IMPROVING THE REGULATORY FLEXIBILITY ACT - H.R. 2345

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IMPROVING THE REGULATORY FLEXIBILITY ACT - H.R. 2345

WEDNESDAY, MAY 5, 2004

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Committee met, pursuant to call, at 2:32 p.m. in Room 2360, Rayburn House Office Building, Hon. Donald Manzullo presiding.

Present: Representatives Manzullo, Velazquez, Beauprez, Case, Akin, Udall, Bordallo

Chairman MANZULLO. This Committee has held a number of hearings during my tenure as chairman in which we examined agency compliance with the Regulatory Flexibility Act, or RFA. These hearings all reached the same conclusion: The RFA is an important law that, if fully complied with in both letter and spirit, has the potential to significantly reduce the regulatory burdens on small businesses.

The efforts of the president, Dr. Graham, the head of OIRA, and Chief Counsel for Advocacy Tom Sullivan have done admirable jobs in improving agency compliance with the RFA. However, their efforts continue to be hindered by bureaucrats that seek to perform the minimum amount of analysis possible and courts that seek to abet them in the process. In short, the efforts to obtain compliance are, in part, hampered by the flaws in the RFA itself.

Given the inadequacies of the RFA, I, along with Mr. Pence, Mr. Terry, and Mr. Ose, introduced H.R. 2345, the Regulatory Flexibility Improvements Act. The bill is designed to significantly strengthen the RFA so that agencies, as President Bush stated, ''will care that the law is on the books.''

H.R. 2345 represents a comprehensive fix to current weaknesses in the RFA. When it was enacted, opponents said it would slow the promulgation of rules. Any examination of the size of the Federal Register in 1980 with that today will see the RFA has done no such thing. During the debate over the amendments to the RFA made by the Small Business Regulatory Enforcement Fairness Act, or SBREFA, opponents argued that judicial review would create a stampede to the courthouse. This Committee is not aware of any such rush by small businesses to file lawsuits challenging RFA compliance, and any arguments about the horrors of H.R. 2345 that will be raised by opponents are also unlikely to come true.

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 agen-

cies through increased compliance and lower costs to small businesses. No good reason exists to oppose those goals and objectives other than obstinacy of the status quo. It the status quo needs fixing, so be it. I promise to work with the individuals testifying, Chairman Sensenbrenner and House leadership, and my colleagues on the Small Business Committee to see that necessary changes in the RFA are made, to paraphrase the president, so the law is on the books, and federal agencies will care that the law is on the books.

I now recognize the Ranking Member, the gentlelady from New York, for her opening remarks.

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

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Small businesses today face an array of challenges that weigh on them more heavily than their corporate counterparts. One of those challenges is federal regulations and the disproportionate burden they place on our nation's small firms. A recent study showed that for firms with fewer than 20 employees, the annual regulatory burden is nearly $7,000 per employee, almost 60 percent higher than that of firms with 500 employees or more. This is unfair, and something needs to be done about it.

The Bush administration has acknowledged this unfairness and has promised to help, but the truth if President Bush actually holds the all-time record for the number of federal regulations submitted and issued under any president. A law is on the books that does offer some protection to small business, the Regulatory Flexibility Act.

Enacted more than two decades ago, the Reg Flex requires federal agencies to consider the impact their regulatory proposals have on small entities. But if agencies were actually doing their homework, then the SBA Office of Advocacy would not have to intervene with them in 50 to 100 cases each year. These demonstrate just how reluctant agencies are to fully comply with the requirements of the Regulatory Flexibility Act. There are loopholes and problems with the Reg Flex that are exploited by these agencies.

The bill before us today, the Regulatory Flexibility Improvements Act, seeks to close some of these loopholes and hold agencies accountable for their overly burdensome rules. At this hearing, we will evaluate H.R. 2345, the changes it proposes to the Reg Flex, and what effect this will have on small businesses.

The bill does several things. First, it clearly defines the specific economic effects to be examined by agencies and sets out requirements for greater precision in performing these analyses. It also provides the leverage advocacy will need to take on these executive agencies in court. In addition, H.R. 2345 would apply the panel process to a handful of agencies that routinely ignore the Reg Flex—the IRS, CMS, and the FCC—and compels them to use a more rigorous system of rule evaluation.

As shown by EPA and OSHA, the panel process has gone a long way in helping identify and reduce the impact of rules on small businesses while still achieving overall health and safety goals. As you can see, H.R. 2345 is an ambitious piece of legislation. Given this and the limited time we have left in the congressional schedule to actually get things done, the likelihood of H.R. 2345 reaching the

president's desk is slim, but I do believe that today is a good start, and I look forward to working with the chairman to reduce the regulatory burden on our nation's small firms. I would also like to thank the chairman for addressing this issue. This is the first hearing we have held in quite some time that directly affects legislation under our Committee's jurisdiction.

The burden of federal regulations is a real problem for small businesses across the country. Unfortunately, agencies tend to use a one-size-fits-all approach that mainly hurts our small business owners. Through H.R. 2345, we have the opportunity to make the Reg Flex a stronger and better enforcement tool, ensuring that federal agencies are held to more stringent regulation standards. If small businesses are less burdened by government rules, they are in a better position to grow our local economies and create jobs, and this will give a boost to our economy and provide employment opportunities for the millions of Americans still searching for work. Thank you, Mr. Chairman.

[Ranking Member Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you. Our first witness will be Congressman Lee Terry, our colleague from the great State of Nebraska. Lee, we look forward to your testimony.

STATEMENT OF THE HONORABLE LEE TERRY (NE-2)

Mr. TERRY. Thank you, Mr. Chairman. I appreciate the invitation to speak here today and the invitation to join you on this bill.

Good afternoon, Ranking Member Velazquez, Mr. Beauprez.

As the chairman mentioned, I represent the Omaha, Nebraska, area, which is home to four Fortune 500 companies and their corporate headquarters, yet almost 90 percent of the employees, my constituents, work for small businesses. Clearly, the American economic engine is powered by small businesses, and I share your passion in helping to protect these businesses.

As I meet with our small business owners almost every day when I am back home, one of the most frequent complaints from small business owners is that federal regulations are onerous, make no sense, confusing, costly, and difficult to implement. Now, Congress first showed its willingness to address these regulatory burdens when it passed the Regulatory Flexibility Act in 1980. Under the Regulatory Flexibility Act, many agencies proposing rules that would have a "significant" economic impact on small businesses, small, not-for-profit organizations, or small government entities must prepare a regulatory flexibility analysis and try to find simpler, less-burdensome ways for such small organizations to comply.

Now, certainly, this is extremely helpful if applied to small businesses. This act, however, did not require an agency to abandon a proposed regulation because it might have a "significant" impact on small entities, only to consider a less-burdensome alternative and to explain why it rejected those alternatives. If a proposed regulation comes under the act, the agency must prepare an initial regulatory flexibility analysis, which is published, along with the proposed rule, and sent to SBA, who oversees the act's enforcement. After the comment period, the agency must prepare a final regulatory flexibility analysis, which should respond to any issues

raised in the public comments and which is published with a final rule and made available to the public.

While the RFA was an important first step in eliminating onerous burdens on small businesses, it was not without its shortcomings. One of the most important aspects of reform is to clarify and expand the rules covered by the RFA. One reform contained in Section 3 of H.R. 2345, amends the coverage of RFA to regulations from agencies that are not currently covered, an important step.

For example, under the Regulatory Flexibility Act, the Federal Communications Commission is not required to make the same small business considerations as the EPA or OSHA. When the FCC is modifying regulations that affect the operation of the telephone network, the agency is not required to examine the impact of the proposed change on small business because it has been determined that small business users are not directly within the regulatory jurisdiction of the FCC, yet almost all small businesses have telephone networks or use telephone services. Further, small businesses often do not have the time or resources to wade through an FCC proposal and relate that impact that it would have on its cost of using the telephone network. I especially hear this from our small local telephone exchanges and rural telephone exchanges that the FCC drafts rules and regulations for the big entities that then include everybody without taking into consideration the impact on the smaller companies.

In fact, last session, Chairman, I introduced a bill that would just simply ask the FCC to take into account this type of impact on small telephone companies and exchanges, which you, through this philosophy, have adopted in your bill, and I thank you.

Now, Mr. Chairman, another important reform that you have included in your bill is a new Section 613 of the RFA which mandates that the chief counsel of the Small Business Administration issue advisories to agencies that must be adhered to during the regulatory writing process. These advisories can be used by small businesses in suits to enjoin agencies from these onerous, illegal, regulations and greatly assist the chief counsel in fighting burdensome regulations on behalf of small businesses.

Mr. Chairman, H.R. 2345 is an important bill for these and other reasons. Your leadership on this issue and the effort to reduce regulatory red tape by championing this legislation is extremely important. At a time when the threat of outsourcing and the need to create new jobs is a priority of Congress, the Regulatory Flexibility Improvements Act provides a big assistance to small business owners.

Mr. Chairman, thank you for this opportunity to testify, and I look forward to working with you in getting H.R. 2345 enacted into law.

[Representative Terry's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Congressman Terry.

Our next witness is Congressman Mike Pence from the great State of Indiana, Hoosier Country.

STATEMENT OF THE HONORABLE MIKE PENCE (IN-6)

Mr. PENCE. That is right. Thank you, Chairman, and thank you for the privilege of permitting me to testify and to return to the Small Business Committee that I had the privilege of serving on during the 107th Congress, and apropos to my testimony today, I had the privilege of serving as the chairman of the Subcommittee on Regulatory Reform and Oversight.

It is really with that background and sitting on the other side of the table, Mr. Chairman, in many hearings just like this on these issues that I was very anxious to support H.R. 2345, the Regulatory Flexibility Improvements Act.

As you know, Mr. Chairman, during my tenure as subcommittee chairman, I held a number of hearings and one very comprehensive roundtable on regulatory burdens facing small businesses. Every trade association and group had different concerns because of the agencies that regulated their members' businesses, yet almost every single witness that came before the subcommittee expressed two consistent themes, and I think they bear amplification today.

First, all of the small businesses that I heard from said they face problems complying with complex, often arcane, federal regulations that they are unaware of until a federal inspector comes walking through the door and informs them that they are in violation.

Secondly, the analysis done in support of regulations often was inadequate and did not focus on the challenges facing those same small businesses. In a word, there was very little relationship to what was happening on the shop room floor in small businesses that I heard from and what was happening in the regulatory state.

Certainly, much has changed since I served as chairman of the Subcommittee on Regulatory Reform. President Bush declared it was the policy of his administration that federal agencies were no longer to ignore compliance with the Regulatory Flexibility Act, and that was progress.

Dr. John Graham, the head of the Office of Information and Regulatory Affairs at OMB, I believe, has done a remarkable job with a small staff in revamping review of regulations and demanding sound scientific and economic support of regulations. Tom Sullivan has been an admirable advocate on behalf of small businesses, and even from my rather distant standpoint, I think he has worked very closely with Dr. Graham in ensuring that federal agencies comply with the RFA.

So there has been progress, and even during my tenure on this Committee, I saw that process work to the benefit, in particular, of one area of small business that saw the rules applied to them change and be conformed to a greater degree of rationale, and it had to do with the reporting of essentially minuscule amounts of lead that were left as a residue in the printing process.

Given the success of this administration in imposing a significant degree of rationality in the issuance of regulations, one might ask, why is it even necessary for us to consider H.R. 2345?

Well, first, Congress continues to enact legislation that will require regulations, such as the prescription drug benefit for Medicare-eligible individuals.

Second, administrations come and go, and so do the people that staff them. Replacements may not always be as qualified or as

dedicated as those that I have previously mentioned, or they may actually bring different agendas based on a different president's policies.

Third, political appointees obviously, we all know, come and go, but most agency personnel remain, and they may not be as committed to compliance with the RFA.

Fourth, court interpretations of the RFA are unchanged by the actions of the Executive Branch, and agency personnel will use those interpretations to avoid performing the analysis that Congress has mandated.

At the bottom, the United States distinguishes itself, I believe, from other nations in that we operate under a rule of law in which the actions even of federal agencies are subject to significant public scrutiny and challenge in the courts. Leaving compliance with the RFA to the whims of federal agency personnel and ever-changing administrations undermines the basic principle that this country is governed by the rule of law and not the rule of man.

Even if Dr. Graham and Mr. Sullivan do their jobs flawlessly, the RFA itself has flaws, the courts have identified those flaws, and agencies will exploit those loopholes to avoid performing analyses that might undercut the rationale for their unprecedented regulatory outcomes, and this is not acceptable.

In evaluating actions that adversely affect the environment, federal agencies first study the scope of any adverse actions, the consequences of taking an action, and alternatives to the proposed actions. Agencies should take the same rational approach when promulgating regulations. But even putting pen to paper, the agency should determine whether a problem exists, the scope of the problem, and potential regulatory alternatives. The RFA can, if all of the loopholes are closed, play a key role in this rational rule-making process, which must be the order of the day in this city.

The president has said that compliance with the RFA is important, and the only way to ensure that compliance really occurs under this president and future administrations is to make the law tougher. For these reasons, I determined that co-sponsorship of H.R. 2345 is critical, and I strongly support your efforts, Mr. Chairman, to move the bill, enact it into law, and protect America's small businesses.

Again, let me thank you, Mr. Chairman, for the opportunity to return to this Subcommittee, and let me also say, inasmuch as the Judiciary Committee also shares some jurisdiction of this legislation, I look forward to working very closely with you and other members of the Small Business Committee to see to its completion in regular order and its passage on the House floor.

