitious and demanding environmental regulation, REACH -- the European Union's new chemicals policy. Section 3 discusses academic research on the "pollution haven" hypothesis, i.e. the assertion that firms move to developing countries in search of looser environmental regulations. Section 4 reviews the literature on ex ante overestimation of regulatory costs, including the recent claims by OMB that costs are more often underestimated (and/or benefits overestimated) in advance.

Turning to the economic context, Section 5 explains why macroeconomic constraints may eliminate any anticipated economic gains from deregulation. Section 6 introduces a further economic argument against welfare gains from deregulation, based on the surprising evidence that unemployment *decreases* mortality. Section 7 briefly concludes.

1. Two arguments against the trade-off

In theory, it would unquestionably be possible to spend so much on environmental protection that basic economic needs could not be met. At a sufficiently high level of

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regulatory expenditures, protecting nature and cleaning up the air and water *could* absorb enough of society's resources to compete with the provision of more fundamental goods, such as food and shelter. From this it is a short leap to the conclusion that the clash between economy and environment actually *is* an urgent problem, requiring detailed analysis of regulations to prevent worsening the terms of the trade-off. But the latter statement only follows logically if environmental policy is in fact consuming substantial resources, which are transferable to other, more basic needs. That is, the assumed urgency of the trade-off rests on the implicit assumptions that the costs of environmental protection are both large and fungible. Either of these assumptions could fail in practice:

- The costs of environmental protection could be nonexistent, or too small to matter; or
- Reduction of regulatory costs might not produce the desired economic benefits.

Environmental protection with little or no costs

Costless environmental improvement is frequently assumed to be impossible by definition. The hidden premise underlying this form of the trade-off argument is that the market economy is already performing as well as possible; that is, it has reached a Pareto optimum. From this perspective, any new expenditure on environmental protection necessarily represents a loss, because it diverts resources away from the things that consumers in their wisdom have chosen for themselves. (Strong forms of this argument come close to denying the existence of public goods, or at least the possibility of efficient delivery of them. Like most discussion of environmental regulation, this article takes it for granted that the government can and should deliver public goods.)

Reverence for market outcomes is at odds with the beliefs of many environmental practitioners, who assume that environmental improvements can bring economic benefits as well. The rhetoric of joint economic and environmental progress includes such overused imagery as "win-win solutions," the "double [or triple] bottom line," and opportunities to pick the "low hanging fruit." The ubiquity of these phrases underscores the extent to which environmental advocates find that the market is improvable – implying that it could not have already been at an optimum.

In a more academic vein, the Porter hypothesis maintains that carefully crafted, moderately demanding regulations can improve economic competitiveness and success in the marketplace (Porter and van der Linde 1995). Likewise, studies of energy conservation and greenhouse gas reduction frequently find opportunities for energy savings at zero or negative net cost, as in the "no regrets" options for climate change mitigation (IPCC 2001, 474-476). The critique of these opportunities is not that they are undesirable; who could argue with free environmental improvements? Rather, economists have argued that, in their own overused metaphors, there are no free lunches, nor $20 bills on the sidewalk. If lunch is expensive and the sidewalk is bare, then the Porter hypothesis must be impossible, and there must be hidden costs associated with energy conservation.

Without attempting a thorough review of this debate, it seems plausible that there are significant cases where essentially costless energy savings and other environmental improvements are possible. In such cases, the fears of regulatory cost burdens and concerns about trade-offs are presumably easy to resolve; there should be a broad consensus supporting the adoption of costless improvements.

However, literally costless improvements are not the only ones to escape from the trade-off; economic constraints do not immediately become relevant to real decisions as soon as regulatory costs are greater than zero. Very small costs of regulation presumably have very small impacts on the economy. Regulations could easily have costs that are too small to matter -- and Sections 2-4 will suggest that this is the case in many important instances. The theoretical consensus that supports costless environmental improvement may vanish once costs become positive, however small; but practical concerns about economic impacts need not arise until costs become large in some meaningful sense.

The question naturally arises: what counts as large? Here it is important to resist the illusion of superficially big numbers. Quantities in the billions, which are commonplace in federal programs and nationwide impact assessments, are essentially impossible to understand in isolation. Some standard of comparison is needed to bring them down to a comprehensible scale. (A million seconds is about 12 days; a billion seconds is about 32 years.) Amounts in the billions of dollars are inevitably thought of as part of a ratio: if X billion dollars is the numerator, what is the appropriate denominator? When none is specified, the default denominator tends to be the listener's personal finances -- in which case one or a few billions look very large indeed.

In contrast, a penny per person per day sounds small. But for the US with its population of about 300 million, a penny per person per day and a total of $1 billion per year are roughly the same. Per capita impacts, as in this example, are sometimes appropriate, particularly when the costs of regulations are spread across the population as a whole. Comparison to the revenues of the affected industry is also a useful standard for evaluating regulatory impacts. For issues affecting the entire US (or the EU), or even a large industry, a few billion dollars (or euros) per year is not a large number. This issue is important in the discussion in Section 2.

Environmental costs that cannot be traded for economic gains

Even when environmental policies impose noticeable economic costs, it does not necessarily follow that these costs could be traded for greater private incomes and consumption, or for the benefits that are thought to accompany higher incomes. There are two strands to this unfamiliar argument, presented in Sections 5 and 6 below, and briefly anticipated here.

First, deregulation might not produce increased economic growth. If a regulation or other environmental policy has measurable economic costs, it consumes resources such as labor and capital that could have been used elsewhere in the economy. The

policy, then, can only be "traded" for whatever those resources could have produced elsewhere -- in economic terms, the opportunity cost of those resources.

During a recession, labor and capital are typically less than fully employed. Supplying more of resources that are already in surplus may not produce anything more; the short run opportunity cost of additional resources could be zero. On the other hand, during expansions such as the late 1990s, the Federal Reserve carefully controls the level of employment and rate of growth; making more resources available for increased growth might just lead the Fed to step harder on the brakes in order to maintain the (unchanged) target pace of expansion. Again, the short-run opportunity cost of additional resources could be zero.

Second, economic growth may not produce the expected or desired benefits. An increasingly common style of analysis converts regulatory costs into health and mortality impacts, based on correlations between income and health. In the extreme, regulatory costs that are thought to lower market incomes have been labeled "statistical murder", because richer people live longer.

