THE GEORGE WASHINGTON UNIVERSITY

WASHINGTON, DC

Prepared Statement of Sofie E. Miller & Daniel R. Pérez
The George Washington University Regulatory Studies Center

Hearing on

Examining How Small Businesses Confront and Shape Regulations

Small Business & Entrepreneurship Committee

United States Senate

March 29, 2017

The George Washington University Regulatory Studies Center
805 21st St. NW, Suite 612
Washington, DC 20052
202-994-7543
RegulatoryStudies@gwu.edu
www.RegulatoryStudies.gwu.edu

Introduction

Thank you Chairman Risch, Ranking Member Shaheen, and Members of the Committee for inviting us to submit for the record our research on the effects of regulation on small businesses and potential prospects for regulatory reform. Sofie E. Miller[1] and Daniel R. Pérez[2] are Senior Policy Analyst and Policy Analyst, respectively, at the George Washington University Regulatory Studies Center,[3] where we analyze the effects of regulation on public welfare.

We appreciate the Committee's interest in regulatory reform, including its effects on small businesses. The focus of our work at the George Washington University Regulatory Studies Center is on federal regulatory policies, processes, and reforms. While we do not focus exclusively on the effects of regulation on small businesses, our research on regulatory best practices and process is directly related to several of the provisions of the legislation being considered here today. With that in mind, our prepared statement includes the following points:

- Small businesses are often indirectly burdened by federal regulation, and these indirect costs are not accounted for in the current regulatory flexibility analysis framework. While exploring opportunities to remedy this oversight, the Committee should be careful to avoid measures of indirect costs that would include double-counting, and may want to consider legislative language that ensures the indirect costs of implementing regulations (such as state implementation plans) are duly considered.
- Regulatory review is an important component of a healthy regulatory process. An evidence-based regulation framework can be helpful for conceptualizing such a review process, and may assist in informing the Committee's efforts to enhance review of rules that impact small entities.
- To the extent that any legislative changes codify regulatory best practices, such as those found within Executive Order 12866, this may successfully strengthen Congress' oversight of agency compliance.
- Efforts to increase the opportunities for small businesses to participate early in the rulemaking process could be valuable in improving regulatory outcomes. However, the Committee should consider potential tradeoffs associated with doing so—with particular attention on possible unintended effects that reduce the efficacy of the existing SBAR process.

---

[1] Sofie E. Miller is a Senior Policy Analyst at the George Washington University Regulatory Studies Center, 805 21st St. NW, Suite 612, Washington, DC. Sofie can be reached at sofiemiller@gwu.edu.

[2] Daniel R. Pérez is a Policy Analyst at the George Washington University Regulatory Studies Center, 805 21st St. NW, Suite 612, Washington, DC. Daniel can be reached at danielperez@gwu.edu.

[3] This testimony reflects the views of the author, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at http://regulatorystudies.columbian.gwu.edu/policy-research-integrity.

The Effects of Regulation on Small Business

Considering the effects of regulation on small businesses is important for at least three reasons. First, as a subsection of regulated industry, they often bear a disproportionate share of regulatory and paperwork burdens relative to larger entities.[4] Second, these larger entities often support agency efforts to regulate since the costs they face from increased levels of regulation can be spread over more employees and capital, and often are outweighed by the benefits created from reduced competition as barriers to entry in the market are increased.[5] Finally, research indicates that the entry of new, often small, firms into the market is an important driver of an economy's aggregate productivity via increased innovation.[6] It is therefore important for agencies to consider the likely effects of their proposed regulations on small businesses to better account for the full costs and benefits of regulation on the public.

Ensuring Reforms are Evidence-Based

Historically, both presidents and members of Congress have recognized the importance of considering the effects of regulation on small businesses and have instituted various executive and legislative requirements, respectively, on the regulatory process for collecting data and assessing input from small businesses during the rulemaking process. More recently, bipartisan effort to create the Commission on Evidence-Based Policymaking (CEP) via passage of the Evidence-Based Policymaking Commission Act of 2016 indicates Congress' commitment to improving the results of government programs by strengthening evidence-based approaches.