[Representative Pence's statement may be found in the appendix.]

Chairman MANZULLO. Thank you. Do any of our colleagues here have any questions to ask of our colleagues?

[No response.]

Chairman MANZULLO. Okay. Well, that was pretty easy. Thank you for your testimony.

If we could have the next panel come up and keep on moving.

[Pause.]

Chairman MANZULLO. Okay. I am waiting for Mr. Sullivan to be the lead-off batter here.

Gentlemen, thank you for coming. Our first witness will be Tom Sullivan, who has done nothing less than a stellar job at the Office of Advocacy and involved in a lot of fights. Tom, I look forward to your testimony.

STATEMENT OF THE HONORABLE THOMAS SULLIVAN, SMALL BUSINESS ADMINISTRATION

Mr. SULLIVAN. Thank you, Mr. Chairman, Congresswoman Velazquez, Congressman Case. It is always nice to appear before a Committee that is considering legislation to strengthen the core mission of the office. It is also nice to be here before a panel of other members of Congress who speak so favorably about the hard work that goes on in the office. So it is an honor to appear before you this afternoon. It is also an honor to address how to make the Reg Flex Act work better. Because my office is independent, these views are my own and do not necessarily reflect the views of the administration or the United States Small Business Administration.

I have prepared a comprehensive, lengthy statement to aid the Committee's work in improving the Regulatory Flexibility Act. I suspect the Committee would appreciate my summarizing instead of reading the document in its entirety.

The Regulatory Flexibility Act, as amended by the Small Business Regulatory Enforcement Fairness Act, has been successful. In the past three years, my office estimates cost savings of over $31 billion, and I will say that again. We estimate cost savings of over $31 billion. Even with the additional requirements under SBREFA and the threat of judicial review, some agencies were not complying with the requirements of the RFA.

A formalized and closer working relationship with John Graham's office at the White House and Executive Order 13272, entitled "Proper Consideration of Small Entities in Agency Rulemaking," were part of the president's small business agenda, and they are making a tremendous difference. The executive order enhances my office's RFA mandate by directing federal agencies to implement procedures and policies for measuring the economic impact of regulatory proposals on small entities. It also requires agencies to notify my office of draft rules that are expected to have a significant economic impact on small entities and to give every appropriate consideration to any comments provided by the Office of Advocacy, including publishing a response to our comments in the Federal Register.

A recent success for small business highlights how the Office of Advocacy and John Graham's Office of Information and Regulatory Affairs relationship and the executive order are working. The construction and development rule, recently announced by the EPA, was something that Small Business and my office and John Graham's office worked on for over two years.

Basically, EPA, recognizing that storm water runoff can lead to pollution in rivers and streams, wanted to create a whole new federal permitting system that takes permit information already required at a state, local, and regional level and superimpose that in-

formation on a new federal permit sent to an office in Washington. Small businesses that are required to work and comment through our office and through the SBREFA panel told EPA, then under the leadership of Governor Whitman, that this was a bad idea. Adding a new paperwork requirement would not result in cleaner water.

So for two years, we have worked to bring that common-sense point of view into EPA, and as of one month ago, EPA finally agreed and decided not to regulate a whole new system of federal permitting requirements on storm water construction and development runoff. That is the most recent victory under the president's direction and the increased attention of agencies to the Reg Flex Act.

The bill that is before us this afternoon, H.R. 2345, is important because even though the last few years have yielded a number of successes, there are certain loopholes in the RFA that were not addressed through the executive order or SBREFA. H.R. 2345 would amend the RFA to address those loopholes.

Since my office is independent, we have to take our direction directly from small business. The way we do that is we hold roundtables, we solicit comments, and information from our regional advocates, and when we did that on this particular bill, the small business representatives, many of whom are behind me in the room listening to this hearing this afternoon, cited five specific issues of importance. The first is closing the loophole of agencies not measuring indirect economic impacts; second, inclusion of IRS interpretative rules; third, the importance of analyzing cumulative impacts; fourth, the importance of analyzing beneficial impacts; and, fifth, the expansion of the panel process to more agencies. And with the chairman's permission, I am prepared to go fairly close to the full 10 minutes.

The direct versus indirect economic impact. Of all of the issues, the most prevalent concern of the small business community is the lack of inclusion of indirect impacts in the current version of the RFA. Pursuant to Sections 603, 604, and 605[b] of the RFA, agencies are required to consider the impact of an action on small business entities, but they do not measure the indirect impact.

You may recall, Mr. Chairman and Congresswoman Velazquez, that there was a hearing we had in this Committee where the INS had proposed to cut off stay, legal extensions of stay, from foreign visitors in this country in the wake of September 11th. We know that that rule, proposed by INS, said that we regulate the activity of individuals, not small businesses.

I think the Committee deserves a lot of credit for recognizing the flawed logic in that, in that small businesses would be affected. The travel industry, the tourist industry, specifically, in the State of Florida, who came to testify also before this Committee, identified that, yes, maybe INS does not directly affect these small businesses, but their actions have a definite impact on the small businesses that are affected by their proposals. That is an indirect impact, and that is a loophole that INS used not to do the analysis. That loophole should be closed, and it is with the passage of H.R. 2345.

Advocacy also supports the expansion of the SBREFA panel process that is in H.R. 2345 to better sensitize CMS, IRS, and the Federal Communications Commission to small business concerns. We do have a concern about the changes in H.R. 2345 with regard to the panel process. The panel process described in Section 6 of H.R. 2345 provides the Office of Advocacy with the responsibility of drafting the panel report.

The current process that exists between OSHA and EPA represents a consensus report negotiated between the offices—the Office of Advocacy, OMB—and the promulgating agency. This process encourages stewardship or a custodian relationship of the rule from the agency. It is my office's view that that is what actually gets the agencies to do the right thing and sensitize their actions to small business.

If this bill gets signed into law simply telling the Office of Advocacy, you write all the reports, it distances the agencies from understanding or being involved or having a stake in their own regulatory process, to believe that if it is a consensus position of how small businesses feel, they are much more likely to endorse and adopt the recommendations coming from those panels. So our suggestion to amend H.R. 2345 to improve an already good bill would be simply to make the panel process consistent with the existing panel process that exists with EPA and OSHA.

Section 9 of H.R. 2345 amends the Small Business Act to allow the Chief Counsel for Advocacy to specify small business size definitions or standards for purposes of any act other than the Small Business Act or the Small Business Investment Act of 1958. My office is concerned that vesting the authority to determine size standards to the chief counsel for advocacy may cause confusion over which SBA office determines size standards. The SBA's Office of Size Standards has the necessary expertise and resources to make appropriate decisions regarding industry size determinations, so I do not believe that that proposed Section 9 of H.R. 2345 will benefit small entities.

To conclude, Mr. Chairman, Advocacy believes that H.R. 2345 makes several needed improvements to the RFA. My office supports this legislation. The amendments will further federal agency understanding of their obligations under the Regulatory Flexibility Act. H.R. 2345 will improve the RFA to allow for a more thorough analysis, foster the consideration of alternatives that will reduce the regulatory burden on small entities, and improve the transparency in the rulemaking process.

Thank you for allowing me to present these views, and I would be happy to answer any questions after the panel has concluded.

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

Chairman MANZULLO. Thank you.

Our next witness is Jere Glover. Jere has been involved in small businesses. In fact, when I first met Jere, you were in the Office of Advocacy, weren't you?

Mr. GLOVER. Indeed, I was, sir.

Chairman MANZULLO. And then you retired and wanted to sail off on your sailboat, but you never ventured far from Washington.

Mr. GLOVER. I got down to Miami. That was close enough.

Chairman MANZULLO. We are thankful that you stuck around because you have got so much wisdom and look forward to your imparting that to us this afternoon.

Mr. GLOVER. Well, thank you.

Chairman MANZULLO. How do you like that introduction?

Mr. GLOVER. Very nice.

Chairman MANZULLO. Sullivan says, 'Why don't you introduce me that way?' I said, 'When you retire, we will say all kinds of things about you, you know.'

STATEMENT OF JERE W. GLOVER, BRAND & FRULLA

Mr. GLOVER. Mr. Chairman, Ranking Member, it is, indeed, an honor to be here and testify before you. I am Jere Glover with Brand & Frulla, a law firm specializing in litigation and regulatory and administrative law.

Overall, I think it is fair to say that the Regulatory Flexibility Act has improved government regulations on how they treat small businesses. The regulatory climate for small business is clearly much better. Most agencies recognize the critical role that small businesses play in the economy, and most have recognized that they need to make their regulations accommodate small business. However, there are a few, as we will talk about later, whose compliance has lagged, and, quite frankly, the courts have been reluctant to fully enforce the law. This experience indicates that it is time for additional modifications to the Regulatory Flexibility Act.

A brief history of how the Regulatory Flexibility Act has come about is important. Prior to 1980, all of the regulations in the government were basically one size fits all. Despite a presidential order, pending legislation, and efforts by the Office of Advocacy to get voluntary compliance with the concept of regulatory flexibility, I think we have to admit that that effort was a failure. The Reg Flex Act was then passed, and agencies immediately began to comply with the law. Unfortunately, over time, several critical flaws in the Regulatory Flexibility Act became apparent, for example, no judicial review, no mandatory small business input, an imprecise role for the Office of Advocacy, and the ease with which agencies could certify that the regulations did not affect a significant number of small businesses. It is unable to escape the conclusion that agencies could ignore the Regulatory Flexibility Act with impunity.

In 1996, the Small Business Regulatory Enforcement Fairness Act was passed to correct some of these shortcomings. As the Committee knows, SBREFA added judicial review provisions to the Reg Flex Act to ensure that agencies would do more than simply provide lip service to the Regulatory Flexibility Act when developing and implementing regulations. While most agencies have markedly improved their compliance with the Regulatory Flexibility Act after SBREFA, some agencies still only give lip service to the Regulatory Flexibility Act and appear to believe that compliance with the Regulatory Flexibility Act is still voluntary.

The Federal Communications Commission appears to have the worst record of compliance. In my written testimony, I gave a number of examples and quotes from letters from various chief counsels' reports on compliance with the Regulatory Flexibility Act and a number of recent letters in the last three years to the FCC. A rea-

sonable view of FCC's compliance is they simply choose to comply when they want to and choose to ignore it most of the time.

Other agencies, such as the Internal Revenue Service and the Center for Medicare and Medicaid Services, have had a similar but somewhat better record but clearly have had problems in recognizing it.

The problem with these recalcitrant agencies is compounded by the fact that some court decisions. Unfortunately, some courts have begun to narrow the scope of the Regulatory Flexibility Act and appear reluctant to enforce the law. True judicial review has been rare. Unless Congress strengthens the RFA, I fear gains that have been achieved will be lost, and agency compliance will deteriorate.

What needs to be done? First, the Congress needs to give the Office of Advocacy independent budget authority. Today, the office has, I think, 43 employees. That is a far cry from the 70-plus employees when the Regulatory Flexibility Act was first passed. Unquestionably, no other agency has produced the returns on government dollars spent Advocacy has generated: $50 billion of regulatory savings for small business compared to an annual budget of the Office of Advocacy of well under $10 million a year. Advocacy can take a great deal of pride under various chief counsels for the work that it has done and the things that it has accomplished.

Second, the judicial review provisions of the Regulatory Flexibility Act need to be strengthened. The RFA should state specifically that courts should defer to any review or determination by the chief counsel for advocacy. The American Trucking case, in this regard, should clearly be reversed.

Third, amendments to the law requiring more detailed analysis to substantiate initial regulatory flexibility analysis and final reg flex analysis, as well as "no impact" certifications, should be required.

The committee proposes several other provisions for strengthening the law. Amendments to the Administrative Procedure Act have been rare. Enactment of the Regulatory Flexibility Act and SBREFA occurred over fierce opposition. Thus, any proposed amendments to strengthen the Reg Flex Act will face significant challenges from various Executive Branch agencies, independent agencies, and perhaps members of Congress, some of whom will raise objections. This should not discourage enactment of those provisions deemed most important. I think the fight is worth taking.

In closing, I think it is important to keep in mind that those who seek to reform bear the burden of persuading agencies and policymakers that it is a national policy to preserve competition, and, more importantly, small business is the force that ensures competition in the American marketplace. Considering whether regulations have an adverse or unnecessary impact on small business is not special treatment. Rather, it is a commitment to a national policy. Avoiding unnecessary regulatory burdens to small businesses is good, sound, public policy.

Thank you for having the opportunity to testify.

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

Chairman MANZULLO. Thank you.

The next witness, Frank Swain is an attorney with Baker & Daniels. He was chief counsel for advocacy from 1981 to 1989. He

has a little bit of experience in that office, and, Frank, I appreciate your input and look forward to your testimony.

STATEMENT OF FRANK SWAIN, BAKER & DANIELS

Mr. SWAIN. Thank you, Mr. Chairman and Ms. Velazquez. I will try to resist the temptation to walk down memory lane too much here. I will say that, not counting Tom, the other members of the panel, I think you have a very unique panel that all are working on the regulatory flexibility bill of 1980.

I, of course, was a teenager at the time, and I am probably in the unusual position of endorsing absolutely every word that both Tom and Jere Glover have mentioned so far about the history of the act and the impact of the act and the deficiencies of a law that was passed under great duress by the Congress in 1980, and the duress was not partisan duress. The duress was really principally from those people that considered themselves the keepers of the Administrative Procedure Act covenant and were resenting the fact that anybody would want to amend the Administrative Procedure Act that were coming out of anything other than a pure, administrative, jurisprudential background.