This line of argument is flawed in several respects. Perhaps the most dramatic response to the "statistical murder" story is the epidemiological evidence that mortality decreases in recessions. If deregulation leads to economic growth, which boosts employment, the expected result is paradoxically not a reduction in mortality.

In the long run, the availability of resources such as labor and capital must have something to do with growth rates, economic opportunities, and improvements in health and welfare. However, the relationship is a subtler and more tenuous one than is often recognized.

2. The low cost of regulating Europe's chemicals

Expensive regulations are less likely to be adopted in the US at present, due to exaggerated fears about regulatory costs, and to an administration that is extremely sympathetic to industry's concerns. Examples of truly expensive regulations may be easier to find elsewhere, such as in the European Union. Regulation has a better name in the EU than in the US; government-imposed constraints on private business that are taken for granted in Brussels would be immediately dismissed as beyond the pale in Washington.

REACH, Europe's new chemicals policy, is one of the most ambitious and demanding EU environmental regulations. (The name is an acronym for Registration, Evaluation, and Authorization of Chemicals.) When it is adopted, likely by early 2007, REACH will require chemical manufacturers and importers to register and test their chemicals for safety. During the 11-year phase-in period, some 30,000 chemicals will likely be registered and tested. Depending on the outcome of the tests, some chemicals (probably a very small minority) may be subject to partial or complete restrictions on

their use in Europe. An appeals procedure allows economic and other arguments to be raised against restrictions on the use of a chemical.

As in the US, industry groups have claimed that the costs of regulation will be prohibitive. A German industry federation commissioned a study, performed by the consulting firm Arthur D. Little (ADL), which presented lengthy calculations purporting to show that REACH would devastate German manufacturing, and seriously weaken the German economy as a whole (Arthur D. Little 2002). A French industry group sponsored another study, to date released only in the form of PowerPoint slides, claiming that France, too, would be flattened by REACH (Mercer Management Consulting 2003).

Numerous studies done without industry funding have reached very different conclusions, finding that the costs of REACH would be much lower, and entirely manageable. The European Commission estimated that the costs of registration and testing would total €2.3 billion over the 11 year period. I directed a study sponsored by the Nordic Council of Ministers, representing the governments of the Scandinavian countries, which estimated the registration and testing costs at €3.5 billion (Ackerman and Massey 2004). Our cost estimate represents less than one euro per person per year, over the 11-year phase-in of REACH.

Perhaps a better standard of comparison is that the €3.5 billion cost, if fully passed on to customers, would increase the average prices of the European chemical industry by a ratio of .0006, or 1/16 of 1%. This is, by any reasonable standard, a very small price change. The spot price of crude oil changes by more than that, on average, 51 weeks out of the year. The cost of REACH, standing alone, might sound big (billions of euros!), but the revenues of the European chemical industry over 11 years amount to a much bigger number of euros. Even a noticeably larger ratio could still seem small: if, as industry has sometimes claimed, most of the costs of REACH will be borne by one third of the chemical industry, the affected companies would be burdened with a price increase of about 1/5 of 1%.

The German industry study, performed by ADL, is the only major study to explain why the costs might be much larger. Yet the authors used only slightly higher figures than everyone else for the direct costs of registration and testing. Their enormous estimates of the costs of REACH came from creative calculation of indirect costs such as decreases in productivity, delays in innovation, etc. In their economic model, industry displays little imagination or adaptability, and never responds to regulation by innovating or switching to safer substitutes. Rather, industry's sole answer to regulation is to notice that profits have decreased, and therefore to decide to cut back on production. A bizarre misreading of basic microeconomic theory led ADL to estimate that production losses would average 9 times any cost increase imposed on German industries. Meanwhile, they mistakenly assumed that costs of REACH would be incurred over only 7 years, rather than 11, thus inflating the annual costs during the phase-in period by more than 50%. These and other mistakes drove cost impacts sharply upward.

They identified many separate pathways by which REACH might conceivably affect industry. Specifically, ADL assumed that each regulatory impact pathway would cause a specified percentage reduction in industry output; all the separate reductions were assumed to be independent, and multiplied to obtain the cumulative reduction. Thus if one regulatory impact is believed to cause a 10% cutback in output, and another to cause a 20% cut, the combination causes output to fall to 90% x 80% = 72% of the original level. This strange, nonstandard methodology seems designed for exaggeration, as any mild overstatement in individual factors will be amplified through multiplication by all the other factors. If ADL has inappropriately doubled the size of one of the individual cost factors, the entire estimate of the cost and impacts of REACH will be doubled via the multiplicative method. The appendix to my Nordic Council study provides a detailed critique of both the individual impact pathways and the overall methodology of the Arthur D. Little study.

The predominant role of indirect cost impacts suggests another comparison: how large is the ratio of indirect costs of regulation to the direct compliance costs? The highest ratio that I am aware of in a government, NGO, or academic study of REACH is about 6 to 1. The implicit ratio in the Arthur D. Little study is 650 to 1. Without knowing precisely what this ratio should be, it is tempting to say that we know what it is not: in an advanced industrial economy such as Germany, there is no visible basis for the claim that regulations impose indirect costs of 650 times their direct compliance costs.

US industry and government have been emphatic in their opposition to REACH, issuing alarmist predictions of its possible impact on the US. (These, too, are greatly exaggerated; at worst, US companies exporting to Europe might face the same percentage cost increase as European companies. A small percentage is a small percentage, whether it is expressed in euros or in dollars.) It seems safe to say that no recent US regulations have approached the ambition or scope of REACH. If one of Europe's most demanding regulations will increase prices by 1/16 of 1%, imagine how much less the costs will be for the timid proposals that still pass muster in Washington.

3. Pollution havens: theory vs. reality[2]

If regulatory costs imposed significant burdens on the economy, it should be easy to find their footprints. Because the costs are not uniformly distributed, there should be dramatic extremes where regulations have trod most heavily on the human landscape. Companies that have closed because of environmental costs, moving to Mexico or other countries where the regulatory climate was more lenient; workers thrown out of jobs by rigid environmental strictures; formerly prosperous communities shut down by the economic burdens of command-and-control regulation -- they should be all around us. If the fabled regulations of mass destruction exist, there is no way to hide them in a bunker; they should be visible for all to see. But the actual, identifiable examples of jobs lost to regulations rarely extend beyond a handful of stories about small numbers of workers in

[2] This section draws heavily on the work of Eban Goodstein (Goodstein 1999) and Kevin Gallagher (Gallagher 2004).

the most directly environmentally damaging, rural industries such as logging and coal mining.

