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Advocacy: the voice of small business in government

Testimony of

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U.S. House of Representatives
Committee on Small Business

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Topic:	Legislation to Improve the Regulatory Flexibility Act

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.*

Chairwoman Velazquez, Ranking Member Chabot, Members of the Committee, good morning and thank you for the opportunity to appear before you today to address legislative improvements to the Regulatory Flexibility Act (RFA). 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 these 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.[1] In response, Congress amended the RFA in 1996 by enacting the Small Business Regulatory Enforcement Fairness Act (SBREFA), which provided for judicial review of agencies' final decisions under the RFA and added requirements for the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA).

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.

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[1] The findings section of the Small Business Regulatory Fairness Act, states that "the requirements of chapter 6 of title 5 of the United States Code, have too often been ignored by government agencies, resulting in greater regulatory burdens on small entities than necessitated by statute." See, Section 202(5) of Public Law 104-121(1996).

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 and improve the success of RFA implementation by creating an executive order that would direct agencies to work with the Office of Advocacy early in the regulatory development process 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." [2]

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 of the requirements of the Act, as well as training to all federal agencies on how to comply with the RFA.

The *Report on the Regulatory Flexibility Act, FY 2006* 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. In general, agencies are complying with the requirements of the executive order. Advocacy continues to work with the agencies to bring them into full compliance with these important mandates of the E.O.

After developing the curriculum for a hands-on training program, Advocacy's staff began classroom training for agencies in 2003. In May 2006, Advocacy made computer-based RFA training modules available to agencies so that agency employees can get initial or refresher RFA expertise on demand. By late 2007, Advocacy had trained the vast majority of federal agencies, departments, and independent commissions that write rules affecting small business.

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,

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

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, 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 fairly successful. In general, agencies are paying closer attention to their RFA obligations. 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. The Office of Advocacy estimates cost-savings totaling over $50 billion since 2001.[3]

Although the RFA is doing a fairly good job in achieving cost savings for small entities, more needs to be done to protect small entities from excessive regulatory burden. In 2005, an Office of Advocacy study prepared by Mark Crain on *The Impact of Regulatory Costs on Small Firms*, determined 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.[4] Legislative

[3] A detailed listing of cost savings can be found in the Office of Advocacy's annual reports on the RFA which are located on Advocacy's website at http://www.sba.gov/advo/laws/flex.

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

action is necessary to continue to lower regulatory costs and level the playing field for small entities.

Suggestions for Modifying the Regulatory Process to Reduce Burdens on Small Entities

The 110th 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 weaknesses in the RFA that were not addressed through SBREFA. After eleven years of working with SBREFA, eight congressional hearings on the RFA and SBREFA, Advocacy's conference on the RFA[5], and several Government Accounting Office (GAO) reports and testimonies[6], now is a good opportunity to consider legislative improvements to the RFA. 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. Agencies are required to consider the direct economic impact of a regulatory action on small entities, but that analysis deprives policymakers of a full understanding of a rule's likely impact on small entities.

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 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 regulated utilities fell outside of 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 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.[7]

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 why the RFA

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[5] A copy of the conference proceedings for the RFA Symposium can be found at *http://www.sba.gov/advo/rfa_sym0905.pdf.*

[6] For a listing of GAO reports and testimonies on the RFA, go to http://www.gao.gov and type Regulatory Flexibility Act in the search engine.

[7] Id. at 342.

should be amended to include having reasonably foreseeable indirect impacts analyzed in the rulemaking process. On April 12, 2002, 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 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 harmful to a particular industry.[8] Advocacy reiterated this position at a hearing before the House Committee on Small Business in June 2002.[9] Representatives from the travel industry also testified at that hearing about the potential economic impacts that their businesses would experience as a result of INS's actions. The rule was eventually withdrawn.

In addition, many times, especially with environmental regulation, 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. Amending the RFA to require federal agencies to consider indirect impacts will help state officials craft less burdensome regulatory alternatives. At least 92 percent of businesses in every state are small businesses.[10] The majority of states now have a small business regulatory flexibility process to ensure that state regulators consider their impact on small entities before adopting new regulations.[11] The rising number of states that have flexibility laws presents a compelling need for federal agencies to analyze the indirect impact of proposed rules so that states can benefit from the analysis when implementing federal mandates. Advocacy strongly supports amending the RFA to ensure that economic impact analyses include indirect economic impacts.

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[8] The Office of Advocacy's comment letter is located at http://www.sba.gov/advo/laws/comments/ins02_0513.html.

[9] 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.

[10] Office of Advocacy, U.S. Small Bus. Admin., REPORT ON THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2005 47-48 (2006) available at http://www.sba.gov/advo/laws/flex/05regflx.pdf.

[11] Advocacy's model legislation and additional information about the state legislation initiative can be found at http://www.sba.gov/advo/laws/law_modeleg.html.

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, may impose 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.

Small entities are limited in what they can do about 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. 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.

Moreover, a recent Government Accountability Office (GAO) report documents the need for more public participation and transparency in federal agencies' review of their existing regulations. The report, *Rexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews*, documents the successes and failures of federal agencies' efforts to review existing regulations.[12] The report spotlights agencies' implementation of section 610 of the RFA.

The Office of Advocacy recently unveiled its Regulatory Review and Reform Initiative (r3). r3 is designed to identify and address existing federal regulations that should be revised because they may be ineffective, duplicative, or out of date. r3 is a tool for small business stakeholders to suggest needed reforms and includes the agency review process under Section 610 of the Regulatory Flexibility Act. r3 will monitor the progress that agencies make toward achieving reforms and we believe federal agencies will do a better job of identifying and revising rules that need to be reformed because of the r3 initiative.

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. Moreover, agencies should be required to submit an annual report on 610 review to Congress, the Office of Information and Regulatory Affairs, and the Chief Counsel for Advocacy. This report should include the status of pending reviews and the outcome of completed reviews.

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[12] See, www.gao.gov/new.items/d07791.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 from an amendment to the RFA that would codify the requirements of E.O. 13272, ensuring that independent agencies are subject to the RFA requirements and creating long-term certainty for small entities.

Advocacy recognizes that section 604 of the RFA requires agencies to respond to comments, including those submitted by Advocacy, 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 2006, 15.7 percent of Advocacy's comments were on improper certifications and 17.7 percent of Advocacy's comments were on inadequate or missing IRFAs. Under the current law, anywhere from 15.7 percent to 33.4 percent of Advocacy's comments could go unaddressed, if agencies decide to certify final rules in lieu of preparing a FRFA. Advocacy suggests that the RFA 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.

Conclusion

The Office of Advocacy has reviewed the Committee Print distributed last week. The bill entitled "The Small Business Regulatory Improvement Act of 2008" addresses the issues outlined in my testimony. I commend this Committee for examining these important issues and I believe your legislation will go far to improve the RFA and help small entities. Thank you for allowing me to present these views. I would be happy to answer any questions.