Office of Advocacy

*A Voice for Small Business*

409 3rd Street, SW ● MC 3114 ● Washington, DC 20416 ● 202/205-6533 ph. ● 202/205-6928 fax ●
www.sba.gov/advo

***Testimony of***

# *Thomas M. Sullivan*

***Chief Counsel for Advocacy***
***U.S. Small Business Administration***

***U.S. House of Representatives***
***Committee on Government Reform***
***Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs***

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| **Date:** | February 25, 2004 |
| **Time:** | 10:00 A.M. |
| **Location:** | Room 2247<br>Rayburn House Office Building<br>Washington, D.C. |
| **Topic:** | "How to Improve Regulatory Accounting: Costs, Benefits, and Impacts of Federal Regulations – Part II" |

*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 Ose and Members of the Subcommittee, good morning and thank you for giving me the opportunity to appear before you today. My name is Thomas M. Sullivan and I am the Chief Counsel for Advocacy at the U.S. Small Business Administration (SBA). Congress established the Office of Advocacy to represent the views of small business before Federal agencies and Congress. The Office of Advocacy is an independent office within the SBA, and therefore the comments expressed in this statement do not necessarily reflect the position of the Administration or the SBA.

Section 624 of the FY 2001 Treasury and General Government Appropriations Act, which was enacted as part of Pub. L.106-554, (referred to as the "Regulatory Right-to-Know Act"), directs the Office of Management and Budget (OMB) to quantify annually the costs and benefits of Federal regulations and to prepare a Report to Congress summarizing the results. Among other things, the Report to Congress is to include an analysis of the impacts of Federal regulations on small business. On February 13, 2004, OMB released the draft Report to Congress, entitled *Informing Regulatory Decisions: 2004 Draft Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities* (Draft OMB Report).

The Subcommittee asked that I provide the Office of Advocacy's assessment of the Draft OMB Report. Specifically, the Subcommittee requested Advocacy's views on (1) the adequacy of the Report's regulatory accounting statement, by agency and program, (2) the adequacy of the Report's analysis of the impacts of Federal regulations on specifically-identified groups, including small businesses, and (3) recommendations for improving future reports to Congress.

The Office of Advocacy's review of the Draft OMB Report has focused primarily on the treatment of small business impacts. Consequently, my comments on the overall report are couched in terms of the adequacy of the Draft OMB Report's discussion of regulatory impacts on small businesses and recommendations to help ensure that future reports quantify these impacts. My testimony today should be considered in conjunction with the comments and recommendations I provided to the Committee on Government Reform last year on regulatory accounting and OMB's Reports to Congress.[1]

In general, Advocacy believes that improving the regulatory analysis to delineate small business impacts, together with greater overall adherence to regulatory accounting requirements, will greatly improve the quality and transparency of the economic analyses provided to OMB under Executive Order 12866,[2] and will in turn allow OMB to develop more comprehensive Reports to Congress.

**The Impact of Federal Regulation on Small Business.**

The Draft OMB Report provides a general overview of the impact of Federal regulations on small entities without specifically quantifying those impacts. The Draft OMB Report acknowledges that Federal agencies need to recognize the impact of their regulations and paperwork burdens on small businesses, and lists the statutes and Executive Orders intended to require considerations of those impacts. The Regulatory Flexibility Act (RFA),[3] as amended by the Small Business Regulatory Enforcement

[1] Testimony of Thomas M. Sullivan, Chief Counsel for Advocacy, U.S. Small Business Administration, before the U.S. House of Representatives, Committee on Government Reform, July 22, 2003, on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003," available at http://www.sba.gov/advo/laws/test03_0722.html.
[2] Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993).
[3] Pub. Law No. 96-354, 94 Stat. 1164 (1980) *codified at* 5 U.S.C. § 601 *et seq.*

Fairness Act of 1996 (SBREFA),[4] Executive Order 12866, and Executive Order 13272[5] each call on agencies to tailor their regulations by business size to impose less burden while achieving regulatory objectives.

While the Draft OMB Report recognizes the importance of the regulatory burden on small business, it does not attempt to quantify the impact of that burden, beyond citing the 2001 Office of Advocacy-sponsored Crain-Hopkins study. The Crain-Hopkins study found that small businesses pay a disproportionately large share of the total Federal regulatory burden, which was estimated to total $843 billion in 2000.[6] For firms employing fewer than 20 employees, the annual regulatory burden in 2000 was estimated to be $6,975 per employee – nearly 60% higher than the $4,463 estimated for firms with more than 500 employees.[7]

To help address this disproportionate impact, the RFA, which was enacted in 1980, requires Federal regulatory agencies to determine the impact of their rules on small businesses, consider effective alternatives that minimize adverse impacts, and make their analysis available for public comment. The RFA was strengthened by SBREFA in 1996, and by Executive Order 13272 in August 2002. Executive Order 13272 requires agencies to establish written procedures and policies on how they consider the impact of their regulatory proposals on small businesses, notify Advocacy of draft rules that are expected to have a significant economic impact on a substantial number of small entities, consider Advocacy's comments on draft rules, and publish a response to Advocacy's comments in the final rule.