The economic impacts of environmental regulations have been intensively studied for years. As Eban Goodstein has demonstrated (Goodstein 1999), there is no evidence that significant numbers of jobs or businesses have ever been lost for environmental reasons. Companies don't move, between states or between countries, to avoid expensive environmental standards, because environmental standards aren't that expensive. Environmental compliance costs are above 2% of industry revenues only in a handful of the most polluting industries; Goodstein cites a maximum of 7% for pulp mills. Among the reasons for major layoffs, as reported by the Bureau of Labor Statistics, environmental and safety-related shutdowns are among the least common, accounting for about 0.1% of job losses (Goodstein 1999; Ackerman and Massey 2002). Contrary to predictions, the Clean Air Act Amendments of 1990 did not destroy jobs; the same is true for the stringent local air quality regulations imposed by the South Coast Air Quality Management District in Southern California. A study of the South Coast regulations concluded, "In contrast to the widespread belief that environmental regulation costs jobs, the most severe episode of air-quality regulation of industry in the [United States] probably created a few jobs." (quoted in Goodstein 1999, 54)

Economists have carried out extensive studies of the "pollution haven hypothesis," i.e. the notion that polluting industries will flee to countries with lax environmental standards. The results have been almost entirely negative. A 1995 review of the literature on the subject concluded

> Overall, there is relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness, however that elusive term is defined... studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location decisions have produced estimates that are either small, statistically insignificant, or not robust to tests of model specification. (Jaffe et al. 1995, 157-158)

A more recent literature review reached similar conclusions (Jayadevappa and Chhatre 2000). Eric Neumayer demonstrated that neither the US nor Germany has had unusually large net outflows of investment in dirty industries; a section of his chapter on the subject is subtitled, "Why is there so little evidence for pollution havens?" (Neumayer 2001) Brian Copeland and Scott Taylor, in a very thorough theoretical and empirical analysis of trade and the environment, conclude that "the evidence does not support the notion that trade patterns are driven by pollution haven motives." (Copeland and Taylor 2003, 277) Kevin Gallagher shows that the dirtiest industries in the US have not been migrating to Mexico, either before or after NAFTA; while these industries have been declining in the US, their share of manufacturing has been declining even faster in Mexico. Moreover, a handful of major industries -- steel, aluminum, and cement -- appear to be cleaner (i.e., emit smaller amounts of criteria air pollutants per dollar of sales) in Mexico than in the US. A likely explanation for this unexpected pattern is that

the Mexican plants are newer than their US counterparts, and incorporate newer, cleaner technology (Gallagher 2004).

The economics literature is nearly, but not quite, unanimous on this question. Two recent articles have found modest empirical support for the pollution haven hypothesis. Matthew Kahn and Yutaka Yoshino use intricate and indirect methods of measuring the pollution intensity of trade inside and outside of regional trading blocs. They find that for trade outside of blocs, middle-income countries tend to expand dirty exports as they grow, while high-income countries expand cleaner exports. The effect is weaker inside regional trading blocs (Kahn and Yoshino 2004).

Matthew Cole presents superficially contradictory findings on trade between the US and Mexico (Cole 2004). (A careful reading shows that his results are not literally in conflict with each other.) On the one hand, the trade flows in both directions are becoming cleaner, but Mexico's exports to the US are becoming cleaner (declining in air pollution intensity) faster than US exports to Mexico. Since 1988, he finds, "The pollution embodied in US imports from Mexico [has been] less than that embodied in exports to Mexico and, furthermore, this gap has been widening rather than narrowing." (Cole 2004, 441) On balance, it is Mexico rather than the US that is escaping from trade-related air pollution on the other side of the Río Grande, seemingly contradicting the pollution haven hypothesis. On the other hand, Cole also finds that US imports, from Mexico and from the world, are growing faster (as a share of US consumption) in industries that have higher pollution abatement costs, just as the pollution haven hypothesis would suggest.

Neither of these articles finds a strong effect, and neither presents a clear, easily interpreted picture of the movement of industry in response to US pollution control costs. Meanwhile, the bulk of the economics literature, as described earlier, continues to suggest that a good pollution haven is hard to find.

4. Advance overestimates of regulatory costs

By now there is a substantial literature demonstrating that the best-known claims of extraordinary costs imposed by environmental policy do not stand up to careful examination. Tales of billions of dollars spent per life saved by esoteric regulations are based on errors and misrepresentation; they represent, as Lisa Heinzerling put it, "regulatory costs of mythic proportions" (Heinzerling 1998), (Heinzerling and Ackerman 2002). No attempt will be made to summarize the full extent of that literature here.

However, one aspect of the issue is worth expanding upon, namely the biases in prospective estimates of regulatory costs. Prospective estimates are, of course, all that is available when a new policy is under discussion. And the evidence is clear: the costs of environmental protection are much more often overestimated, rather than underestimated, in advance.

A classic example is the 1974 OSHA standard for workplace exposure to vinyl chloride. Consultants to OSHA estimated the costs of reducing vinyl chloride exposure at around $1 billion; industry estimates were even higher. Actual costs turned out to be around a quarter of OSHA's estimate, since industry quickly developed new, cost-effective technologies to comply with the regulation (U.S. Congress Office of Technology Assessment 1995).

Similar patterns have been found for many environmental standards. One study found that compliance costs for environmental regulations were overestimated in advance in 11 out of 12 cases (Hodges 1997). Another study found that advance cost estimates for environmental compliance turned out to be more than 25 percent too high in 14 out of 28 cases, while they were more than 25 percent too low in only 3 of the 28 cases (Harrington et al. 2000). A study for Environment Canada and the Ontario Ministry of Energy, Science and Technology, focusing specifically on the costs of controlling chlorinated substances, confirmed that overestimation of regulatory costs is more common than underestimation (Cheminfo Services 2000).