Since regulation is a distinct subset of federal policymaking with many existing legal requirements governing the rulemaking process, the George Washington University Regulatory Studies Center submitted a public interest comment to the Commission offering an integrated framework for a system that produces evidence-based regulation (EBR). This process is summarized in the appendix on page 11 of this statement. As we submitted to CEP: "an EBR process plans for, collects, and uses evidence throughout the life of a regulation to predict, evaluate and improve outcomes."

Congressional efforts to advance legislation that expands the use of evidence and improves agency performance in analyzing the impacts of regulation on small businesses can lead to improved regulatory decisions and better outcomes. The following submission outlines several

---

[4] Nicole V. Crain and Mark Crain. "The Impact of Regulatory Costs on Small Firms" Prepared for Small Business Administration Office of Advocacy, September 2010. Available at: https://www.sba.gov/sites/default/files/The%20Impact%20of%20Regulatory%20Costs%20on%20Small%20Firms%20(Full).pdf

[5] Bruce Yandle, Bootleggers and Baptists, REGULATION, May/June 1983.

[6] Davis, S. J., Haltiwanger, J. C., & Schuh, S. (1996). Job Creation and Destruction. Cambridge, Mass.: MIT Press.

aspects of the regulatory process that may be useful to consider in designing legislative reforms focused on small businesses.

Small Business Regulatory Flexibility Improvements Act

The Small Business Regulatory Flexibility Improvements Act (S. 584) would make a number of amendments to the Regulatory Flexibility Act (RFA), which directs federal regulatory agencies to identify regulations that affect small businesses. Below we discuss three proposed amendments and their potential impacts on the regulatory process and the regulated community.

Consideration of Indirect Costs to Small Businesses

S. 584 would provide a definition of the "economic impact" that agencies are charged with assessing to include "any indirect economic effect (including compliance costs and effects on revenue) on small entities which is reasonably foreseeable and results from such rule (without regard to whether small entities will be directly regulated by the rule)." This change would have a profound effect on which rules are included in the regulatory flexibility agenda and subject to regulatory flexibility analysis and §610 review, and would bring the standards for such analyses into closer alignment with existing best practices on agency benefit-cost analysis.

The Office of Management and Budget's Circular A-4, "Regulatory Analysis," instructs agencies to look beyond the direct costs and benefits of regulation and identify the indirect effects of regulation as well (i.e. the "expected undesirable side-effects and ancillary benefits").[7] According to Circular A-4:

> Your analysis should look beyond the direct benefits and direct costs of your rulemaking and consider any important ancillary benefits and countervailing risks. An ancillary benefit is a favorable impact of the rule that is typically unrelated or secondary to the statutory purpose of the rulemaking (e.g., reduced refinery emissions due to more stringent fuel economy standards for light trucks) while a countervailing risk is an adverse economic, health, safety, or environmental consequence that occurs due to a rule and is not already accounted for in the direct cost of the rule (e.g., adverse safety impacts from more stringent fuel-economy standards for light trucks).[8]

Despite these articulated best practices, courts have not interpreted the RFA's economic impact assessment requirements to include indirect costs to small businesses. According to former Small

[7] Office of Management and Budget. *Circular A-4 to the Heads of Executive Agencies and Establishments: Regulatory Analysis.* September 17, 2003. Available at https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf

[8] Ibid, Page 26.