But as I mention in my statement, 1980 was an era of great ferment of regulatory issues, and in 1980, of course, with the election of President Reagan there was a sort of renewed interest in controlling regulatory agencies, and lots of organizations and agencies in the Reagan administration were proposing very significant, statutory and regulatory reforms and, really, the Regulatory Flexibility Act, in my view, is the only time that Congress has passed a law that imposes regulatory reform procedures on a whole host of regulations.

What we have learned over the intervening 20-some years is that [a], as was mentioned, enforcement powers were somewhat lacking at the outset. The Congress has gone a long way to correcting that through SBREFA, and now what we realize, and possibly because there are better enforcement powers now, the agencies seem to be more interested than ever in avoiding those conditions that trigger the regulatory flexibility analyses in the first place.

So, to the extent that this bill is largely, not exclusively, but largely focused on what I will call the "front end," that is, the decision by agencies whether to do the required analyses and the ability of the Office of Advocacy and others to monitor and correct those decisions when they are wrong; that is really an important step, and I hope that, although, as was mentioned, it will not be noncontroversial with the particular agencies, it is real important to try to go forward with that.

I will briefly mention just a couple of other points which I think are very good in the bill. As this Committee and you know, Mr. Chairman, I have been working with an issue involving the IRS for two years, involving mobile machinery. You were kind enough to have a hearing last year at which that issue, among others, was discussed as an example, and it continues to be an example of a regulatory change that has a very significant impact on a very substantial number of small businesses, and no analysis was done, and the IRS said, we do not have to do an analysis.

And I mention in my testimony, I actually sort of failed the theology course as to why they cannot do the analysis or they are not required to do the analysis. It is, in my view, a very abstruse set of arguments that they are making involving the Paperwork Reduction Act and Reg Flex and so on and so forth. But suffice it to say that Congress has got to go back and make perfectly clear that the IRS needs to do an analysis on most of the decisions that they make that have a regulatory impact, whether they designate them as interpretive or otherwise.

Three other quick points. The positive impact. a number of agencies say, we are changing things for the good; therefore, we do not have to do a small business impact. My response when I was chief counsel and now continues to be, well, if you are changing it for the good, how do you know you could not change it even more if you do not do an analysis? I think that that is a necessary change.

I like the provision that requires agencies to quantify what they are doing. You would think that is a no-brainer. How can you measure the impacts unless you quantify? We are well ahead of where we were 20 years ago when I was chief counsel. The ability to do that and what we know about economics and what we know about data bases, every agency should be able to do that.

Finally, I will mention this. It has been mentioned before. The indirect-impact situation is very important. The direct costs of a rule are often minor compared to the indirect costs, and agencies need to be required to step up to the plate and analyze those costs, too.

Mr. Chairman and Ms. Velazquez, thank you for the opportunity to make this statement. It is a pleasure to continue to be able to work on small business regulatory issues as I have for some time. In some ways, I am not worried about working myself out of a job if this legislation is passed because it continues to be an intense set of issues for small business, but I do think that enactment of this bill or something close to it would be a major step forward, and we appreciate very much in the small business community your support.

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

Chairman MANZULLO. Thank you.

Our next witness is Dr. Jim Morrison, who is president of the Small Business Exporters Association, and, Jim, we look forward to your testimony.

STATEMENT OF JIM MORRISON, SMALL BUSINESS EXPORTERS ASSOCIATION

Mr. MORRISON. Thank you very much. Thank you also for allowing me to appear on a panel with these public servants, all of whom I have a great admiration for.

Chairman Manzullo, Representative Velazquez, members of the Committee, thanks for having me appear here today. I am Jim Morrison. I serve as the president of a small business organization, the Small Business Exporters Association, but I am here today primarily as a private citizen. I have been asked to comment on H.R. 2345 in the light of my background in helping develop the Small Business Regulatory Enforcement Act and the Regulatory Flexi-

bility Act, so I will try to do so. I hope this information will be helpful as you go forward.

By way of historical context, the idea for the Reg Flex Act was suggested to me in April of 1977 by Mr. Milt Stewart, who later became the first chief counsel for advocacy. At the time, I was on the staff of Senator Gaylord Nelson of Wisconsin, the chairman of the Senate Small Business Committee. Senator Nelson also liked the idea, and we drew in Senator John Culver of Iowa and others to help us move forward on the bill.

In my written testimony, I describe in some detail my daily work on the RFA from then through the final passage in 1980. In the interest of time, I will not repeat all of that here, but I do think it is fair to say that I worked with every major player on the bill, and I sweated every line and, I think, pretty much every word of that bill for three years.

Although I was not a congressional staffer on SBREFA, I again worked very closely on it on a daily basis with those who were drafting and negotiating the bill, since I was the head of an association coalition at that time in favor of the legislation.

From that historical perspective, let me say a few words about your bill. First of all, I think it gets two very important points right: the extent to which the Reg Flex Act was modeled on the National Environmental Policy Act [NEPA] and the key congressional mandate of both RFA and SBREFA, which is the need for process change and culture change at the agencies.

On the first point, both Senators Nelson and Culver were noted environmentalists. Each was a principal sponsor of a number of important environmental statutes. Several of their staff attorneys were deeply steeped in environmental law. We had many, many conversations in the late seventies about using NEPA as a model for the RFA.

The consensus view was that NEPA offered a proven approach to sensitizing agencies to a set of external considerations and that it was an understood quantity by the courts and the administrative law bar. We believed that, by paralleling NEPA, we could successfully integrate the RFA into established administrative law with minimal disruptions.

Our concern, however, was that litigants might seek to halt agency actions before they were finalized. This is called ''interlocutory review.'' This was allowed under NEPA, and it led to enormous abuse. We wanted to avoid that, but there were many disagreements about how to do so. This is what led to the tortured language about judicial review in the original RFA. It did not work. It confused the courts, and it created a pressing need for later revisions. That was the key reason we needed SBREFA some years later.

In many other respects, however, the RFA and NEPA are strikingly similar. An agency certification of no small business impact under Section 605[b] of the RFA is meant to mirror the finding of no environmental impact under NEPA. The final regulatory flexibility analysis under Section 604 of the RFA parallels the environmental impact statement under NEPA, and so on.

Both the RFA and NEPA were designed to alter agency culture and agency process without overturning the agencies' statutory

frameworks. While there has been progress in getting the agencies to internalize the small-entity considerations under the RFA, to this day, they do not seem to grasp that the RFA is every bit as much the law of the land as NEPA and that RFA analyses should be just as thorough and careful.

The courts need some guidance, too, in my opinion. Judicial scrutiny of RFA analyses is typically far below that given to environmental impact statements. H.R. 2345 commendably tackles these concerns.

In addition to these broad culture and process issues, the bill also addresses several specific problems very well. It clarifies the lead role of the chief counsel for advocacy in administering the RFA. Despite extensive responsibilities that Congress gave the chief counsel on both statutes, some court decisions have suggested that the views of the chief counsel do not need to be treated with deference by the agencies or the courts. This completely misreads congressional intent, in my opinion, and fundamentally endangers the RFA. The statute depends upon the chief counsel being able to stand up for small entities that are unaware of agency actions and unable to defend themselves from needless harm by the agencies.

Congress needs to reassert the importance of the chief counsel to the RFA. Your bill could simply state that the agencies and the courts should give deference to Advocacy's views, or it could have the Office of Advocacy write some basic rules for agency compliance with the RFA.

Another good element of H.R. 2345 is its treatment of indirect economic impacts of the rules. We tried to solve the indirect-effects problem in both the RFA and SBREFA, but we could not find the right statutory wording. I wish we had thought of the approach that H.R. 2345 uses, paralleling the way the Council on Environmental Quality [CEQ] writes rules for agencies—a brilliant stroke.

I also like the bill's approach of defining indirect effects as "indirect economic effects of a rule that an agency reasonably could have foreseen." Since both of these proposed language changes for RFA are based on settled principles of environmental law, expanding them into small-entity law should not create undue difficulties for the agencies or the administrative law bar. I urge the Committee to report the bill with both provisions.

H.R. 2345 also works to bring Treasury IRS rules fully within the ambit of RFA, a very worthy cause which I hope will come to fruition.

In my written testimony, I cite several other features of the bill which I think are good improvements to the RFA. While I would be careful about assigning more responsibilities to Advocacy than the office has the staff or budget to handle, overall, I think H.R. 2345 is an excellent bill. That completes my prepared remarks. Thank you.

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

Chairman MANZULLO. Thank you very much.

I want to go back to a statement that Tom Sullivan made with regard to, I believe, the size standards. Tom, do you want to repeat that statement? I think you were analyzing 2345 and made a comment on that.

Mr. SULLIVAN. The comment that I had made in my oral statement was that Section 9 of 2345 amends the Small Business Act to allow the Chief Counsel for Advocacy to specify small business size definitions or standards for purposes of any act other than the Small Business Act or the Small Business Investment Act of 1958. I had voiced my concern that vesting the authority to determine size standards to the Chief Counsel for Advocacy may cause confusion over which SBA office determines those size standards. The current SBA Office of Size Standards has the necessary expertise and resources to make appropriate decisions regarding industry size determinations.

Chairman MANZULLO. One of the reasons it is in there is the hope that the Office of Advocacy could redo a size standard a lot faster than SBA. We had a terrible situation with several of Ms. Velazquez—the travel industry—remember that hearing, Ms. Velazquez?——

Ms. VELAZQUEZ. Uh-huh.

Chairman MANZULLO [CONTINUING] And we had to have both Mr. Barreto here and Dr. Graham, and that was the afternoon that I said I was going to lock the door here until you guys come up with a solution. Mr. Pineles, our Regulatory Counsel whispered, I guess that might be a regulation by coercion. The courts might be prone to knock it down. It just reached the point after months and months and months and months. Nothing was happening. Now the SBA is in the process of getting all kinds of information. They put up a kite for the purpose of drawing information, and obviously that is the appropriate way to deal with the different groups that are interested in seeing it going. That is one of the reasons it was put in there. Did that have any impact on———.

Mr. SULLIVAN. Yes, Mr. Chairman. It has a tremendously impact on my comment. First of all, you made the comment that the committee hearing that you had might have produced a beneficial regulation by coercion. Even though I recognize the sense of why you characterize it that way, my thoughts are a little bit different, and they are extremely complimentary of the oversight role of this body. My office would not be able to claim the successes of $31 billion cost savings without the aggressive oversight of this Committee. It works very well. It does not always work perfectly, but it works very well.

Chairman MANZULLO. We make a lot of noise. That is for sure.

Mr. SULLIVAN. And sometimes we get results. I think there are very recent activities that demonstrate those results, one being the travel industry and the CRS rules that the Department of Transportation was promulgating. I know that their representatives are here listening to this testimony today.

The reason I have concerns with shifting some of the responsibilities and authorities from SBA's Size Standards Office to my office is consistent with the approach government-wide. SBA really is no different than any of the other agencies that we seek to sensitize to small business with the RFA. In order for the Reg Flex Act to work, the agencies must do their homework themselves, knowing full well that the Office of Advocacy is looking over their shoulder, knowing full well that this Committee is looking over their shoulder.

Chairman MANZULLO. With that new memorandum of agreement with OIRA, you now have additional powers.

Mr. SULLIVAN. We do, and when we are looking over an agency's shoulders and seeing things going the wrong direction, that MOU does allow for us to get those issues directly before John Graham, and he directs his attention immediately to them. The reason that I have concerns with that provision in 2345 is it almost gives the program office, whether it is at SBA, Department of Transportation, or anywhere else, the excuse not to do their homework and to simply pawn it off on the Office of Advocacy to do their homework for them. I think that that is a dangerous movement towards the way that the Reg Flex can actually work.

Chairman MANZULLO. We can take a look at that. We had a series of hearings, two hearings, when HUD was in the process of trying to change that. But the RESPA, finally somebody woke up over there and withdrew it because of the angst that was caused. That was an $8 billion impact on small business, and the scholarship was just horrible. Why is it? Do we have a bunch of lazy bureaucrats in the agencies? Doesn't anybody take us seriously? Do we have to haul these agencies here one by one and say, follow the Regulatory Flexibility Act, threaten lawsuits? What is it?

To the four of you, if you could make any change in the RFA to wake these agencies up to the fact that small businesses are extremely important, what would you change in it? Jim, let us start with you.

Mr. GLOVER. I think that some agencies need to lose some very important and high-profile lawsuits, and I think that would be the most important thing. It is not so much a change in the RFA, although strengthening judicial review provisions would facilitate that, but it is a change in the environment in which people regulate.

Chairman MANZULLO. That is, some good defeats.

Mr. GLOVER. Correct.

Chairman MANZULLO. Judicially, we need some good impeachments to get these judges to follow the law as opposed to being creative. You do not have to comment on that.

Frank?

Mr. SWAIN. Well, Mr. Chairman, I agree with Tom that the biggest weapon on Reg Flex is to try the public embarrassment of the agency and the agency director, you and the other members of this Committee.

Chairman MANZULLO. I can do that.

Mr. SWAIN. That really works. It cannot be done on every regulation. Ultimately, to use the 50 cent word, the Advocacy Office's powers are hortatory. They can stand up and exhort people to do different things or do them better, but ultimately the decision still has to be made by the agency, and that is a tension that there will always be any time you set up a regulatory agency to regulate, and somebody else, whether it is OMB or Advocacy, to review.