An in-depth examination of prospective cost estimates for regulations by Thomas McGarity and Ruth Ruttenberg reviews most of these as well as quite a few other examples, and identifies a series of reasons why cost estimates are biased upward in advance: (McGarity and Ruttenberg 2002)

- Regulators rely on regulated industries for empirical data, and the industries have a clear interest in secrecy and/or inflated cost estimates, either of which will discourage strict regulation.
- The likelihood of court challenges to strict regulations pushes agencies toward making conservative assumptions, again tilting in favor of the regulated industries.
- For lack of information, agency analyses often compare the costs of a proposed regulation to a zero regulation baseline, rather than the appropriate measurement of the incremental costs relative to existing regulations.
- Companies' reported costs of regulatory compliance sometimes include costs of upgrading other equipment at the same time that environmental controls are installed.
- Regulatory analyses frequently take a static approach, ignoring the learning curve effects, economies of scale, and regulation-induced productivity increases that may result from new environmental standards.

On the other hand, McGarity and Ruttenberg note that there are also downward biases in cost estimates, including a tendency to ignore indirect social costs of regulation, reliance on vendors of control technologies that are eager to win new markets, and a failure to take sufficient account of "Murphy's law" in projecting responses to regulatory requirements. On balance, the factors producing upward bias appear more numerous and more powerful.

The OMB response: 2004

However, the opposite perspective continues to be argued in the annual reports from OMB's Office of Information and Regulatory Affairs (U.S. Office of Management and Budget 2004; U.S. Office of Management and Budget 2005). The 2004 report devoted three pages (U.S. Office of Management and Budget 2004, 51-53) to the discussion of ex ante versus ex post regulatory cost estimates, leading with the assertion that many commentators believe costs are underestimated in advance. OMB cites three studies in support of the view that regulatory costs are typically underestimated. Yet all three simply claim that costs are large, not that advance estimates are consistently low. The details of these claims are not impressive:

- Mark Crain and Thomas Hopkins, in a consultant report for the Small Business Administration, agonize at length over the plausible idea that there are economies of scale in regulatory compliance, so that smaller firms have a higher compliance cost per employee (Crain and Hopkins 2000). For its estimates of environmental regulatory costs, the study uses the high end of the range published by OMB. So in citing this study, OMB is effectively citing itself, not a new source of information.
- Harvey James estimates the costs of compliance with 25 OSHA regulations as of 1993 (James 1998). But he also observes that the cost per firm was 5.5 times higher in a 1974 study of OSHA compliance costs done by the National Association of Manufacturers. James then simply asserts that the costs per firm could not be lower today than in 1974. On that basis, he multiplies his 1993 numbers by 5.5 -- thereby eliminating all empirical content in his study of 1993 costs, and simply recycling a 1974 estimate by an anti-regulatory industry group.[3]
- Finally, a detailed economic modeling exercise by Dale Jorgensen and Wilcoxen estimates the impact of the environmental regulations on US economic growth (Jorgenson and Wilcoxen 1990). They state at the outset that they have not attempted to assess any of the benefits, to consumers or to producers, of a cleaner environment. As a result, "the conclusions of this study cannot be taken to imply that pollution control is too burdensome or, for that matter, insufficiently restrictive." (Jorgenson and Wilcoxen 1990, 314-315)

  Modeling costs but not benefits, they find that the growth rate was reduced by 0.19% due to regulations during 1974-1983. They analyze a scenario involving the complete absence of regulations, including removal of all limitations on the use of high sulfur coal, and all motor vehicle pollution controls. Even if one were willing to contemplate such a wholehearted embrace of smog, acid rain, and toxicity, there are two reasons why the effect on the growth rate would be smaller today: the study was based on a period when the first round of spending for compliance with the Clean Air Act and the Clean Water Act was underway; and it

[3] The polemical nature of this study is suggested by its prominent table of the costs of compliance with OSHA regulations proposed in the late 1970s. Almost all of the costs in the table are for compliance with a generic carcinogen standard -- presumably the standard that was rejected in the *Benzene* decision. Only in a note many pages later, at the end of the article, does James acknowledge that the generic carcinogen standard was never actually implemented.

was also a period when the dirty industries which account for most pollution control spending represented a larger fraction of the US economy than at present.

The OMB response: 2005

In its 2005 report, OMB takes a different tack. In a chapter entitled "Validation of benefit cost estimates made prior to regulation," the report reviews "47 federal rules where pre-regulation estimates of benefits and costs were made by federal agencies and some post-regulation information is published by academics or government agencies." (U.S. Office of Management and Budget 2005, 42) The bottom line judgment is that overestimates of benefit-cost ratios were more common than underestimates: 11 were declared accurate (meaning that advance estimates were within 25% of the retrospective judgments), 22 advance estimates were too high, and 14 were too low.

OMB's report is not strictly comparable to other literature on advance cost estimates. It differs from other analyses in restricting its attention to estimates made by federal agencies; many of the most controversial and politically significant estimates are made by or sponsored by industry groups. Thus it could still be the case that regulatory cost estimates that arise in political debates are typically overestimated, whether or not federal agencies have a tendency toward underestimates.

Moreover, OMB examines both costs and benefits, and finds advance estimates to be too high much more often for benefits than for costs. Evaluating OMB's judgments on benefits estimates would be a substantial task, which for the most part is not undertaken here. Regulations do not operate in a vacuum; even in hindsight, it is not immediately obvious how large the benefits from a regulation have turned out to be. If a regulation reduces the risk of death in an industry or community, it is necessary to distinguish the effects of the regulation itself from any other factors that may have altered death rates in the same period. In other words, a retrospective study would be needed to identify those benefits -- and methodological errors could bias the retrospective, as well as the prospective, estimate.

Despite these differences in approach, OMB's discussion of the 47 rules appears to be a response to the findings of advance overestimates of costs. Even on its own terms, accepting OMB's judgments on the individual rules, the report is fundamentally unpersuasive, for two reasons. First, the report does not establish a reasonable basis for inferring that federal agencies tend to overestimate; its data do not contain a statistically significant bias toward overestimates. Second, the report's main finding is entirely due to its treatment of OSHA estimates, which raise a number of unique issues unrelated to general biases in estimates.