Business Administration Chief Counsel for Advocacy Thomas Sullivan, this interpretation is "[the] biggest loophole in the RFA" because the limited analysis "deprives policymakers of a full understanding of a rule's likely impact on small entities."[9]

A classic example of the shortcoming of the current definition of "economic impact" is the National Ambient Air Quality Standards (NAAQS). Pursuant to the Clean Air Act, the Environmental Protection Agency (EPA) issues recurring NAAQS rulemakings restricting the emissions of six criteria air pollutants: ozone, particulate matter (PM), carbon monoxide, nitrogen dioxide, sulfur dioxide, and lead.[10] In these rulemakings, EPA sets an emissions threshold, compliance with which state and local environmental protection agencies are responsible by instituting "state implementation plans." Despite the very significant costs of EPA's NAAQS regulations,[11] they are not considered to have a direct economic impact on small businesses because the ultimate enforcement and implementation falls to the states. Such an approach disregards the significant indirect costs that small businesses bear as a result of federal regulation.[12]

Bounding "Indirect Costs"

In broadening the definition of "economic impact," Congress and agencies should be cautious of using a definition that is so broad it may lead to double-counting the costs of regulation. For example, a regulation that requires an expensive manufacturing retrofit has upfront costs to the manufacturer that are accounted for in a traditional benefit-cost analysis. This upfront cost may also have downstream effects, such as higher consumer costs or a loss of jobs. Counting the direct cost of retrofitting (upstream) and the indirect costs of job loss (downstream) would be counting the same costs both upstream and downstream, and as a result would be double-counting.[13] Congress and regulatory agencies should be cautious about using a definition that is

---

[9] Hearing on Legislation to Improve the Regulatory Flexibility Act Before the H. Comm. on Small Business, 110th Cong. (2007) (testimony of Thomas Sullivan, Chief Counsel for Advocacy, Small Business Administration), available at https://archive.org/stream/gov.gpo.fdsys.CHRG-110hhrg39383/CHRG-110hhrg39383#page/n45/mode/1up

[10] U.S. Environmental Protection Agency. "NAAQS Table," available at https://www.epa.gov/criteria-air-pollutants/naaqs-table%20

[11] See, for example: U.S. Environmental Protection Agency. "Regulatory Impact Analysis for the Final Revisions to the National Ambient Air Quality Standards for Particulate Matter." EPA-452/R-12-005. December 2012. U.S. Environmental Protection Agency. "Final Ozone NAAQS Regulatory Impact Analysis." EPA-452/R-08-003. March 2008.

[12] Keith Holman. "The Regulatory Flexibility Act at 25: Is the Law Achieving Its Goal?" *33 Fordham Urban Law Journal* 1119 (May 2006).

[13] Brian F. Mannix discusses the problems with counting both upstream and downstream costs of regulation as they pertain to changes in employment. See Brian F. Mannix, "Employment and Human Welfare: Why Does Benefit-Cost Analysis Seem Blind to Job Impacts?" in *Does Regulation Kill Jobs?* edited by Coglianese Cary, Finkel Adam M., and Carrigan Christopher, 190. University of Pennsylvania Press, 2013.

broad enough to include double-counting while considering how to expand the scope of the "economic impacts" that are relevant for agencies to assess.

In addition, S. 584§2(b)9(B) specifies that consideration of "indirect economic impact" extends to impacts that are "reasonably foreseeable" from the rule at hand. The Committee may want to consider language that specifically denotes the consideration of the impacts on small businesses of state implementation of federal rules (see the NAAQS example above). For example, in the 112th Congress, Senator Snowe offered Senate Amendment 299 to S.493, the SBIR/STTR Reauthorization Act of 2011, which addressed this consideration using the following language:[14]

> Section 601 of title 5, United States Code, is amended by adding at the end the following:
>
> (9) the term 'economic impact' means, with respect to a proposed or final rule—
>
> (A) the economic effects on small entities directly regulated by the rule; and
>
> (B) the reasonably foreseeable economic effects of the rule on small entities that—
>
> …(ii) are directly regulated by other governmental entities as a result of the rule…

The language in (9)B(ii) above addresses indirect costs borne by small entities as a result of state regulations that implement federal rules to ensure that important economic effects are not excluded.