I agree with Jim that the most significant changes could be made if we had some better court decisions that would bring us more into the mainstream of giving deference to SBA's positions, and that part of the law, I think, is useful, that gives Tom some—I am not a smart enough administrative lawyer to articulate it, but gives

Tom's or the chief counsel's opinions a greater level of deference in front of the courts such as similar to that that they are supposed to pay to the regulating agency. Now, how that would work out, I would be happy to talk informally about, but I think that would be very important.

Chairman MANZULLO. He does not want to feel like Rodney Dangerfield, you know.

Mr. SWAIN. That is the dilemma that I think every chief counsel for 25 years has tried to deal with.

Chairman MANZULLO. Tom?

Mr. SULLIVAN. Mr. Chairman, I think that we do get respect, and so in that way we certainly are distinct from Mr. Dangerfield.

The one change, I think, that small businesses consistently come to my office and say has to be done with the Reg Flex Act and a loophole that needs to be closed is the indirect impacts. Small businesses repeatedly come in and say, look, I know that I am not being directly regulated, but it is so obvious that my business will be devastated if this rule is allowed to go forward, and at that point, our office is largely helpless.

All of these other activities that we talk about; our office can raise significant issues on the RFA. Now, we may lose those issues, but it will not be for want of trying. When it comes to indirect impacts, we cannot even raise those issues because the courts say the agencies do not have to do the analysis. So for that reason, I believe closing the indirect-impact loophole is the most important change for H.R. 2345.

Chairman MANZULLO. That is similar to the IRS with its interpretive. In fact, several years ago, the IRS decided to take a dentist in rural Illinois and put him on the accrual system as a pilot program, and once the commissioner found out about that, he took care of that.

Mr. SULLIVAN. Well, Mr. Chairman, you gave me only one choice for a change. If you had given me two, that would have been the second.

Chairman MANZULLO. That would be the second one there. But the IRS goes, just say it is interpretive, and, therefore, we do not have to do any obeisance to the statute. It does not make sense.

Jere, you looked at this for a long time.

Mr. GLOVER. I have, and, unfortunately, the cases that have been coming down in the last few years have weakened the law, and I think unless you get some clear reversals and some agency regs thrown out, the agencies, no matter what other change you make, will not take the law seriously. And I think that the judicial review provisions are critical, and I think deference to the chief counsel's opinion is secondary to that but is very high ranked because I think that the courts should have considered this to be just like NEPA and have not.

I think all of us involved in passing the law in 1980 and in SBREFA when judicial review was provided felt that we really put serious teeth into it, and a fair review of the court decisions that are coming down indicates the courts will go to great lengths to find reasons not to find a violation of the Reg Flex Act. In many cases, they simply ignore the law and do not discuss it at all while

it is briefed. In other cases, they find some other excuse not to do it.

We have had very few clean successes in the courts, and unless you change that, the agencies will always do something for Reg Flex, but when it comes to something they really want to do for some other reason, they are going to ignore it, or they are going to give it lip service and move on. Only the fear of having all of their work thrown out and having to start all over will make them respect the Reg Flex Act.

Chairman MANZULLO. Thank you.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Sullivan, the remarkable savings that your office has achieved is something of a double-edged sword. On the one hand, you testified that you have achieved a regulatory cost savings of $47 billion over the last three years. Those savings do not even include scores of items where savings are impossible to estimate.

I know you are proud of this record, but doesn't this level of proposed burden indicate that the agencies still have not gotten the message? I mean, part of the president's small business plan was to order agencies to reduce the burden on small businesses, yet the agencies continue to propose more and more burdens unless you intervene to stop them. So is the president's plan failing?

Mr. SULLIVAN. Ms. Velazquez, I do not believe that the president's plan is failing. You actually point out a very interesting dynamic related to the cost savings. We do articulate $31 billion of cost savings over the last three years. The irony in that statement, Congresswoman, is that the better job we do, the less cost savings will occur. The reason that that statement is true is because the whole sense of the Reg Flex Act is for agencies to consider small business impact before they propose rules, very early on in the process.

So this may not slow down the level or number of rules that appear in the Federal Register, but what it should do is make sure that if an agency is adequately considering small business impact, preproposal, then what you read in the Federal Register would be the least-burdensome set of alternatives left to articulating the regulatory direction of laws that are passed by Congress. So in that scenario, Congresswoman, we would end up documenting less cost savings. We would also end up not necessarily articulating fewer rules, but we would have some indication that those rules are better sensitized to small business impact, better analytically and publicly fleshing out the analysis of how they will affect small business than they are currently.

You also stated, isn't there still a tremendous problem? And the answer to that is yes, and that is why it is so important that legislation like this to amend the RFA gets serious consideration. We have a lot of work to do.

Ms. VELAZQUEZ. Sure. It is being shown by the amount of cost saving in terms of regulation and the fact that you mentioned the $31 billion. When we added the other numbers that you included, it totals $37 billion over the last three years. So, on the one hand, you have orders coming from the warehouse saying to the federal agencies that they have to do cost analyses in terms of the impact

of those regulations on small businesses, but the fact that you have been able to stop them from doing so shows that they are not getting the message and complying with the president's orders.

Mr. SULLIVAN. The Congresswoman points out exactly why the RFA needs to be improved or strengthened, because even though we do document more and more savings, we are still not there yet.

Ms. VELAZQUEZ. I have five minutes. Let me make the other question.

Mr. Sullivan, I was surprised that the new Section 613, which directs Advocacy to write government-wide regulations to support implementation of the RFA, was not listed among your top priorities. In fact, I was more surprised that you do not mention it at all in your testimony. Do you support this proposed new section, and why didn't you mention it?

Mr. SULLIVAN. Congresswoman, there are a number of priorities that the small business groups have come in to tell us were important in improving the Reg Flex Act, and the ability to write rules was not in that laundry list of improvements. For the record, and you do, just by asking the question, give me the opportunity to bolster the record, my office is fully supportive of that provision to give our office the authority.

Ms. VELAZQUEZ. Thank you. Do you think it would be difficult to write these regulations?

Mr. SULLIVAN. Yes. It will be difficult, but certainly we will improve the overall framework of regulatory development for small business.

Ms. VELAZQUEZ. Do you think it is possible to receive deference from the courts for your opinion on compliance with the RFA without regulations, as Mr. Glover and Mr. Morrison suggest?

Mr. SULLIVAN. I believe that the legislative fix to give our office deference will likely make the difference. The specific legislative authority for our office to write the rules will obviously bolster our chances, but I do not know, with absolute certainty, how the courts will view that.

Ms. VELAZQUEZ. Thank you.

Mr. Glover, your testimony includes a cost analysis of the panel process using the RFA. The bill we are considering will add the IRS, CMS, and the FCC to this costly process. Assuming that these will add at least 20 panels per year to Advocacy's workload,—IRS, for example, assumes that they will have to do 10 panels per year—can you walk us through the costs associated with that level of effort? How many lawyers, support staff, supervisors? Would they need a support contract? Can you give us a ball park figure?

Mr. GLOVER. I viewed the panel process as one of my most important roles once the briefs have passed, and I try to attend every panel meeting. We had, generally speaking, two staff work on the panel process, one of the professional staff and one of the economists. We averaged five to 600 hours per panel in terms of workload. The most successful panel that we were involved with, we had outside economists, consultants, do the analysis. Probably the best money I ever spent in my life was the one for the ergonomics rule where we had an outside consultant go over OSHA's economics panel.

You figure about every three panels equals one more person, seven people, minimum, to get 20 panels. You are talking about two and a half to $3 million.

Ms. VELAZQUEZ. Two and a half to $3 million.

Mr. GLOVER. You need the economic background and support certainly at the beginning of the process. Once you get down, you may not need as much economist time as you do when you start, but those first few times, and you are learning a lot more about the agencies. I always felt the panel process was the highest return on investment that we made in terms of resources because we were getting there before the agency had publicly locked into a position.

Ms. VELAZQUEZ. Mr. Swain, I know that you have been through this process before. Do you agree with those estimates?

Mr. SWAIN. Ms. Velazquez, we had something similar to panels, but that provision was not available to me when I served. I do not have a view as to the numbers, although the number of people that Jere suggested strikes me as about right. If you have a panel, you cannot do it halfway; you really have to have somebody pretty much dedicated to it. So I would not be surprised if it were well north of a million and maybe, depending on how many times they did it, two or three.

And the problem that every chief counsel has is that you have to make choices as to which rules you get engaged with because there are many more rules that arguably impact small business than you could possibly deal with, so every time you choose to look at an FCC rule, there is somebody over at the EPA that you probably should be looking at that you just do not have the human power to do it.

So if this provision of the bill is passed, I think it would be necessary to significantly increase the budget of the office because I do not think anybody can borrow enough people to do the panels and continue to do the regular job.

Ms. VELAZQUEZ. Thank you.

That brings me to you, Mr. Sullivan. You strongly support the expansion of the panel process, and I am sure that you have thought long and hard about how much the panel process will cost. If we pass this legislation, do you have the resources to implement it?

Mr. SULLIVAN. I believe that our office does have the resources at full staff to abide by the legislation if it is signed into law.

Ms. VELAZQUEZ. I am stunned to hear that, sir. Mr. Glover and Mr. Swain here; they sat on that chair that you are sitting today, and they are saying two and a half million dollars. We are bringing them as witnesses here because of their expertise and their experience.

I just cannot accept you sitting there with a straight face and telling me that you have the resources. You know you do not, the same way the administrator does not have the resources, and knowing that the budget that was submitted to us was not adequate, and you saw what happened back in January when we had to shut down, or they shut down, the 7[a] loan program because the administration did not submit an adequate budget.

You know you do not have the resources, and I would ask for you to submit to this Committee in writing your informed estimate of

how much and how many panels per year you have, how much was spent on those panels in terms of resources, how many panels you will expect if H.R. 2345 is adopted, and your analysis of the cost to Advocacy in terms of resources.

Mr. SULLIVAN. You certainly will have that analysis, Congresswoman. Thank you.

Ms. VELAZQUEZ. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

Congresswoman Bordello?

Ms. BORDALLO. Thank you, Mr. Chairman.

Good afternoon, gentlemen. I think my question would be directed to Mr. Sullivan. I see that Section 3 of H.R. 2345 would require land management plans issued by the United States Forest Service and the Bureau of Land Management, that they be subject now—this is something new—to the requirements of the RFA. What are the implications of this change for all parties involved, including private landowners, private small businesses, and the respective agencies, as they attempt to comply with their new statutory mandates?

Mr. SULLIVAN. Congresswoman, the practical effect of the language would be to close a loophole from a Supreme Court case that dealt the RFA a little bit of a blow, and that was to not recognize the land management regulatory system as final actions for purposes of the Reg Flex Act, and the listing of the Land Management Act provisions just simply closes that loophole.

Ms. BORDALLO. I see.

Mr. SULLIVAN. The chairman's counsel actually is someone that my office relies on when we are stretched for staff because we do have very few staff, and we have to rely on outside folks, including congressional staff and stakeholders and small business groups. Barry Pineles was very astute in identifying that the Supreme Court case that dealt with land management plans had shut small business out of the process from commenting substantively on them, and this provision in 2345 fixes that problem.

Ms. BORDALLO. Fixes that up. So it was an oversight and something we had to correct. Is that correct?

Mr. SULLIVAN. That is correct, Congresswoman.

Ms. BORDALLO. Does the RFA currently apply to the Fish and Wildlife Service and National Park Service, and if so, what sort of impact has it had on small businesses, the agencies themselves, or any other interested parties, in your experience?

Mr. SULLIVAN. In my experience, with regard to the Fish and Wildlife Service in the Department of Interior, we have definitely gotten their attention. The fisheries management plans that are going on, most intensely in my home town of Boston, will severely impact small fishermen or small businesses that have devoted their lifetime to fishing, and for some time the policies in those plans really kind of shut small business out of the process. And with the work of my office in every part of that system, from the regional management systems all the way here to Washington out of the Department of Commerce, we have inserted ourselves into that process to the point that now they are coming to us for advice on the economic impact analysis prior to writing management plans rather than afterwards.

We have got a long way to go with the Fish and Wildlife Service, but we are better off now than we were about five years ago.

Ms. BORDALLO. Naturally, I am interested in this because I represent a territory in the Pacific. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. Well, thank you very much.

Something has to be done. There is a law on the books that people just do not seem to take seriously, and a major agency has put out a proposed regulation, taking just a very shallow view of the RFA, should know better, but I think it is just a pattern that is out there.

As I recall, Tom, when the president put out the executive order, wasn't there something in there that instructed your office to teach these agencies how to comply with the RFA?

Mr. SULLIVAN. Yes, Mr. Chairman. Getting the respect of agencies is more than simply writing the letters criticizing their approach or criticizing their lack of compliance with the RFA. That goes to some distance but really not enough. So in the president's executive order, he required not only for us to remain vigilant in publicly criticizing the agencies' approach or lack of compliance with the RFA but also to train the agencies with how they are supposed to take into account their impact on small business.

Chairman MANZULLO. Tell us your experience there because I know you had quite a program. You invested a lot of time and energy on that.

Mr. SULLIVAN. We actually have a senior counsel, Claudia Rayford, who has run that program with tremendous success. I will get the specific numbers to the Committee after the hearing. We have trained over a dozen agencies where we go in for close to a full day with the rule writers and walk them through, step by step, this is what it takes to do the legitimate outreach, the legitimate economic analysis, the legitimate consideration of less-burdensome alternatives in order to comply with the Reg Flex Act. Every one of these trainings has received compliments from the folks that we are ordinarily critical of. It has been a sea change of attitude from an adversarial attitude towards a partnership attitude, and we have actually taken it a little bit further.