The choice of rules was based solely on data availability, heavily skewed by a few sources that reviewed multiple rules. OMB refers to the rules as a "convenience sample" which is not necessarily representative of federal rules in general (U.S. Office of Management and Budget 2005, 48). But let us suppose for the moment that they were a

true random sample of federal rules and agency estimates, and see what the sample would imply about the overall tendency to overestimate.

With 11 advance estimates accurate, 22 over, and 14 under, OMB's sample is not terribly far from finding the average estimate to be accurate. Change just 4 of the overestimates to under, and all trace of bias would disappear. How likely is it that the appearance of bias has occurred purely by chance? For the purpose of statistical analysis, OMB's judgments can be converted to numbers: 0 for accurate, -1 for underestimates, and +1 for overestimates. Then the sample mean is 0.17, and the standard error is 0.13. The null hypothesis that the true mean is zero, i.e. no bias, cannot be rejected, with $p = .19$. In other words, if there was no bias in reality and we drew a random sample of 47 cases, there is a 19% probability that it would look at least as biased as the OMB sample. Of course, standard statistical practice, which OMB would certainly insist on in agency scientific analyses, requires $p = .05$ or less to reject the null hypothesis of no effect.

In contrast, the Harrington et al. study mentioned earlier (Harrington et al. 2000), which found 3 underestimates of costs, 14 overestimates, and 11 accurate, passes the significance test with flying colors: using the same numerical scoring, the sample mean is .38, with a standard error of .13. The null hypothesis that the true mean is zero is clearly rejected, with $p = .005$; there is less than a 1% probability of getting the Harrington et al. result by chance if there is no real bias in advance cost estimates. (Note that Harrington et al. find a tendency to overestimate regulatory costs, while OMB alleges a tendency to overestimate benefit-cost ratios. Thus "overestimate" has opposite implications in the two contexts.)

Not only does the slight appearance of bias in the OMB study turn out to be statistically insignificant; it is also entirely due to OMB's treatment of the 13 OSHA rules. As shown in Table 1, all of the tilt toward overestimates comes from the OSHA rules, where OMB believes that overestimates of benefit-cost ratios are essentially the norm. (OSHA's 1974 vinyl chloride rule, discussed above, a famous case in which advance estimates of costs were far too high, did not make it into OMB's "convenience sample.") Among the non-OSHA rules in OMB's sample, underestimates slightly outnumber overestimates, although with $p > .5$ (see table) it is completely clear that this pattern is not statistically significant.

Table 1. OMB analysis of advance benefit-cost estimates

	Total	OSHA	All other
Accurate	11	2	9
Overestimate	22	11	11
Underestimate	14	0	14
p value for no bias	*.19*	*.00*	*.56*

As can be seen from a glance at the data, there is essentially no chance that the true mean, or bias, is the same for the OSHA and non-OSHA rules (statistically, the hypothesis that the two groups have equal means is rejected with $p < .00001$).

So in the end, the scant evidence of overestimates provided by OMB comes down to their treatment of the 13 OSHA rules. In 6 of the 13 cases, OMB relied on a single source, an article by Si Kyung Seong and John Mendeloff (Seong and Mendeloff 2004). That article discusses OSHA's tendency toward prospective overestimates of benefits, suggesting several explanations. Prospective estimates from regulatory agencies typically assume complete implementation of proposed rules, whereas retrospective evaluations reflect actual, potentially incomplete implementation. The availability of data on workplace fatalities improved significantly in 1992, allowing more accurate estimates of reduced mortality due to regulations; 9 of the 13 OSHA rules in the OMB study were adopted before 1992. Seong and Mendeloff also suggest that OSHA is more likely to be inaccurate in analyzing less expensive rules, which naturally receive less analytical effort; and they conclude that OSHA systematically overestimates the benefits of training programs.

Thus the allegation that OSHA overestimates benefits could simply reflect the agency's beleaguered status. Ever since the Reagan administration, OSHA has been particularly hard-hit by industry and conservative attacks, budget cuts, and defeats in the courts. As a result, OSHA may be more constrained and powerless than other regulatory agencies. It is all too believable that OSHA is constantly planning on complete implementation of its rules but unable to achieve it, or that it has been forced to stick to small proposals, frequently involving nothing more than training programs. According to Seong and Mendeloff, the result would be a pattern of overestimation of benefits of OSHA regulations. This is an important story, but it bears no resemblance to OMB's suggestion of a pattern of systematic overestimation of benefit-cost ratios by government agencies.

5. Opportunity costs and growth-growth trade-offs

The previous sections have suggested several reasons to doubt that environmental regulations impose huge economic costs. This section turns to the economic context of the debate, arguing that even if regulatory costs look significant, deregulation might produce surprisingly little additional growth and personal consumption.

The costs of regulation do not consist of goods that would be of direct use to consumers; if regulation were rolled back, it would not be helpful to simply redistribute scrubbers, filters, catalytic converters and the like to other uses. Rather, the trade-off hypothesis must be that regulation requires the use of productive resources, principally labor and capital; in the absence of regulation, these resources could be used to produce consumer goods (or other desirable products). A related assumption, normally taken for

granted, is that expanding the available supplies of labor and capital would in fact increase the production of consumer goods.[4]

Yet the truth of that related assumption is less obvious than it might seem. Suppose that deregulation occurs during a recession. In that case, unemployed labor and capital are already available on the market; indeed, that is almost the definition of a recession. It is far from certain that increasing the surplus of idle labor and capital will produce any economic benefit in the short run.

Alternatively, suppose the deregulation occurs during an economic expansion. It is becoming increasingly standard practice for the Federal Reserve to maintain tight control of the pace of expansion, effectively preventing an acceleration of growth above a target level. In the late 1990s, for instance, economic growth was limited by Federal Reserve intervention -- not by regulations, or by the availability of labor or capital. Again, an increase in available productive resources might not have led to any additional output, income, or consumption in the short run. If deregulation had put more labor and capital on the market, the Fed might have simply clamped down harder to achieve its targets (Goodstein 1999).