Modifying Requirements for Agency Regulatory Flexibility Analysis

S. 584 would expand the requirements for agencies' regulatory flexibility analyses to include detailed statements that include 1) describing the reasons why action by the agency is being considered; 2) describing the objectives of, and legal basis for, the proposed rule; and 3) estimating the number and type of small entities to which the proposed rule will apply. To the extent that the requirements contain similar language to Executive Order (EO) 12866, codifying these requirements may make agencies more responsive to them, encourage accountability, increase transparency, and encourage an evidence-based regulatory approach.[15]

[14] Legislative text available here: https://www.congress.gov/amendment/112th-congress/senate-amendment/299/text

[15] Marcus Peacock, Sofie E. Miller, and Daniel R. Pérez. "Public Comment to the Commission on Evidence-Based Policymaking. The George Washington University Regulatory Studies Center. November 08, 2016. Available at https://regulatorystudies.columbian.gwu.edu/public-comment-commission-evidence-based-policymaking

Executive Order (EO) 12866 has underpinned federal regulatory policy and processes since it was signed by President Clinton in 1993, and it has been upheld by both Republican and Democratic presidents in the intervening 24 years. EO 12866 established both a regulatory philosophy and 12 principles of regulation to guide federal regulatory agencies as they write, analyze, and review their regulations. This EO provides agencies with important, nonpartisan standards to improve regulatory process, regulatory analysis, and regulatory outcomes. While President Trump has issued new cross-cutting regulatory executive orders, they appear to supplement, rather than replace, EO 12866.[16]

Effects on the Role of the Chief Counsel for Advocacy

S. 584 proposes changes regarding both the procedure and scope pertinent to preparing an initial regulatory flexibility analysis required under §603. Several of these revisions—including both the definition of what constitutes a "rule" and which agencies are required to comply with the statute—would significantly broaden the participation of the Chief Counsel for Advocacy of the Small Business Administration (SBA).

As currently worded, the bill would change the definition of what is considered a "rule" to the broadest definition contained within the Administrative Procedure Act.[17] The new definition would include: amendments to previously issued rules, general statements of agency policy, agency guidance, and interpretive rules. Additionally, this bill removes the current designation of a "covered agency," currently defined in §609(d) to mean only (1) the Environmental Protection Agency; (2) the Consumer Financial Protection Bureau of the Federal Reserve System; and (3) the Occupational Safety and Health Administration of the Department of Labor.

While it is difficult to quantify the number of additional small business advocacy review (SBAR) panels this would create, it is reasonable to assume that this would require significantly more analyses and coordination of comments from the small business community by the Chief Counsel for Advocacy and the Office of Information and Regulatory Affairs. S. 584 seems to explicitly recognize this in Sec. 13. Comptroller General Report:

> Not later than 90 days after the date of enactment of this Act, the Comptroller General of the United States shall complete and publish a study that examines whether the Chief Counsel for Advocacy of the Small Business Administration has the capacity and resources to carry out the duties of the Chief Counsel under this Act and the amendments made by this Act.

[16] Susan E. Dudley. "Latest Trump Executive Order Provides Guidance on 'Enforcing the Regulatory Reform Agenda'." The George Washington University Regulatory Studies Center. February 27, 2017. Available at https://regulatorystudies.columbian.gwu.edu/latest-trump-executive-order-provides-guidance-%E2%80%9Cenforcing-regulatory-reform-agenda%E2%80%9D

[17] 5 U.S.C. §551(4).

As the Center has previously suggested, the problem of inadequate funding can often be addressed by the reallocation of resources within an agency.[18]

Affecting the Timing of SBAR Panels

Part of the value of an agency consultation with an SBAR panels derives from the timing of this practice within the rulemaking process. Currently, EPA, CFPB, and OSHA are required to "assure that small entities have been given an opportunity to participate in the rulemaking process"[19] for any rule "which will have a significant economic impact on a substantial number of small entities."[20] Small business panel members have a chance to meet with agency officials to exchange data and talk through potential regulatory alternatives early in the process—before an agency has already decided on a particular regulatory approach. Research indicates that considering alternatives early in the rulemaking process is a particularly valuable best practice.[21] This essentially allows small business to have "a voice" earlier in the process relative to the general public, which only provides public comment during normal notice and comment periods.