Knowing that we are not going to be able to shoulder this entire burden ourselves, we have opened up this training to all stakeholder groups like NFIB, Chambers of Commerce, builders and contractors, home builders, and also congressional staff. They came in for a training as though they were regulators to simply be informed how we are training agencies. We believe that that better arms the small business community with the knowledge to know what are agencies supposed to be doing.

And Congresswoman Velazquez points out a significant issue of resources. If more agencies have to do the analysis, and, hopefully, more agencies do the analysis and come to my office first, that means more work, and one of the ways that we are hopeful to spread out that work is to better inform and arm all of the stakeholder community with what to expect from the agencies so that not only is the Office of Advocacy acting as an oversight mechanism as the enforcer of the RFA, but the Associated Builders and Contractors are, the Chamber of Commerce is, NFIB is, the Na-

tional Small Business Association is, similarly to the way Congress and this Committee, in particular, also was looking over the shoulders of agencies to make sure that they were doing the Reg Flex Act.

Chairman MANZULLO. Have you noticed any positive results? Are they listening to you? is my question.

Mr. SULLIVAN. Some are, and some are not, and if they all were listening and acting, then I would have different testimony submitted to this Committee saying, you know, the system is not broken; let us not fix it. Some are listening. The ones that we get in and train are giving positive response and then actually following up with our office to say, look, we are working on a few regulatory proposals. Can we work with you to make sure that our impact analysis meets the straight-face test?

The classic example is after September 11th when FDA was trying to look at rules to protect the nation's food supply. When the President signed the executive order, and folks at FDA learned about this, they came to our office and said, oh, we should probably check with you before we start writing rules that are going to affect mom and pop supermarkets and local farm stands, and they did, and it is that type of early interaction———.

Chairman MANZULLO. Did you notice that the RFA report was of quality as a result of the meeting with you? Maybe that is not a fair question. Let me ask the question again. Do you feel that the fact that they came to you ended up in a report that was more responsive than if they had not come to you?

Mr. SULLIVAN. It is a better starting point than we have had in the past, but we are still not at the point where we can simply step back and say, you know, this agency really gets it, and we look forward to their final reports and rules because we are confident that that is going to reflect an adequate analysis of small business impact and alternatives. We are not at that point yet; otherwise, we would not need a strengthening of the RFA.

Chairman MANZULLO. Well, again, I want to thank you all for coming this afternoon. We continue to work on it. We continue to work on the bill. I always appreciate your input.

Ms. BORDALLO. Mr. Chairman, can I put in a point?

Chairman MANZULLO. Sure. Absolutely. Go ahead.

Ms. BORDALLO. Mr. Chairman, I am, you know, rather new here, a freshman member of Congress, but you mentioned something that kind of caught my attention, and that was, is there any mechanism in place for agencies that do not pay any attention?

Mr. SULLIVAN. Congresswoman, right now, the mechanism is for my office to file an Amicus action in support of a challenge to an agency, so that is a litigation alternative that exists. It is the hammer.

Ms. BORDALLO. Is it effective?

Mr. SULLIVAN. It is not as effective as it could be, and that is one of the things that H.R. 2345 seeks to close as a loophole. If the Congresswoman would allow for me to amend a response to the Ranking Member as well, I think that, Congresswoman, I answered you, I think, a little bit too shortly when I said we can handle the resources of the panels. I think that in fairness to the Committee and the attention that you bring to the Reg Flex Act, yes, I think

that we can handle it with our resources, but that is not fair to you to say that if we cannot, then it is incumbent on me to come to this Committee and say, these are the additional resources that we need.

So not only will I get the chairwoman the breakdown of the panels, but I also will give this Committee my commitment that when we are past the breaking point or close to it, we will absolutely come to this Committee first and ask for the additional resources we need to make this amendment, this law, work. Thank you, Congresswoman Bordallo.

Chairman MANZULLO. Thank you very much. The Committee is adjourned.

[Whereupon, at 3:57 p.m., the Committee was adjourned.]

Congress of the United States

House of Representatives

108th Congress

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515–0515

Statement of Donald A. Manzullo
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC
May 5, 2004

The Committee has held a number of hearings during my tenure as Chairman in which we examined agency compliance with the Regulatory Flexibility Act or RFA. These hearings all reached the same conclusion. The RFA is an important law that, if fully complied with in both letter and spirit, has the potential to significantly reduce the regulatory burdens on small businesses.

The President also recognized the importance of the RFA in a March 19, 2002 speech and noted that federal bureaucrats tended to ignore the law. That speech gave rise to a memorandum of understanding between the Chief Counsel for Advocacy and the Director of the Office of Information and Regulatory Affairs (OIRA) at the Office of Management Budget. The President also issued an Executive Order mandating that agencies develop procedures for complying with the RFA.

The efforts of the President, Dr. Graham, the head of OIRA, and Chief Counsel for Advocacy, Tom Sullivan have done admirable jobs in improving agency compliance with the RFA. However, their efforts continued to be hindered by bureaucrats that seek to perform the minimum amount of analysis possible and courts that seek to abet them in

the process. In short, the efforts to obtain compliance are, in part, hampered by the flaws in the RFA itself.

Given the inadequacies of the RFA, I, along with Mr. Pence, Mr. Terry, and Mr. Ose introduced H.R. 2345, the Regulatory Flexibility Improvements Act. The bill is designed to significantly strengthen 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 but I will highlight two of the most significant changes.

As one of the witnesses will testify, 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 harming the growth of the American economy. After all, even NEPA recognizes the importance of socio-economic effects of actions. Should not agencies develop detailed information on the economic impact of their regulations? Of course agencies should, and H.R. 2345 ensures that they will.

The other major change relates to the Office of Advocacy and its role under the RFA. 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. Furthermore, the United States Court of Appeals for the District of Columbia Circuit has determined that the interpretations of the RFA by the Chief Counsel are not to be given any more deference than is deserved by the persuasiveness of the arguments. 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.

H.R. 2345 represents a comprehensive fix to current weaknesses in the RFA. When the RFA was enacted, opponents said it would slow the promulgation of rules. Any examination of the size of the Federal Register in 1980 with that today will see that the RFA has done no such thing. During the debate over the amendments to the RFA made by the Small Business Regulatory Enforcement Fairness Act or SBREFA,

opponents argued that judicial review would create a stampede to the courthouse. This committee is not aware of any such rush by small businesses to file lawsuits challenging RFA compliance. And any arguments about the horrors of H.R. 2345 that will be raised by opponents are also unlikely to come true.

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. No good reason exists to oppose those goals and objectives other than the obstinacy of the status quo. If the status quo needs fixing so be it. I promise to work with the individuals testifying, Chairman Sensenbrenner and House leadership to see that necessary changes in the RFA are made, to paraphrase the President, so the law is on the books and federal agencies will care that the law is on the books.

I now recognize the ranking member, the gentlelady from New York, for her opening remarks.

COMMITTEE ON SMALL BUSINESS
RANKING DEMOCRATIC MEMBER

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Congress of the United States
House of Representatives
Washington, DC 20515

NYDIA M. VELAZQUEZ
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STATEMENT
of the
Honorable Nydia M. Velázquez, Ranking Democratic Member
House Committee on Small Business
Regulatory Flexibility Improvement Act of 2003 – H.R. 2345
May 5, 2004

Thank you, Mr. Chairman.

Small businesses today face an array of challenges that weigh on them more heavily than their corporate counterparts. One of those challenges is federal regulations, and the disproportionate burden they place on our nation's small firms.

A recent study showed that for firms with fewer than 20 employees, the annual regulatory burden is nearly $7,000 per employee – almost 60 percent higher than that of firms with 500 employees or more. This is unfair – and something needs to be done about it.

The Bush administration has acknowledged this unfairness, and has promised to help. But the truth is President Bush actually holds the all-time record for the number of federal regulations submitted and issued under any president.

A law is on the books that does offer some protection to small business – the Regulatory Flexibility Act (RFA). Enacted more than two decades ago, the RFA requires federal agencies to consider the impact their regulatory proposals have on small entities.

But if agencies were actually doing their homework, then the SBA Office of Advocacy wouldn't have to intervene with them in 50 to 100 cases each year. This demonstrates just how reluctant agencies are to fully comply with the requirements of the RFA.

There are loopholes and problems with the RFA that are exploited by these agencies. The bill before us today – the Regulatory Flexibility Improvement Act (H.R. 2345) – seeks to close some of these loopholes and hold agencies accountable for their overly-burdensome rules. At this hearing, we will evaluate H.R. 2345, the changes it proposes to the RFA, and what effect this will have on small businesses.

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The bill does several things. First, it clearly defines the specific economic effects to be examined by agencies, and sets out requirements for greater precision in performing this analysis. It also provides the leverage Advocacy will need to take on these executive agencies in court.

In addition, H.R. 2345 would apply the panel process to a handful of agencies that routinely ignore the RFA – the IRS, CMS and the FCC – and compels them to use a more rigorous system of rule evaluation. As shown by EPA and OSHA, the panel process has gone a long way in helping identify and reduce the impact of rules on small businesses, while still achieving overall health and safety goals.

As you can see, H.R. 2345 is an ambitious piece of legislation. Given this, and the limited time we have left in the Congressional schedule to actually get things done, the likelihood of H.R. 2345 reaching the president's desk is slim. But I do believe that today is a good start, and I look forward to working with the Chairman to reduce the regulatory burden on our nation's small firms.

I would also like to thank the Chairman for addressing this issue. It is the first hearing we have held in quite some time that directly affects legislation under our Committee's jurisdiction.

The burden of federal regulations is a real problem for small businesses across the country. Unfortunately, agencies tend to use a one-size-fits-all approach that mainly hurts our small business owners. Through H.R. 2345, we have the opportunity to make the RFA a stronger and better enforcement tool, ensuring that federal agencies are held to more stringent regulation standards.

If small businesses are less burdened by government rules, they are in a better position to grow our local economies and create jobs. And this will give a boost to our economy and provide employment opportunities for the millions of Americans still searching for work.

Thank you, Mr. Chairman.

Statement of the Honorable Lee Terry
Before the House Small Business Committee
U.S. House of Representatives
Washington, DC
May 5, 2004

Mr. Chairman, thank you for inviting me to testify today before the Committee and for your leadership in protecting America's small businesses.

I represent Nebraska's Second Congressional District located in the heartland of America. My district, like many others, is home to numerous small businesses, the lifeblood of our communities.

In the midst of our recent national debate on "outsourcing" and creating more jobs within the United States, the small business community plays a vital role. Small businesses represent more than 99 percent of all employers, are responsible for the majority of job creation, and are represented by 12 million owners who are women or minorities. Clearly, the American economic engine is powered by small business.

One of the reasons that small business owners are reluctantly considering outsourcing is because they are hurt disproportionately by the costs imposed by government regulations. In fact, one of their most common complaints from small business owners is that federal regulations are onerous, often make no sense, and are written in ways that makes compliance difficult.

Congress first showed its willingness to address these regulatory burdens when it passed the Regulatory Flexibility Act (5 USC 601) in 1980.

Under the Regulatory Flexibility Act, many agencies proposing rules that would have a "significant" economic impact on small business, small not-for-profit organizations, or small governmental entities must prepare a Regulatory Flexibility Analysis (RFA) and try to find simpler, less burdensome ways for such small organizations to comply with federal requirements.

The Act did not require an agency to abandon a proposed regulation because it might have a "significant" impact on small entities, only to consider less burdensome alternatives and to explain why it rejected those alternatives.

If a proposed regulation comes under the Act, the agency must prepare an Initial Regulatory Flexibility Analysis, which is published along with the proposed rule and sent to SBA, who oversees the Act's enforcement.

After the comment period, the agency must prepare a Final Regulatory Flexibility Analysis, which should respond to any issues raised in the public comments and which is published with the final rule or made available to the public.

While the RFA was an important first step in eliminating onerous burdens on small business, it was not without shortcomings. One of the most important aspects of reform is to clarify and expand the rules covered by RFA.

One reform, contained in Section 3 of H.R. 2345, amends the coverage of the RFA to regulations from agencies that are not currently covered.

For example, under the current Regulatory Flexibility Act, the Federal Communications Commission (FCC) is not required to make the same small business considerations as the EPA, OSHA, or other agencies. When the FCC is modifying regulations that affect the operation of the telephone network, the agency is not required

to examine the impact of the proposed change on small business because it has been determined that small business users are not directly within the regulatory jurisdiction of the FCC. Yet almost all small businesses have telephone networks and/or use telephone services. Further, small businesses often do not have the time or resources to wade through a FCC proposal and relate the impact that it would have on its cost of using the telephone network.

Mr. Chairman, in the 107th Congress, I introduced legislation that would have required any rural impact analysis to be submitted to the FCC for review, including an analysis describing the impact of a proposed rule on rural telephone companies and wireless carriers. I am pleased to see that you have included a similar reform in H.R. 2345.

To further illustrate my point, when the Federal Energy Regulatory Commission mandated open access for electricity transmission, Congress required FERC to assess the impact of those rules in a detailed environmental impact statement.

Likewise, when the EPA modified its national ambient air quality standards for ozone and particulate matter, it had to prepare an environmental impact statement.