In the long run, the availability of labor and capital must have something to do with the pace of economic growth. The manner in which that long run effect occurs, however, depends on macroeconomic mechanisms about which there is no consensus. Would additional labor and capital somehow accelerate the recovery from recession, or make the next recession less deep? In an expansion, would the Fed quickly notice that increased output is now possible without risking inflation, or would it take years -- perhaps even another business cycle -- for the Fed's targets to adjust to the additional resources? Both theoretical and empirical macroeconomic analysis would be required to have confidence about the answer to these questions.

A common critique of risk-reducing regulation today is that it should examine "risk-risk" trade-offs, considering not only the risk directly addressed by regulation, but also the offsetting risks that might be indirectly created by the regulation. It is equally the case that calculations involving the costs of regulation should examine the "growth-growth" trade-offs, considering not only the resources used in regulatory compliance, but the actual benefits available from using those resources elsewhere. In the short run, there may be no foregone growth at all. If the claim is that deregulation would create additional growth only in the long run, via slow, complex pathways, then the usual arguments about the need to discount future benefits would apply to this economic gain. Not only the extent of growth, but the timing, needs to be calculated in order to determine the real opportunity cost of the resources used to comply with regulations.

[4] The same discussion applies not just to consumer goods, but to any desirable goods that could be produced with the resources used for regulatory compliance. Likewise, it applies to the resources saved by avoiding new regulation, as well as the resources released by deregulation. For narrative simplicity, this section tells the story purely in terms of deregulation and consumer goods.

6. Is employment hazardous to your health?

A clever rhetorical strategy has appeared in recent economic arguments for deregulation. Rather than emphasizing the monetary costs of regulation per se, critics of regulation have converted these costs into numbers of deaths that supposedly result from the expenditures. Expensive regulations can thus be charged with "statistical murder." As Lisa Heinzerling and I have argued (Ackerman and Heinzerling 2004, chapter 3), the statistical murder theory is doubly fallacious. The correlation between income and mortality is weak in developed countries, except at very low income levels; different variants of the statistical murder story have used widely differing prices per life saved, resting on different indirect inferences from very limited data. Moreover, regulation does not remove money from the economy, so much as cause it to be spent in different sectors. Incomes decrease for those who produce and sell polluting products, but increase for those who develop, install, and operate pollution controls, monitor compliance, and research and debate regulatory options. Whether or not one considers this reallocation to be desirable, it is primarily a change in the composition, not the aggregate level, of national income.

But an even more decisive rebuttal is available. Remarkably enough, the statistical evidence shows that mortality decreases during recessions, and increases as employment rises. So even if the costs of regulation were large enough to matter (despite the evidence to the contrary in sections 2-4), and even if deregulation boosted economic growth and employment in the short run (despite the arguments to the contrary in section 5), the result might well be an increased death rate.

The evidence on mortality and business cycles is presented in a symposium in the December 2005 issue of the International Journal of Epidemiology. The lead article, by José A Tapia Granados, presents and analyzes data for the US throughout the 20th century (Tapia Granados 2005a). Age-adjusted mortality rates are significantly, negatively correlated with unemployment rates -- meaning that death rates go up when unemployment goes down -- for the population as a whole, and separately for men and women, and for whites and nonwhites. The relationship is strongest for the working age population.

Looking at individual causes of death, in the late 20th century (after 1970) deaths from traffic accidents, major cardiovascular diseases, and cirrhosis of the liver were all significantly, negatively related to the rate of unemployment. In earlier periods, there was also a strong relationship between employment and flu and pneumonia deaths, and a weaker but significant relationship with cancer deaths, in the same "perverse" direction. Of the major causes of death examined in the article, only suicide shows the naïvely "expected" pattern of worsening when unemployment rises.

Another study, by Christopher Ruhm, similarly found that for 1972-1991, increased unemployment was associated with decreases in total mortality in eight of 10 major causes of death (Ruhm 2000). The two exceptions were Ruhm's findings of no

significant relationship between unemployment and cancer deaths, and, as in the study discussed above, more suicides at times of higher unemployment.

When more people are working, there is more traffic and therefore more traffic fatalities. There is also more stress at work and hence more cardiovascular disease. During economic upturns, alcohol and tobacco consumption increase, as does obesity; meanwhile, time spent on exercise, sleep, and social interactions all decrease. In the past, workplace contagion may have caused deaths by spreading infectious diseases such as flu and pneumonia. Even though some underlying causes of mortality, such as stress, involve chronic, long-term conditions, the timing of deaths may reflect short-term triggers related to employment. Heart attacks among the working age population are known to peak on Mondays (Willich et al. 1994).

Although counterintuitive, the finding of an association between increased employment and increased mortality is not new. Peer-reviewed publications making this point date back to 1922, and have continued throughout the intervening years. Most have been in public health journals, although at least one has appeared in a leading economics journal (Ruhm 2000). US, Canadian, and British data all support the idea that recessions are somehow better for health. One epidemiologist, M. Harvey Brenner, has long challenged this finding (Brenner 2005), but Tapia and Ruhm both provide effective critiques of Brenner's statistical methodology (Ruhm 2000; Tapia Granados 2005b). Tapia maintains that Brenner has used excessively complicated models with too little data to validate them, undermining the credibility of his time series results. Ruhm suggests that Brenner's earlier study of a 40 year span from the 1930s to the 1970s primarily reflects the decline in mortality that occurred as the US emerged from the 1930s depression. This era witnessed important medical and nutritional advances, as well as rising incomes and declining unemployment.

Two other major objections should be noted. First, at an individual level, death rates are higher for the unemployed than for the employed. This is not incompatible with the aggregate pattern. Perhaps mortality is always higher for the unemployed than for the employed, but is higher for each group during economic expansions than during recessions. Then it is easy to construct numerical examples in which overall mortality increases during expansions (Tapia Granados 2005b).

Second, over the long run it is clear that rising incomes have been associated with falling death rates. However, the correlation is not perfect; the periods of fastest declines in death rates are not the times of fastest increase in incomes. The long-run decreases in mortality may be caused by changes that are only loosely correlated with income, such as improvements in sanitation, public health, and achievement of minimum nutritional standards. Over the long run, the decrease in mortality rates is one of the most important effects of economic development; but this need not imply any relationship to short-term economic fluctuations in an already developed country. Small gains in average income, hypothesized to occur as a result of deregulation, could be associated with no improvement, or even worsening, in public health and nutritional standards for the poor.