It may be valuable for Congress to consider the effect of its proposed revision to §609, which may create the unintended consequence of reducing the value of the SBAR process. S. 584 proposes striking subsection (b) of §609 which currently states: "Prior to publication of an initial regulatory flexibility analysis…a covered agency shall…" and replacing it with: "(b)(1) Prior to publication of any proposed rule…an agency shall…" The Committee should ensure that this does not inadvertently relax statutory requirements for agencies to include SBAR review early in their regulatory process.

Expanding Requirements for Periodic Review of Rules

Various Executive Orders and Congressional statutes require agencies to conduct analyses prior to issuing regulations; these requirements create incentives for agencies to focus significant resources on their *ex ante* predictions of the future effects of proposed rules. These expert predictions, however, rely on several assumptions about uncertain future market conditions, prices, and consumer behavior.[22] Retrospective review (*ex post* analysis) provides a valuable opportunity for agencies to measure the actual impacts of their regulations and compare them

[18] Peacock, Miller, and Pérez. 2016

[19] 5 U.S.C. §609(a).

[20] 5 U.S.C. §602(a)(1).

[21] Carrigan, C., and Shapiro, S. (2016) What's wrong with the back of the envelope? A call for simple (and timely) benefit–cost analysis. Regulation & Governance, doi: 10.1111/rego.12120.

[22] Susan E. Dudley, Brian F. Mannix, Sofie E. Miller, and Daniel R. Pérez. "Public Comment on OMB's Interim Guidance Implementing Section 2 of the Executive Order Title 'Reducing Regulation and Controlling Regulatory Costs,'" The George Washington University Regulatory Studies Center. February 10, 2017. Available at https://regulatorystudies.columbian.gwu.edu/public-comment-omb%E2%80%99s-interim-guidance-implementing-section-2-executive-order-titled-%E2%80%9Creducing

with *ex ante* predictions. These *ex post* analyses not only improve future agency ex ante predictions but can also help agencies fulfill existing requirements to "modify, streamline, expand, or repeal [existing rules] in accordance with what has been learned."[23] Unfortunately, although regulatory agencies are required to comply with the practice of regularly conducting retrospective review, agencies seldom conduct rigorous, routine review of their regulations.[24]

S. 584 modifies the statutory requirements under §610 of the RFA, which requires agencies to review each rule estimated to have a significant economic impact on a substantial number of small entities within ten years of a final rule's publication.[25] Notable additions include: changes that broaden the list of rules under review (where the head of an agency could determine that a rule should be included for review regardless of whether the agency originally conducted a RFA), a decrease in the maximum amount of time that the head of an agency can extend such reviews (from 5 years to 2), and a requirement that each agency submit an annual report of the results of its review to Congress. Researchers find that agencies exhibit historically low review rates in complying with §610.[26]

Enhancing codified requirements to conduct retrospective review such as §610 can serve as an incremental step in subjecting compliance to greater oversight by Congress. Designing regulations with a transparent plan for conducting retrospective review can provide a better framework for agencies to successfully conduct valuable *ex post* analysis.[27]

For instance, Senators Heitkamp and Lankford have proposed S. 1817, the Smarter Regulations Act, which is consistent with the Center's EBR framework (see appendix). This bill would require agencies to include a framework within major rules for conducting retrospective review which involves writing into the rule: the timeframe for reassessment, the metrics that will be used to gauge efficacy, and a plan for gathering the necessary data.[28] Such provisions would provide agencies with an incentive to think prospectively about how to retrospectively review their rules, and allow them to design their regulations in advance to improve the prospects for

[23] Executive Order 13563, "Improving Regulation and Regulatory Review" January 18, 2011.