While each of these considerations required a voluminous assessment of environmental impacts, none of the decisions required an assessment of the economic impact of regulations on small businesses. Yet these impact assessments are predictable, significant, and carry a price tag to the small business owner.

Mr. Chairman, another important reform you have included in your bill is a new Section 613 of the RFA, which mandates that the Chief Counsel of the Small Business Administration issue advisories to agencies that must be adhered to during the regulation-

writing process. These advisories can be used by small businesses in suits to enjoin agencies from onerous, illegal regulations and greatly assist the Chief Counsel in fighting burdensome regulations on behalf of small businesses.

Mr. Chairman, H.R. 2345 is an important bill for these and other reasons. Your leadership on this issue and the effort to reduce regulatory red tape by championing this legislation is important. At a time when the threat of outsourcing and the need to create new jobs is a priority of the Congress, the Regulatory Flexibility Improvements Act provides a big assist to small business owners.

Mr. Chairman, thank you again for this opportunity to testify and I look forward to working with you in getting H.R. 2345 enacted into law.

Statement of Mike Pence
Before the
Committee on Small Business
United States House of Representatives
Washington, DC
May 5, 2004

Thank you, Chairman Manzullo for inviting me to testify. I had the pleasure of serving you and America's small businesses for two years as Chairman of the Subcommittee on Regulatory Reform and Oversight. It is appropriate that I return to this Committee room to testify on a bill that I chose to cosponsor – H.R. 2345, the Regulatory Flexibility Improvements Act.

During my tenure as a Subcommittee Chairman, I held a number of hearings and one very comprehensive roundtable on the regulatory burdens facing small businesses. Every trade association and group had different concerns because of the agencies that regulated their members' businesses. Yet, almost all the witnesses that came before the Subcommittee expressed two consistent themes. First, small businesses faced problems complying with complex, often arcane federal regulations that they are unaware of until a federal inspector comes through the door. Second, the analyses done in support of regulations often were inadequate and did not focus on the problems facing small businesses.

Certainly much has changed since I became Chairman of the Subcommittee on Regulatory Reform and Oversight. President Bush declared that it was the policy of his Administration that federal agencies were no longer to ignore compliance with the Regulatory Flexibility Act. Dr. John Graham, the head of the Office of Information and Regulatory Affairs (OIRA) at the Office of Management and Budget has done a remarkable job with a small staff in revamping review of regulations and demanding sound scientific and economic support for regulations. Tom Sullivan has been admirable advocate on behalf of small businesses and from my, albeit distant, perch is working closely with Dr. Graham in ensuring that federal agencies comply with the Regulatory Flexibility Act (RFA).

Given the success of this Administration in imposing a significant degree of rationality in the issuance of regulations, why is it necessary to enact H.R. 2345? First, Congress continues to enact legislation that will require regulations, such as the prescription drug benefit for Medicare-eligible individuals. Second, administrations come and go and so do the people that staff them. The replacements may not be as qualified or as dedicated or may have different agendas based on that President's policies. Third, political appointees come and go but most agency personnel remain and they may not be as committed to compliance with the RFA. Fourth, court interpretations of the Regulatory Flexibility Act are unchanged by the actions of the Executive Branch and agency personnel will use those interpretations to avoid performing the analyses that Congress mandated. At bottom, the United States distinguishes itself from other nations because it operates under the rule of law in which the actions of federal agencies are subject to significant

public scrutiny and challenge in the courts. Leaving compliance with the RFA to the whims of federal agency personnel undermines the basic principle that this country is one of rule by law not people.

Even if Dr. Graham and Mr. Sullivan do their jobs flawlessly, the RFA itself has flaws. Courts have identified those flaws and agencies will exploit those loopholes to avoid performing analyses that might undercut the rationale for their predetermined regulatory outcomes. That is simply unacceptable.

In evaluating actions that adversely affect the environment, federal agencies first study the scope of any adverse actions, the consequences of taking an action, and alternatives to the proposed action. Agencies should take the same rational approach when promulgating regulations. Before even putting pen to paper, the agency should determine whether a problem exists, the scope of the problem, and potential regulatory alternatives. The RFA can, if all the loopholes are closed, play a key role in this rational rulemaking process.

The President has said compliance with the RFA is important and the only way to ensure that compliance really occurs under this President and in future administrations is to make the law tougher. For these reasons, I determined that cosponsorship of H.R. 2345 is important and support your efforts to move the bill, enact into law, and protect America's small businesses.

Again let me thank, you, Mr. Chairman, for the opportunity to testify. As a member of the Judiciary Committee, which also has jurisdiction on this legislation, I look forward to assisting your efforts in moving this important legislation.

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Testimony of
Thomas M. Sullivan
Chief Counsel for Advocacy
U.S. Small Business Administration

U.S. House of Representatives
Committee on Small Business

Date:	May 5, 2004
Time:	2:00 P.M.
Location:	Room 2360 Rayburn House Office Building Washington, D.C.
Topic:	Improving the Regulatory Flexibility Act-H.R. 2345

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 Manzullo, Ranking Member Velazquez, Members of the Committee, good afternoon and thank you for the opportunity to appear before you today to address H.R.2345, 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. As Chief Counsel for Advocacy, I am charged with monitoring federal agencies' compliance with the Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA). Because my office is independent, these views are my own and do not necessarily reflect the views of the Administration or the U.S. Small Business Administration.

Success of the Small Business Regulatory Enforcement Fairness Act

Congress enacted the RFA in 1980 after determining that uniform federal regulations produced a disproportionate adverse economic hardship on small entities. In an attempt to minimize the burden of regulations on small entities, the RFA mandated federal agencies to consider the potential economic impact of federal regulations on small entities and 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. Therefore, agencies could not be held legally accountable for their noncompliance with the statute. Consequently, many agencies ignored the RFA and did not conduct full regulatory flexibility analyses in conjunction with their rulemakings. In response to the widespread agency indifference, Congress amended the RFA in 1996 by enacting the

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 analysis is prepared to ensure that the agency has considered the economic impact of the regulation on small entities and that the agency has considered all significant regulatory alternatives that would minimize the rule's economic impact on affected small entities. The RFA allows an agency to certify a rule in lieu of preparing a regulatory flexibility analysis if the head of the agency "certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." Pursuant to SBREFA, the agency must provide a factual basis for the certification.

SBREFA has been successful. In general, agencies have paid closer attention to their RFA obligations and implemented 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 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.[1] Similarly, in FY 2002, the Office of Advocacy's efforts to improve agency compliance with the RFA

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

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.[2] Most recently, 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.

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 giv[ing] 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. To further this goal, on August 13, 2002, the President signed Executive Order (E.O.) 13272, titled "Proper Consideration of Small Entities in Agency Rulemaking."[3]

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

[2] 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, Advocacy's interventions in FY 2002 resulted in more than $3 billion in first year cost savings.
[3] E.O. 13272 can be found on the Office of Advocacy's website at http://www.sba.gov/advo/laws/eo13272.pdf.

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.

As a result of E.O. 13272, all Cabinet-level departments, except the Department of State and the newly formed Department of Homeland Security, have developed written plans in compliance with E.O. 13272. The performance of the independent agencies, however, was not as stellar. Of the 75 independent regulatory agencies, only 16 responded to the requirements of the E.O. Of those 16, only eight provided written procedures, six claimed that they did not regulate small entities, and two claimed to be exempt from the E.O.. In terms of training, Advocacy has trained 19 agencies and is planning to train 30 agencies before the end of this year. More importantly, several agencies have actively sought ways to improve their compliance either through involving Advocacy early in the rulemaking process or reaching out to small entities.

The Construction and Development Water Quality (C&D) rule considered by the U.S. Environmental Protection Agency (EPA) is indicative of the type of success that can be achieved through interagency cooperation and agency compliance with the dictates of the RFA and E.O. 13272. The original draft proposed rule carried a price tag of almost $4 billion per year. The rule contained new requirements that overlapped with existing storm water programs. Fortunately, small business had a voice in the rulemaking process

because of the panel process that was enacted as part of SBREFA. The panel requirements apply to EPA and the Occupational Safety and Health Administration (OSHA) and require those agencies to formally consult with small businesses prior to issuing a proposed rule. Small businesses provided information about the potential impact of EPA's C&D rule and offered other options. After reviewing the information, the SBREFA panel concluded that the C&D requirements would add substantial complexity and cost to current storm water requirements without a corresponding benefit to water quality. The panel recommended that EPA not impose the C & D requirements, and focus instead on improving public outreach and education about existing storm water rules. On March 31, 2004, EPA announced that it would not impose new duplicative, costly, and complex requirements for construction sites.[4]

H.R. 2345

Even though the last few years have yielded a number of successes, there are certain loopholes in the RFA that were not addressed through the E.O. or SBREFA. H.R. 2345 would amend the RFA to address many of the gaps or problem areas. Since Advocacy takes its guidance from small entities, Advocacy met with small entity representatives to discuss the most important issues in H.R. 2345. The most prevalent issues are:

1) direct v. indirect economic impacts;
2) inclusion of the Internal Revenue Service's (IRS) interpretative rules;
3) the importance of analyzing cumulative impacts;
4) the importance of analyzing beneficial impacts; and
5) the expansion of the panel process to more agencies.

[4] A press release on the C&D rule can be found at http://www.sba.gov/advo/press/04-11.html.

Direct v. Indirect Economic Impacts

Of all the issues, the most prevalent concern of the small business community is the lack of inclusion of indirect impacts in the current version of the RFA. Pursuant to sections 603, 604 and 605(b) of the RFA, agencies are required to consider the economic impact of an action on small entities. Although the RFA does not define economic impact, the committee report for the RFA suggested that agencies should consider direct and indirect impacts of the proposed regulation. The courts, however, have interpreted the RFA differently.

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. F.E.R.C., 249 U.S. App. D.C. 64, 773 F.2d 327 (1985) (hereinafter Mid-Tex). Mid-Tex addressed a FERC rule that electric utility companies could include in their rate bases amounts equal to 50% of their investments in construction work in progress (CWIP). 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 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.[5]

[5] Id. at 342.

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. E.P.A., 175 F.3d 1027, 336 U.S.App.D.C.16 (D.C.Cir., May 14, 1999) (hereinafter ATA). In the ATA case, 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 5 USC § 605(b). The basis of the certification was that EPA had concluded that small entities were not subject to the rule because the NAAQS regulated small entities indirectly through the 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.[6] 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.[7]

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 decisionmaking 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, who would the utilities pass the investment costs on to, etc. Unfortunately, the idea of the RFA not applying to indirect economic impacts is now being used by agencies in cases where the impact is reasonably foreseeable, which usurps the spirit of the RFA.

[6] Id.
[7] Id.

The 2002 Immigration and Naturalization Service's (INS) rule on B nonimmigrant alien visas 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 (6) months 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 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 economically devastating to a particular industry.[8] Advocacy reiterated this position at a hearing before the Small Business Committee in June 2002.[9] Representatives from the travel industry also testified at that hearing about

[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 is located at http://www.sba.gov/advo/laws/test02_0619.html.

the potential economic impacts that their businesses would have experienced as a result of INS's actions.

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. 2345, which defines economic impact to include foreseeable indirect economic impacts. Requiring agencies to perform a regulatory flexibility analysis would provide the public with information about the potential economic impact of an agency's proposed action. More important, it would require agencies to consider less costly alternatives that would help create an environment where entrepreneurship can flourish.

Inclusion of Certain Interpretative Rules Involving the IRS

Section 3(f) of H.R. 2345 expands the scope of applicability of the RFA to IRS actions that impose a recordkeeping requirement without regard to whether the requirement is imposed by statute or regulation. Traditionally, the IRS's compliance with the RFA has been marginal. The IRS implements changes that are resource-intensive for small entities. However, it often usurps the RFA by asserting that the particular action is not a legislative rulemaking. Small entities, therefore, are often subjected to burdensome and costly actions without the benefit of an analysis or the consideration of less costly alternatives. Section 3(f) of H.R. 2345 addresses that problem by requiring the IRS to prepare an IRFA for all recordkeeping requirements. Advocacy strongly supports section 3(f).

Cumulative Impacts

Another issue that small business representatives feel strongly about is the consideration of cumulative impacts. Unlike the National Environmental Policy Act (NEPA), the RFA does not require agencies to consider the cumulative economic impacts of their regulatory actions. Therefore, it is possible for an agency to institute a series of regulatory changes that individually may not have a significant economic impact but may be cumulatively devastating when a small business has to comply with two or more of them.

An example of cumulative impacts can be found in the regulations that were implemented by the Department of Health and Human Services under the Medicare anti-fraud reforms that came out of the Balanced Budget Act of 1997. The statute affected every type of business in the health care industry. If we single out the home health industry, the Medicare reforms resulted in multiple regulations, each burdensome in their own right. These regulations included an interim payment system for home health agencies, surety bonds for home health agencies, a prospective payment system for home health agencies, and OASIS (outcome and assessment information set) patient assessment reporting. The cumulative impact of these rules was devastating to the home health care industry, but since the different segments of the rule were implemented at different times, the agency did not consider the cumulative impact of its actions.

Section 4 of H.R. 2345 addresses this problem by requiring agencies to estimate the cumulative economic impact of a proposed rule on small entities. For the reasons stated above, Advocacy supports this amendment to the RFA.