Needless to say, there is not much left of the anti-regulatory "statistical murder" story once this perspective on unemployment and mortality is acknowledged.

7. Conclusion

This article has presented several pieces of the picture of regulatory costs; by way of conclusion, it may be helpful to briefly summarize the argument as a whole.

Reports of the economic burden imposed by regulatory costs have been greatly exaggerated. The widely imagined trade-off between economic prosperity and environmental protection rests on multiply mistaken premises. Many environmental policies impose little or no net costs on the economy; even when regulatory costs appear significant, there may be no short run opportunity to exchange those costs for additional economic growth; and even when growth occurs, it may not lead to desired outcomes such as reduced mortality.

Even a policy as ambitious as REACH will lead to very small cost increases, raising the price of chemicals sold in Europe by an estimated 1/16 of 1%. Claims of ominously greater impacts appear primarily in industry-funded studies, the most detailed of which relies on an idiosyncratic and indefensible methodology. Likewise, there is little evidence of jobs actually lost to regulations, outside of a few of the most environmentally damaging, extractive industries. The "pollution haven hypothesis," suggesting that companies move to regions or countries with more lenient environmental regulations, has been rejected by virtually all analysts who have studied the question.

Several researchers have found that prospective estimates of the costs of regulation are more likely to be too high than too low. One of the principal voices rejecting this finding is that of OMB, which has maintained in its annual reports that regulatory costs may be underestimated or benefit-cost ratios overestimated in advance. The grounds for this contrary conclusion include citation of a limited number of unconvincing studies, and manipulation of a regulatory data set which does not show a statistically significant tendency toward overestimates of benefit-cost ratios.

Even when regulations have significant costs, it is not necessarily the case that these costs are fungible. In a recession, idle economic resources are already available and are not creating short-run growth; in an expansion, the Federal Reserve may enforce predetermined limits on the pace of growth in order to prevent inflation. It is now common to discuss the need for a "risk-risk analysis," comparing old risks alleviated by policies to the new risks created by the same process. It is equally necessary to consider a "growth-growth analysis," comparing economic costs imposed by policies to the actual opportunity cost of the same resources used elsewhere.

Finally, even if growth were to occur as a result of deregulation, it is not certain that it would lead to the anticipated beneficial consequences, such as reduced mortality. A remarkable line of empirical research demonstrates that in the US and several other

countries in the 20th century, age-adjusted mortality rates increased during economic expansions and declined during recessions. The rhetorical equation of regulations with reduced growth and increased mortality, dubbed "statistical murder" by regulatory critics, turns out to be dead wrong.

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July 25, 2006

David Frulla, Esquire
Kelley Drye Collier Shannon
3050 K Street, N.W., Suite 400
Washington, D.C. 20007

Dear Mr. Frulla:

Thank you for appearing at the legislative hearing on H.R. 682, the "Regulatory Flexibility Improvements Act," on July 20, 2006. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on this matter.

We have enclosed for your review a copy of the official transcript of this hearing. The transcript is substantially a verbatim account of remarks actually made during the hearing. Accordingly, please only make corrections addressing technical, grammatical, or typographical errors. No substantive changes are permitted. Please return any corrections you have by Friday, August 11, 2006, to Leslie Prill, Staff Assistant for the Subcommittee on Commercial and Administrative Law, B353 Rayburn House Office Building, Washington, DC 20515. If you have any questions, please feel free to contact Susan Jensen, Subcommittee Counsel, at (202) 225-2825.

In addition, Subcommittee Members were given the opportunity to submit written questions to the witnesses pursuant to the unanimous consent request agreed upon at the hearing. These questions are annexed. Your responses will help inform subsequent legislative action on

this important topic. Accordingly, please submit your written responses to these questions by Friday, August 11, 2006, to Ms. Prill at the aforementioned address. Your responses may also be submitted by e-mail to: leslie.prill@mail.house.gov.

Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

CC\lbp
Enclosure

Questions for David Frulla
Kelley Drye Collier Shannon

1. As you may know, OMB Watch has criticized H.R. 682. I quote:

   By requiring agencies to review all such rules every ten years, this bill would drain agency resources by diverting them away from protecting the public and into navel-gazing analyses. Even proven protections such as the ban on lead in gasoline and safeguards protecting workers against black lung would be subject to these reassessments. These analyses would be even more burdensome than under current law, because the bill would force agencies to calculate reasonably foreseeable indirect economic effects, which agency representatives at a recent Senate roundtable suggested would be so speculative as to be useless for policymakers.

   What is your response?

2. The GAO has recommended that Congress provide greater clarity concerning the key terms and provisions of the Regulatory Flexibility Act.

   To what extent does H.R. 682 address these concerns?

3. The GAO cites several questions that it says "remain unresolved." What is your response to the two questions noted below?

   Should agencies review rules that had a significant impact at the time they were originally published, or only those that currently have that effect?

   Should agencies conduct regulatory flexibility analyses for rules that have a positive economic impact on small entities, or only for rules with a negative impact?

4. How do you respond to OMB Watch's assertion that H.R. 682 purportedly gives corporate interests a greater advantage in the regulatory process by allowing the Office of Advocacy of the Small Business Administration to preview proposed rules before they are published in the Federal Register?

KELLEY DRYE
COLLIER SHANNON

August 11, 2006

VIA HAND DELIVERY

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives Committee on the Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515-3951

Re: Your July 25, 2006, Letter Regarding July 20, 2006, Hearing on H.R. 682

Dear Chairman Cannon:

Thank you again for the opportunity to testify on July 20th before the Subcommittee on Commercial and Administrative Law regarding H.R. 682, the Regulatory Flexibility Improvements Act. As I explained in my testimony, the Regulatory Flexibility Act is an important law, and it should be amended to effectuate its long-standing congressional purposes and address issues that have arisen since enactment of the Small Business Regulatory Enforcement Fairness Act.