[24] Sofie E. Miller, "Learning from Experience: Retrospective Review of Regulations in 2014," Working Paper, The George Washington University Regulatory Studies Center, November 2015. See also: Reeve T. Bull, "Building a Framework for Governance: Retrospective Review and Rulemaking Petitions," Admin. L. Rev., 67:265 (2015).

[25] 5 U.S.C. §610(a).

[26] 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," Fordham Urban Law Journal. Vol. 33, No. 4 (2005). See provides three reasons why compliance rates are likely low: 1) agencies "restart the clock" by amending regulations, 2) agencies often make determinations that rules are not actually affecting small entities, and 3) some agencies may simply be neglecting to comply. p. 121

[27] Susan E. Dudley. "Retrospective Evaluation of Chemical Regulations," OECD Environment Working Papers, No. 118. March 2017. Available at http://www.oecd-ilibrary.org/environment/retrospective-evaluation-of-chemical-regulations_368e41d7-en;jsessionid=nalggmwk9wyy.x-oecd-live-02

[28] Smarter Regs. Act of 2015, S. 1817, 114th Cong. (2015).

review. This approach could both institutionalize review and improve regulatory outcomes by helping agencies to think proactively about how to measure the success of their rules.

Closing Thoughts

The Committee is undertaking an important effort by considering the effects of federal regulation on small businesses. In particular, the consideration of indirect costs would have a significant effect on which rules are considered to have an impact on small businesses. The omission of these costs from previous analyses has disadvantaged small businesses, and as the Committee considers how to address these costs in future rulemakings it should be careful to clearly define which costs are being measured to avoid double-counting. The Committee may also consider statutory language clarifying that indirect costs incurred via implementing regulations (such as NAAQS state implementation plans) are included in this definition.

Efforts to increase the opportunities for small businesses to participate early in the rulemaking process and broaden the scope of rules that agencies can consider in their retrospective reviews could be valuable in improving both outcomes and predictions of future regulatory costs and benefits. Congress should consider any possible tradeoffs associated with doing so—with particular attention on not inadvertently reducing the value or effectiveness of the existing SBAR process. Additionally, to the extent that any legislative changes codify regulatory best practices, such as those found within Executive Order 12866, this may successfully strengthen Congress' oversight of agency compliance.

Finally, the Committee may be well served by delaying action on the legislation under discussion today until the Small Business Administration Office of Advocacy is staffed with a Chief Counsel. Congress could benefit greatly from the expertise of SBA Advocacy, and allowing time for this important position to be filled could provide the Committee with a useful perspective on the current process and how the proposed bills may change it.

APPENDIX[29]

Regulatory Studies Center

THE GEORGE WASHINGTON UNIVERSITY

Evidence-Based Regulation Framework

I. Regulatory Design

A. Identify the problem (state the "compelling public need").

B. Evaluate whether modifications to existing rules can address the problem.

C. Identify and assess available alternatives to direct regulation.

D. If regulating, determine that the preferred alternative addresses the problem.

E. Set clear performance goals and metrics for outputs and outcomes.

F. Exploit opportunities for experimentation.

G. Plan and budget for retrospective review.

II. Regulatory Decision-making

A. Assess the expected benefits, costs, and other impacts.

B. Clearly separate scientific evidence from policy judgments.

C. Make relevant data, models and assumptions available to the public.

III. Retrospective Review

A. Reassess planned retrospective review and modify if necessary.

B. Gather necessary data on regulatory outputs and outcomes.

C. Implement retrospective review plan.

D. Compare measured outcomes to original performance goals.

E. Reassess the rule using new information and the factors in the regulatory design.

[29] We have separately submitted our full public comment on Evidence-Based Regulation for the Congressional record; the full comment can be accessed on our website here: https://regulatorystudies.columbian.gwu.edu/public-comment-commission-evidence-based-policymaking