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[4] Pub. Law No. 104-121, 110 Stat. 857 (1996) *codified at* 5 U.S.C. § 601 *et seq.*
[5] Exec. Order No. 13,272, 67 Fed. Reg. 53,461 (Aug. 13, 2002).
[6] See *The Impact of Regulatory Costs on Small Firms*, an Advocacy-funded study by W. Mark Crain and Thomas D. Hopkins (October 2001), available at http://www.sba.gov/advo/research/rs207tot.pdf.
[7] *Id*.

As referenced in the Draft OMB Report, Advocacy's recently released its *Report on the Regulatory Flexibility Act, FY 2003* (FY 2003 RFA Report) in January 2004.[8] The FY 2003 RFA Report highlights those agencies that have successfully evaluated their draft rules' impacts on small businesses and have adopted less burdensome alternatives. These less burdensome alternatives saved small business more than $6 billion in 2003. Unfortunately, some agencies continue to fail to conduct small business impact analyses. The FY 2003 RFA Report documents agencies that do not comply with the RFA. Those agencies' failure to conduct an impact analysis when proposing new rules and regulations makes it nearly impossible to get an accurate picture of the true impact of their regulatory actions.

The Draft OMB Report does not attempt to quantify, on an annual basis, what the impact of Federal regulation actually is on small business. I suspect that OMB's Office of Information and Regulatory Affairs (OIRA) receives some rules from agencies accompanied by good economic analysis and some without. The Draft OMB Report would benefit from impact analyses that, at a minimum, should accompany all major rules reviewed by OIRA (e.g., rules expected to impose over $100 million in annual costs). From the Office of Advocacy's perspective, the Draft OMB Report would also benefit from *small business* impact analyses that should be prepared for rules reviewed by OIRA.

While Advocacy would have preferred to see a quantitative analysis of the regulatory impacts on small business in the Draft OMB Report, I would be remiss if I did not commend Dr. Graham and our colleagues in OIRA for their daily efforts to ensure

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[8] Office of Advocacy, *Report on the Regulatory Flexibility Act, FY 2003, The Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act and Executive Order 13272* (January 2004), available on the Office of Advocacy webpage, http://www.sba.gov/advo.

agencies' compliance with the Regulatory Flexibility Act through interagency review of proposed regulations.

On March 19, 2002, the President announced his Small Business Agenda, which included the goal of "tearing down the regulatory barriers to job creation for small businesses and giv[ing] small business owners a voice in the complex and confusing federal regulatory process."[9] To accomplish this goal, the President sought to strengthen the Office of Advocacy by enhancing its relationship with OIRA and directing agencies to work closely with Advocacy and properly consider the impact of their regulations on small entities pursuant to Executive Order 13272. Advocacy and OIRA signed a Memorandum of Understanding (MOU) to ensure the two offices work closely together as early as possible in the regulation development process to address small business issues, particularly as they relate to disproportionate regulatory burden.[10] Together, the two offices are able to work with Federal agencies to make improvements in their impacts analyses, help ensure that small business issues are addressed and, where possible, ease regulatory burdens. With a focus on information sharing between Advocacy and OIRA during interagency review of draft rules under Executive Order 12866, the two offices work collaboratively to address small business concerns early in the rulemaking process. Much of our success in making Federal agencies more accountable to small entities, as documented in the 2003 RFA Annual Report, is due to our close working relationship with OIRA.

Furthermore, OMB has been responsive to Advocacy's past recommendations aimed at improving agencies' cost-benefit data and the analysis of regulatory impacts on

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[9] President Bush's Small Business Agenda, announced March 19, 2002, can be viewed at http://www.whitehouse.gov/infocus/smallbusiness/regulatory.html.
[10] The Memorandum of Understanding can be viewed at http://www.sba.gov/advo/laws/law_mou02.pdf.

small businesses. Advocacy believes OMB's recently issued Circular A-4, "Regulatory Analysis,"[11] will go a long way to improve agency compliance with Executive Order 12866. Better cost-benefit analysis will also enable OMB to issue more comprehensive Reports to Congress. OMB Circular A-4 includes a section calling on Federal agencies to identify the effects of rules on small businesses, wages, and economic growth. The accompanying Regulatory Accounting worksheet has a section for agencies to list the impacts of their rules on small businesses, wages, and economic growth. The Circular became effective on January 1, 2004, so increased agency identification of impacts was not included in the Draft OMB Report. We encourage OMB to use its return letter authority to enforce agency compliance with Circular A-4, including use of a Regulatory Accounting Statement that includes quantification of the impacts on small business, wages, and economic growth.

Advocacy is also pleased that OMB called for nominations for promising regulatory reforms to address the regulatory burden confronting manufacturers and to reduce the overall tax paperwork burden. Prior nominations evaluated by OMB are prompting ongoing revisions to regulations that are likely to reduce the regulatory burden borne by small businesses, including small manufacturers. The U.S. Environmental Protection Agency (EPA), for example, has announced that it is now considering revising paperwork requirements for businesses that must file annual Toxic Release Inventory reports, while still providing significant environmental information to the public. Advocacy believes that such regulatory reforms could be effective in reducing the regulatory burden on small business, particularly in the manufacturing sector.