In this letter, I will respond, in writing, as you requested, to your follow-up questions to me contained in your July 25, 2006 letter. In the interests of conserving space, I have not reproduced your detailed questions, but have attached them to this letter. I also attach corrections to my transcript consistent with the instructions in your letter. My answers to your questions are as follows:

1. OMB Watch may criticize agencies' duty under the RFA, 5 U.S.C. § 610, to review their regulations every ten years, but that has been the law for more than 25 years. A newly published law review article by a former Assistant Chief Counsel for Advocacy has demonstrated empirically that Federal agencies have routinely failed to meet their Section 610 review obligations. In fact, the author's research into agency review rates reveals that agencies fail to review almost all required rules. Michael R. See, *Willful Blindness: Federal Agencies' Failure to Comply with the Regulatory Flexibility Act's Periodic Review Requirement—And Current Proposals to Invigorate the Act*, 33 FORDHAM URB. L.J. 1199, 1214-18 (2006). (A copy of this law review article is attached.) Further, an agency that does conduct a Section 610 review is ten times more likely to do nothing or increase small business burdens than actually to reduce the impact of its rules on small entities. *Id.* at 1218-19. Congress should ensure that agencies comply with the laws it has passed. OMB Watch would certainly agree that agencies should comply in substance with the Nation's environmental and consumer protection laws. The RFA, and Section 610, should be accorded the same respect.

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Finally, with respect to the issue of indirect benefits, I explained in both my written and oral testimony, and SBA Chief Counsel for Advocacy Thomas M. Sullivan explained in his oral testimony, that the "indirect effects" standard should address reasonably foreseeable impacts on small businesses that are the targets of the agency regulation in question. This is a matter that can be addressed with careful legislative language, as well as with RFA implementing regulations developed by the SBA Chief Counsel. See my response to Question 2, *infra*.

2. For years, GAO has recommended revision of key RFA terms, such as "significant impact" and a "substantial number." Section 10(a) of H.R. 682 would, through enactment of a new 5 U.S.C. § 613, require the Chief Counsel for Advocacy to develop and promulgate "rules governing compliance with" the RFA. This important provision has two benefits that I explained in detail in my written testimony. First, it would allow the "expert" Office of Advocacy to develop a comprehensive set of definitions for the RFA's key terms and provisions. Based on its years of experience, the SBA Office of Advocacy can more effectively develop these definitions through a rulemaking process than the Congress could reasonably expect to do through legislation.

   In my testimony, I also explained that, in my experience, certain agencies employ parochial and counter-statutory definitions of key RFA terms. For instance, the Environmental Protection Agency bases a determination of a significant economic impact on a small business's gross revenues, as opposed to its profitability, and a court has deferred to EPA's approach because the EPA had the authority to develop its own RFA implementing guidelines. *Ad Hoc Metals Coalition v. Johnson*, 1:01cv0766 (PLF) (D.D.C., Jan. 20, 2006). The SBA Office of Advocacy, however, correctly identifies profitability as the relevant metric in determining what impacts a business can withstand, rather than gross revenues. Small Business Administration Office of Advocacy, *A Guide for Government Agencies: How to Comply With the Regulatory Flexibility Act* (May 2003), 17-18. Second, providing such rule-writing authority to the Office of Advocacy would establish that courts should defer to the Office of Advocacy's regulations defining the types of RFA terms to which the GAO recommendations apply.

3. a. Having agencies determine in their Section 610 reviews which rules currently have a significant economic impact on a substantial number of small entities—assuming they do so in a fair and impartial way—would focus agency resources on those regulations that are burdening small businesses and other small entities at the present time. Such an approach could help tailor agency work-load to the greatest current effect. However, consideration of the current impact of rules that had a significant economic impact on a substantial number of small entities when implemented does not represent an academic exercise. For instance, industries that once had a preponderance of small entities may have changed in character through consolidation or other factors in a decade, perhaps due in whole or material part to the impactful regulatory regime. In fact, these regulations might have forced industry consolidation or served as an effective barrier to entry for small businesses. It is important for an agency to determine and recognize when its regulations are themselves either causing or contributing to a change in the economic structure of a sector of the regulated community. It may be equally important for an agency to mitigate such effects on small entities once these effects are recognized.

b. The RFA's legislative history provides that:

> Agencies may undertake initiatives which would directly benefit such small entities. Thus, the term "significant economic impact" is neutral with respect to whether such impact is beneficial or adverse. The statute is designed not only to avoid harm to small entities but to promote the growth and well-being of such entities.

126 Cong. Rec. H8,468 (daily ed., Sept. 8, 1980). This is as true today as it was in 1980. Further, the law should make clear that the RFA is not designed to minimize any such beneficial impacts. Also, an economic impacts analysis that considers not only the burdens, but any benefits, of a proposed rule on small entities, would provide a fairer understanding of its impact. The Office of Advocacy has addressed this issue in detail in its *Guide for Government Agencies*, at 21-22.

4. In "corporate interests," OMB Watch appears to be including the millions of mom-and-pop businesses in the U.S. with fewer than five employees that are among the entities Congress intended to protect in the RFA. The RFA's legislative history explains that Congress found in the late 1970's that small businesses were confronting comparatively large and disproportionate regulatory burdens and that small businesses had no ability to contest or seek to ameliorate these regulatory impacts, even if they were aware that a proposed rule was being considered. Accordingly, Congress created the Office of Advocacy within the SBA to ensure these small businesses had a responsible entity available to assist them in a comprehensive and organized way. Congress reaffirmed and expanded the Office of Advocacy's leading role in SBREFA, including by developing the panel process.

   Moreover, early notice can help make a rulemaking more efficient and minimize the potential for RFA analyses and regulatory adjustments to cause any potential delay in the rulemaking process—a goal OMB Watch would presumably support. Such notice can thus help ensure that a proposed rule employs accurate information and develops tailored and useful alternatives where appropriate. The rulemaking would then not have to be side-tracked to develop new alternatives or fix inaccurate information after the notice and comment stage. Furthermore, timely public input into the rulemaking process through panels and other informal means is fully consistent with recent trends in administrative law and procedure to ensure informed agency decision-making. For its part, the SBA Office of Advocacy has issued a series of reports to Congress which, among other things, detail how SBREFA has been effective in helping to tailor agency regulations overall and in specific instances.

* * *

Thank you for the opportunity to submit these additional views. Please do not hesitate to contact me if you have any questions or require additional information.

Sincerely,

David E. Frulla

Enclosures
(1) List of Questions
(2) Edited Transcript
(3) Law Review Article