Beneficial Impacts

H.R. 2345 also amends the RFA to require agencies to consider the beneficial impacts of regulatory actions on small entities. Currently, the RFA is silent as to whether agencies need to consider beneficial impacts. However, the legislative history of the RFA indicates that Congress considered the term "significant" to be neutral with respect to whether the economic impact is beneficial or harmful to small businesses. It states 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 also to promote the growth and well-being of such entities.[10]

Although Advocacy has consistently maintained that agencies should analyze the beneficial impacts of the RFA, most agencies do not perform such an analysis. From Advocacy's standpoint this is unfortunate. By analyzing the beneficial impacts, the agency would be providing the public with important information about its assumptions in the rulemaking process. Amending the RFA to include beneficial impacts would clarify the original congressional intent and increase the transparency of the rulemaking process for small entities.

Suggested Improvements to H.R. 2345

Expansion of the Panel Process

Advocacy supports the expansion of the SBREFA panel process to better sensitize the Centers for Medicare and Medicaid Services (CMS), IRS and the Federal

[10] 126 Cong. Rec. H8,468 (daily ed. Sept. 8, 1980).

Communications Commission (FCC) to small business concerns. However, Advocacy is concerned about the changes that H.R. 2345 makes to the panel process. The panel process described in section 6 of H.R. 2345 provides Advocacy with responsibility for drafting the panel report. The current process produces a consensus report negotiated between Advocacy, OMB, and EPA or OSHA. Because it is a consensus document, agencies typically follow the recommendations. Moreover, Advocacy has developed a productive panel process with EPA and OSHA that may be jeopardized if the process is statutorily restructured at this time. Advocacy, therefore, recommends that H.R. 2345 expand the panel process to CMS, IRS and the FCC but make it consistent with the panel process that is currently in place.

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. 2345 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. Advocacy is concerned that vesting the authority to determine size

standards to the Chief Counsel for Advocacy may cause confusion over which SBA office determines size standards. 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 HR 2345 will benefit small entities.

Requiring Agencies to Address Advocacy's Written Comments

Although section 4(b)(3) of H.R. 2345 requires agencies to respond to Advocacy's comments if an agency prepares a FRFA, 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 2003, 11.7% of Advocacy comments were on improper certifications and 15.5% of Advocacy comments were on inadequate or missing IRFAs.[11] Under H.R. 2345, therefore, anywhere from 11% to 26% 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. 2345 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. H.R. 2345 in this way sets into law a key component of E.O. 13272 and would provide further assurance that small business has a voice in the rulemaking process.

610 Periodic Review

Section 610 of the RFA requires agencies to periodically review all rules that have or will have a significant economic impact on a substantial number of small entities.

[11] See, Report on the Regulatory Flexibility Act, FY 2003, page 14.

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. Section 7 of H.R. 2345 amends the RFA to require an agency to submit an annual report on the result of its plan to Congress and OIRA. I recommend that H.R. 2345 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.

Conclusion

Advocacy believes that H.R. 2345 makes several needed improvements to the RFA. The amendments will further federal agency understanding of RFA obligations. H.R. 2345 will improve the RFA to allow for a more thorough analysis, foster the consideration of alternatives that will reduce the regulatory burden on small entities, and improve the transparency in the rulemaking process.

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

JERE W. GLOVER TESTIMONY

UNITED STATES
HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

WASHINGTON, D.C.

May 5, 2004

Chairman Manzullo, Ranking Member Velazquez, and Members of the Committee, it is a pleasure to appear before you today to discuss strengthening the Regulatory Flexibility Act. I am Jere W. Glover with Brand and Frulla, P.C., a law firm specializing in litigation and regulatory and administrative law[1], and am CEO of two high tech small businesses. Prior to joining Brand and Frulla, I was Chief Counsel for Advocacy from 1994-2001. During my tenure as Chief Counsel, we issued over 100 reports and economic studies, testified before Congress over 30 times, intervened in over 200 agency rulemaking proceedings, and reviewed over 5,000 regulations.

I have spent much of my career trying to reduce the regulatory burden on small businesses to create a fair economic playing field that allows small businesses to grow and to ensure that regulations imposed on small businesses are really necessary, while addressing the problems actually caused by small business but without compromising public policy objectives.

Overall I believe it is fair to say that the Regulatory Flexibility Act ("RFA") has changed the way government regulations treat small business. The regulatory climate for small business has clearly improved. To illustrate: It has been documented that modifications to agency regulatory proposals have saved small business over 50 billion dollars. This would not have occurred without the RFA. Unfortunately, as I will illustrate, some agency compliance has lagged and the courts have seemed reluctant to fully enforce this law. This experience indicates that it may be time for additional modifications to the RFA.

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[1] I believe that our Firm has been involved in more RFA litigation since SBREFA's enactment than any other law firm in the country. We have been involved in litigation regarding RFA/SBREFA compliance with five 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), and the Federal Communications Commission (regarding wireline portability.)

A brief history of the Regulatory Flexibility Act will help us understand the current regulatory climate for small business. Prior to 1980, small business' biggest complaint with the government was the burden of regulations on their businesses. All regulations were size blind, meaning regulations were "one size fits all." A few very enlightened public servants, the Honorable Milton Stewart, the first Chief Counsel for Advocacy at SBA, Senator Gaylord Nelson, former Chairman of the Senate Small Business Committee and my fellow witness today, Jim Morrison, were in the forefront arguing for flexibility in regulatory design.

Once the concept of regulatory flexibility was developed and introduced in the Senate, my job at the time, as Deputy Chief Counsel for Advocacy, was to convince the Federal agencies to adopt the idea. Armed with a Presidential directive to have each Federal agency list its significant small business accomplishments in preparation for the 1980 White House Conference on Small Business, and a presidential executive order directing agencies to use regulatory flexibility in their regulations, I met with the heads and senior staff of all of the agencies to discuss small business regulatory flexibility. While a few agencies were willing to try the concept on a few regulations, the effort to obtain voluntary implementation of this regulatory reform could hardly be regarded as a success. Not surprisingly, the 1980 White House Conference went on to recommend adoption of the Regulatory Flexibility Act as one of its top priorities. The RFA became law later in 1980.

The Office of Advocacy, at the time 70 employees strong, started educating the agencies and trade associations about the wonderful new law. Over time several critical flaws became apparent, e.g. no judicial review, no mandatory small business input, an imprecise role for the Office of Advocacy and the ease with which agencies could certify that a regulation did not

affect a significant number of small businesses. It was difficult to escape the conclusion that agencies could ignore the RFA with impunity.

In 1996, after another White House Conference on Small Business, Congress passed and President Clinton signed the Small Business Regulatory Enforcement Fairness Act (SBREFA), which corrected some of these shortcomings. The Office of Advocacy, then with a staff of 58 employees, educated and trained over 2,000 agency and trade association employees. Compliance with the RFA clearly improved. During the past seven years, compliance with the RFA has saved small business over 50 billion dollars because agencies found ways to eliminate unnecessary burdens on small business without compromising their statutory missions. The RFA, as amended by SBREFA, clearly was starting to have significant impact on agency deliberations and decisions. Agencies were beginning to learn that they could craft regulations that could accomplish their public policy objectives without unduly burdening small business. They were also learning that it was good public policy to balance their statutory objectives with another national objective, namely that of preserving small business as the growth engine in the economy – that doing so was not special treatment for small business, rather rational rule-making. As the Committee well knows, SBREFA added judicial review provisions to the RFA, at 5 U.S.C. § 611, to ensure that federal agencies would do more than pay "lip service" to the RFA in developing and implementing regulations with significant impacts on small businesses and other small entities nationwide. *See* 142 Cong. Rec. S3242, S3245 (*daily ed.*, Mar. 29, 1996) (SBREFA- Joint Managers' Statement of Legislative History and Congressional Intent).

While most agencies have markedly improved their compliance with the RFA, some agencies have still only given lip service to the RFA and appear to believe that compliance with the RFA is still voluntary. The Federal Communications Commission appears to have the worst

compliance record of any agency. Let me list quotes about the FCC from Chief Counsel for Advocacy's annual reports to Congress on compliance with the RFA:

(1) "...the Federal Communications Commission's (FCC) compliance with the RFA has been inconsistent." (2003);

(2) "The Federal Communications Commission's (FCC) compliance with the RFA has been sporadic..." (2002);

(3) "...IRFA was significantly flawed and did not address the mandates of the RFA. ...The FCC is vague and fails to comply with the RFA in this regard." (2001);

(4) "The Federal Communications Commission (FCC) is notorious for its poor compliance with the RFA. (2000);

(5) "the FCC's regulatory flexibility analysis was insufficient." "...FCC's IRFA were insufficient to satisfy the statutory requirements of the RFA." (1999);

(6) "In summary, the FCC failed to meet the statutory requirements of the Administrative Procedure Act, the RFA, and the PRA." (1998);

(7) "...the regulatory flexibility analysis ... was untimely, improperly published, and inadequate." (1997).

For a more complete list, see Appendix 2. Appendix 1 is a more recent list of comments from Office of Advocacy Letters to the FCC from 2001-2003.[2] Other agencies such as the Internal Revenue Service and the Center for Medicare and Medicaid Services (CMS) also have often refused to comply with the RFA.

The problem with these recalcitrant agencies is compounded by some court decisions. Unfortunately, some courts have begun to narrow the scope of the RFA and appear to be reluctant to enforce the law. True judicial review of the act has been rare. The *amicus curiae* authority of the Chief Counsel has also rarely been used. In the absence of judicial enforcement

[2] In the interest of full disclosure, I am involved in litigation with the FCC on its compliance with the RFA. This discussion reflects my and other Chief Counsels frustration with the FCC.

of the law as intended by Congress when it enacted SBREFA, some agencies again have found ways to avoid compliance with the RFA. Unless Congress again strengthens the RFA, I fear the gains achieved will be lost and agency compliance will deteriorate.

The first thing the Congress needs to do is give the Office of Advocacy independent budget authority. Today the Office has forty-three employees. Yet provisions in the bill we are discussing today impose significant new mandates on the Office of Advocacy without recognizing the need for additional staff or expense funds. For example, the proposal before the Committee would call for more Small Business Advocacy Review Panels now mandatory only for the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA). In our report, *Background Paper on The Office of Advocacy 1994-2000*[3], we described that SBREFA panels are labor intensive, requiring Advocacy to commit between 500-600 hours on average, with some panels requiring as much as 700 hours of intensive staff time. This is but one example of the additional tasks the proposal before this Committee would impose on the Office of Advocacy. If it is to take on more panels, it needs more staff.

Unquestionably, no other agency has produced the returns Advocacy has generated - over 50 billion dollars to date, compared to an annual budget for the Office of Advocacy of under 10 million dollars. It can take pride in this accomplishment. But I do not see how the Office can absorb these additional duties without a significant increase in budget and staff. Experience shows that SBA Administrators' control of the Office of Advocacy's budget means that the office will continue to lose funding and staff. Given this reality, expectations from enactment of this bill will not be fulfilled. Failure will be assured. Thus, independent budget authority has to

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[3] *Background Paper On The Office of Advocacy 1994-2000,* Office of Advocacy, Small Business Administration, November 1, 2000, p. 35

be our first priority. The budget review process will give Congress the opportunity to measure the Office of Advocacy's effectiveness in exercising the mandates given to it.

Second, the judicial review provisions of the RFA need to be strengthened. The RFA should specifically state that courts should defer to any review and determination by SBA's Chief Counsel for Advocacy that a particular agency action is subject to the RFA, that an agency must comply with its provisions and that any attempted final action will be overturned by the courts.[4] The RFA establishes the Chief Counsel as the RFA "watch dog,"[5] and he and his experienced staff have a detailed familiarity with when the RFA should apply, as well as the benefit of an overall perspective on the many and varied ways that agencies attempt to avoid or defeat their RFA compliance obligations.[6] Congress should resolve this potential conflict between the cases in favor of deference to the SBA Chief Counsel for Advocacy on issues within his or her area of expertise.

Third, an amendment is needed to require more detailed analyses to substantiate IRFA, FRFAs and agency "no impact" certifications.

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[4] Some thought should be given to whether the Chief Counsel should be given "standing" to seek a temporary injunction when he/she determines an agency is not complying with the RFA.

[5] *See Southern Offshore Fishing Ass'n*, 995 F. Supp. at 1434; *Greater Dallas Home Care Alliance*, 36 F. Supp.2d at 767 & n.8.

[6] *Compare Southern Offshore Fishing Ass'n, supra,* n.9, with *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). Congress should resolve this potential conflict between the cases in favor of deference to the SBA Chief Counsel for Advocacy on RFA issues.

Finally, the proposal under consideration by the Committee includes several other provisions for strengthening the law. Amendments to the Administrative Procedure Act have been rare. Enactment of the RFA and SBREFA occurred only over fierce opposition. Thus any proposed amendment to strengthen the RFA will face significant challenges from various Executive Branch agencies, some of whom may raise objections worthy of serious consideration. This should not discourage enactment of those provisions deemed most important. I think the fight is worth taking.

In closing I think it is important to keep in mind that those of us seeking reform bear the burden of persuading agencies and policy makers that it is national policy to preserve competition and, more importantly, that small business is the force that ensures competition in a market economy. Considering whether regulations have an adverse and unnecessary impact on small business is not special treatment. Rather it is a commitment to a national policy that does not conflict with other congressional mandates to protect the environment, to ensure worker safety, to construct a telecommunications industry that serves all the people, etc. Avoiding unnecessary regulatory harm to small business results in sound public policy. Agencies need to understand and come to believe that that is the goal of the RFA.