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[11] OMB Circular A-4, Regulatory Analysis (Sept. 17, 2003), can be viewed at http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf.

**The Regulatory Accounting Statement.**

The Draft OMB Report includes a regulatory accounting statement, as required by the Regulatory Right-to-Know Act. Unfortunately, as has been the case in prior years, the Draft OMB Report's regulatory accounting statement reflects major gaps in the cost and benefit information received from the Federal agencies. Agencies that promulgated six of the twelve major new "social regulations" reviewed by OIRA in 2003 – rules that are anticipated to provide societal benefits while imposing at least $100 million in new costs upon regulated entities each year – provided no information about the cost or benefits of their rules.

For example, the Health and Human Services' Center for Medicare and Medicaid Services (CMS) adopted new standards for the security of health information under the Health Insurance Portability and Accountability Act of 1996. The standards impose new paperwork management requirements on health care plans, doctors, and other health care providers. Although CMS acknowledged that the standards would cost these entities more than $100 million in compliance costs annually, the agency failed to estimate the costs and benefits of the standards for OMB.

Likewise, the U.S. Department of Agriculture's Agricultural Marketing Service (AMS) issued revised price formulae for butterfat, protein, and nonfat solids used in milk, cheese, and butter. Although the changes are estimated to impose at least $100 million in new costs, AMS provided no estimates of the costs or benefits of the action to OMB.

Agencies' failure to provide data on the costs and benefits of their rules potentially harms OMB's ability to abide by the Regulatory Right-to-Know Act, and it

also contravenes Executive Order 12866, which requires this information to be provided pursuant to OIRA's review of major rules. Moreover, agencies' failure to provide regulatory accounting information makes rules far less transparent to the public. Small entities are particularly affected when agencies ignore Executive Order 12866 requirements, since a lack of impact analysis means that agencies are unlikely to satisfy the regulatory flexibility analysis required under the Regulatory Flexibility Act and Executive Order 13272.

While my testimony focuses on ways to better achieve the goals of the Regulatory Right-to-Know Act, I should also acknowledge the efforts that are underway within the Administration to accomplish the Act's objectives. Every two years the Office of Advocacy produces a study on the impact of federal regulations on small businesses. The 2001 Crain-Hopkins study[12] is being updated and will be published later this year. Second, Advocacy's RFA Annual Reports commend agencies for leadership and shames others for noncompliance. The U.S. Department of Commerce's recently released report, *Manufacturing in America*,[13] highlights the need for cost-benefit and regulatory impact analysis that will be part of the Department of Commerce's new Assistant Secretary for Manufacturing and Services' responsibilities. OMB has returned rules to agencies when regulatory action is poorly justified. And the recently issued OMB Circular A-4 has significant potential to help address the deficiency in obtaining regulatory impact data.

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[12] *The Impact of Regulatory Costs on Small Firms*, an Advocacy-funded study by W. Mark Crain and Thomas D. Hopkins (October 2001).

[13] U.S. Department of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturing* (January 2004).

Congressional oversight is also tremendously helpful. This hearing sends a message to agencies that analysis does matter. The Paperwork and Regulatory Improvements Act of 2003 would compel Federal agencies to analyze the impacts of their regulations on small businesses and state and local governments. This would help identify whether the costs imposed on small firms by regulations are justified by their benefits. If cost and benefit estimates are required for small entities on regulatory accounting statements, small business considerations would figure more prominently in agencies' regulatory calculus.

**Recommendations for Improving OMB's Future Reports to Congress.**

*Increased Use of OMB Return Letters***.**

Advocacy strongly recommends that OMB issue return letters on a rule-by-rule basis to enforce agency compliance with the Executive Order 12866 and OMB Circular A-4. We note that former OMB Director Mitch Daniels advised this Committee on March 24, 2001, that OMB would issue return letters to enforce agency compliance with the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4. Advocacy believes that return letters should be issued to agencies that do not follow OMB's Circular and Bulletin(s) on accounting for regulatory impacts imposed on small entities.

*Improved Regulatory Accounting***.**

H.R. 2432 would amend the Regulatory Right-to-Know Act to require (1) agencies to submit annual estimates to OMB of the costs and benefits of their regulations and paperwork requirements, (2) OMB in turn to develop regulatory accounting

statements, and (3) five agencies to undertake pilot projects to conduct regulatory budgeting. Advocacy recommends that the bill also require agency submissions to OMB (and OMB's corresponding accounting statements) identify and analyze regulatory impacts on small entities, consistent with the impact analysis required under the current regulatory accounting law.

**Conclusion.**

Advocacy believes that improving the regulatory analysis of small business impacts, together with greater adherence to regulatory accounting requirements in general, will greatly improve the quality and transparency of the economic analyses provided to OMB under Executive Order 12866, and will in turn allow OMB to develop more comprehensive Reports to Congress.

Thank you for allowing me to present these views. I would be happy to answer any questions.