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Appendix 1

QUOTES FROM THE OFFICE OF ADVOCACY TO THE FCC, 2001-2003

"The Commission's FRFA did not include the required impact analysis or alternatives." Reply to Opposition to the Petition for Reconsideration of the Office of Advocacy, U.S. Small Business Administration, CG Docket No. 02-278, October 30, 2003.

"Advocacy recommended that the FCC consider issuing a further notice of proposed rulemaking, if possible, to solicit small business input before issuing a final order in response to the petitions for reconsideration." Letter from Eric Menge, Assistant Chief Counsel for Telecommunications, to FCC, October 10, 2003 at p.2.

"Advocacy requests that the FCC revisit this decision in light of the economic impact on these small entities and the fact that the Commission did not conduct an adequate Regulatory Flexibility Analysis ("RFA") of the impact." Petition for Reconsideration of the Office of Advocacy, U.S. Small Business Administration, CG Docket No. 02-278, August 25, 2003, at p. 2.

"The FCC's Report and Order Does Not Comply with the RFA." Petition for Reconsideration of the Office of Advocacy, U.S. Small Business Administration, CG Docket No. 02-278, August 25, 2003, at p. 3, Heading II.

"The FCC's Report and Order Does Not Comply with the RFA. ...Both the initial regulatory flexibility analysis ("IRFA") and the final regulatory flexibility analysis ("FRFA") do not satisfy the requirements of the RFA as they failed to address the costs that the rule would impose upon small business, small trade associations, membership organizations, and small non-profit organizations." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, August 14, 2003 at p. 4.

"Finally, the Commission did not comply with the RFA as it did not adequately describe the impact of these compliance requirements nor consider alternatives to minimize the impact." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, August 14, 2003 at p. 5.

"This is not the first time the Commission has issued an NPRM when an NOI is more appropriate. Advocacy has sent letters to the Commission in other proceedings, commenting that the Commission is using the NPRM process to gather basic information from industry and without providing specific information on the terms of the regulatory proposal." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, April 9, 2003, at p. 3.

"The IRFA Does Not Address the Impact on Small Businesses. In its IRFA, the Commission described the need for and the objectives of the proposed rules, as well as identified the affected classes of small businesses. However, the FCC did not analyze the impact that the proposed rule would have on small businesses." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, April 9, 2003, at p. 4.

"To comply with the RFA, Advocacy recommends that the Commission publish for comment a revised IRFA." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, February 5, 2003, at p. 1-2.

"The FCC's Rulemaking IS More Suited for a Notice of Inquiry than an NPRM" Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, February 5, 2003, at p. 3, Heading 2.

"The IRFA did not address these issues described above nor analyze what the impact will be on 7,000 small ISPs." "The Office of Advocacy recommends that the Commission revise its IRFA to include an analysis of the impact that classifying wireline broadband Internet access service as an information service would have on small ISPs." Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to FCC, August 27, 2002, at p. 5.

"The Commission's NPRM seeks extensive comment on issue areas rather than specific proposals or tentative conclusions. These sorts of requests to the public are better suited for an NOI than a proposed rule. Furthermore, when the Commission proposes specific rules, it must complete a supplemental initial regulatory flexibility analysis ("IRFA") to comply with the Regulatory Flexibility Act of 1980 ("RFA"), as amended by the Small Business Regulatory Enforcement Fairness Act, Subtitle II of the Contract with America Advancement Act." Comments of the Office of Advocacy, U.S. Small Business Administration on the Initial Regulatory Flexibility Analysis of the Notice of Proposed Rulemaking, MM Docket Nos. 01-317, 00-244, March 13, 2002, at p. 1-2.

"When the Commission proposes specific rules in this docket, it will need to conduct a supplemental IRFA. ...In the supplemental IRFA, the Commission should examine the impact of the compliance requirements of the proposed rules and explore alternatives. In addition, because of the far-reaching nature of this proceeding, Advocacy encourages the FCC to hold a forum with small businesses to discuss the impact upon small businesses." Comments of the Office of Advocacy, U.S. Small Business Administration on the Initial Regulatory Flexibility Analysis of the Notice of Proposed Rulemaking, MM Docket Nos. 01-317, 00-244, March 13, 2002, at p. 4.

"Finally, the NPRM lacks specific rules and the FCC is using it to gather basic industry information about the impact of B&K. Commission should transfer this rulemaking to a Notice of Inquiry which is much more suited as a means to gather information. The Commission can use the comments gained in response to this NPRM to analyze the small business impacts in an IRFA." Reply Comments on the Initial Regulatory Flexibility Analysis and Notice of Proposed Rulemaking of the Office of Advocacy, U.S. Small Business Administration, November 6, 2001 at page iii.

"Finally, the Commission's general questions in this rulemaking are more appropriate to a Notice of Inquiry (NOI) than an NPRM. Advocacy recommends that the Commission change this rulemaking to an NOI." Reply Comments on the Initial Regulatory Flexibility Analysis and Notice of Proposed Rulemaking of the Office of Advocacy, U.S. Small Business Administration, November 6, 2001 at page 2.

"Advocacy believes that this is because of the general nature of the proposed rule, which limited the Commission from doing a thorough analysis. To correct this, the Commission should switch the NPRM to an NOI." Reply Comments on the Initial Regulatory Flexibility Analysis and Notice of Proposed Rulemaking of the Office of Advocacy, U.S. Small Business Administration, November 6, 2001 at page 13.

"The Commission's 3rd R&O did not comply with the RFA for a number of reasons. ...The Commission should issue a supplemental IRFA that requests comment on the effect on small businesses of the Commission's decision to require that carrier employees drop-off the phone call during a third party verification." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, May 3, 2001, at p. 1.

"The Commission Cannot Conduct a FRFA on a Issue without Conducting an IRFA and Soliciting Comment on the Impact of the Issue." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, May 3, 2001, at p. 2, Heading 3.

"The Commission did not raise the drop-off requirement in the IRFA. Therefore, small businesses did not have the opportunity to comment on the proposal, and the Commission did not provide an analysis of the compliance costs or alternatives to the drop-off requirement." "Therefore, the Commission cannot conduct a FRFA on the drop-off requirement, as this issue was never raised in the IRFA." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, May 3, 2001, at p. 3.

"Advocacy has concluded that the Commission's decision to not address the small business issues raised in the petitions for reconsideration does not comply with the RFA." "This needs to be undertaken as soon as possible, as the Commission's rulemaking is grievously in violation of the RFA." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, April 19, 2001, at p. 1.

"The Commission adopted a rule that has extensive impact on small businesses without conducting an IRFA and requesting comment. The FCC cannot issue a FRFA on a subject on which it never conducted an IRFA." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, April 19, 2001, at p. 4.

"The Commission published a regulatory flexibility analysis in conjunction with its Notice of Proposed Rulemaking (NPRM), but the analysis is inadequate: the Commission fails to clearly state its regulatory objectives, fails to describe the impact on small businesses, and fails to propose alternatives designed to minimize this impact." Comments of the Office of Advocacy, U.S. Small Business Administration, April 13, 2001, at p. 1.

"The Commission should issue a supplemental regulatory flexibility analysis addressing these concerns." Comments of the Office of Advocacy, U.S. Small Business Administration, April 13, 2001, at p. 5.

"Advocacy reviewed the FRFA and IRFA and found that neither complied with the law." "The Order's FRFA Does Not Comply with the RFA." "The FRFA Does Not Adequately Consider

Alternatives to the Audit Requirement." "The FNPRM's IRFA Does Not Comply with the RFA." "The IRFA Does Not Describe Small Entities in the Secondary Market." "The IRFA Does Not Adequately Describe the Costs of Auctioning Numbering Resources." "The IRFA Does Not Adequately Consider Alternatives to the Auctions Costs." "The Order's FRFA and the proposed rule's IRFA do not comply with the RFA for the reasons given above. Because the deficiencies are significant, Advocacy strongly recommends that the Commission reconsider the small business concerns raised in this letter and in the public docket." Letter from Susan M. Walthall, Acting Chief Counsel for Advocacy, to Chairman Michael K. Powell, March 30, 2001, at p. 1-6.

"In its January 9, 2001 letter, Advocacy advised the Commission that the IRFA accompanying its NPRM did not satisfy the requirements of the RFA, because the agency did not examine the costs of the proposed rules nor explore alternatives that would accomplish the agency's regulatory goals while reducing burdens." Letter from Mary K. Ryan, Deputy Chief Counsel for Advocacy, to Chairman Michael K. Powell, February 6, 2001, at p. 2.

"Advocacy has found that the IRFA did not satisfy the requirements of the RFA, as it did not describe a vast majority of the compliance requirements contained in the NPRM and their impact on small firms. Nor did it discuss significant alternatives that would accomplish the objectives while minimizing the significant economic impact on small entities. These two elements are crucial to the RFA." Letter from Jere W. Glover, Chief Counsel for Advocacy, to Chairman William E. Kennard, January 9, 2001, at p. 2.

"The current IRFA does not satisfy the requirements of the RFA. It fails to describe many of the compliance burdens that the proposed regulations would impose on small businesses. Furthermore, the IRFA does not describe alternatives that are available to the Commission that would lessen the impact on small entities while still achieving the FCC's regulatory goals." Letter from Jere W. Glover, Chief Counsel for Advocacy, to Chairman William E. Kennard, January 9, 2001, at p. 6.

"An 'initial regulatory flexibility analysis,' prepared in conjunction with the notice of proposed rulemaking, is significantly flawed and does not address the mandates of the Regulatory Flexibility Act (RFA)." Comments of the Office of Advocacy, U.S. Small Business Administration, January 5, 2001, at p. 1.

"But it is the FCC's responsibility under RFA to analyze and describe impact." Comments of the Office of Advocacy, U.S. Small Business Administration, January 5, 2001, at p. 4.

Appendix 2

QUOTES FROM ANNUAL REPORTS OF THE SMALL BUSINESS ADMINISTRATION 1995-2003

"...the Federal Communications Commission's (FCC) compliance with the RFA has been inconsistent." "The FCC did not conduct an adequate analysis of the impact on small entities as required by the RFA." "Advocacy also recommended that the FCC complete a supplemental IRFA to comply with the RFA. The FCC declined Advocacy's recommendations..." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act and Executive Order 13272, Fiscal Year 2003, January 2004 at pp. 50-53.

"The Federal Communications Commission's (FCC) compliance with the RFA has been sporadic...The FCC's notices of proposed rulemaking often do not contain any specific regulatory approaches or regulatory text. Instead, the FCC issues a series of broad questions soliciting comments. Because the FCC provides the details of the regulation only in the final rulemaking, it is difficult, if not impossible, for Advocacy and affected small entities to assess the impacts at the proposed rule stage and recommend less burdensome regulatory alternatives for the FCC's consideration." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Fiscal Year 2002, January 2003 at p. 29.

"...stating that the **IRFA was significantly flawed and did not address the mandates of the RFA. ...The FCC is vague and fails to comply with the RFA in this regard**. ...current IRFA does not satisfy the requirements of the RFA." "Further, the most recent rulemaking drew conclusions on issues not raised in an IRFA and without an opportunity for small businesses to comment on an IRFA." "...FCC did not adequately assess the economic impacts of these actions on small businesses. ...IRFA was inadequate." "Advocacy commented that the FCC did not comply with the RFA." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Fiscal Year 2001, February 2002 at p. 36-38.

"**The Federal Communications Commission (FCC) is notorious for its poor compliance with the RFA.** ...The FCC's regulatory flexibility analyses are invariably cut-and-paste, offer no real insight, and are entirely divorced from the 'substantive' portions of the rulemaking. ...Advocacy sees little evidence that change is occurring to improve compliance." 20 Years of the Regulatory Flexibility Act, Office of Advocacy, U.S. Small Business Administration, 2000, at p. 22.

"Advocacy filed comments with the FCC, asserting that the **FCC's regulatory flexibility analysis was insufficient." "...FCC's IRFA were insufficient to satisfy the statutory requirements of the RFA."** "Advocacy pointed out that the FCC's regulatory flexibility analyses did not satisfy the requirements of RFA." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Fiscal Year 1999 (2000) at p. 35-36.

"Advocacy contended that this was not sufficient compliance with the RFA." **"In summary, the FCC failed to meet the statutory requirements of the Administrative Procedure Act, the**

RFA, and the PRA." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Calendar Year 1998 (1999), at p. 46-47.

"The Office of Advocacy asserted that **the regulatory flexibility analysis** accompanying the Joint Board's recommended decision **was untimely, improperly published, and inadequate**." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Calendar Year 1997 (1998), at p. 39.

"The FCC's proposed rules applicable to number portability could have created significant regulatory hurdles for small telephone companies." "As initially proposed, **there was a risk that smaller telephone providers might bear a disproportionate burden for financing these safeguards**." Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Calendar Year 1995, at p. 16.

Emphasis added

Statement of Frank S. Swain

before the Committee on Small Business

US House of Representatives

May 5, 2004

Regarding Improving the Regulatory Flexibility Act – H.R. 2345

Chairman Manzullo, Ranking Member Velázquez and Members of the Committee.

Thank you for inviting me to participate in this hearing on HR 2345, the Regulatory Flexibility Improvement Act of 1980. This Committee, in my opinion, really came into the modern era in 1980 when it began to give serious attention to the general regulatory issues which affected large numbers of small businesses. To be sure the Committee's program oversight responsibilities for SBA are essential. But we cannot lose sight of the fact that millions of businesses who never touch SBA programs are daily impacted by federal government regulations. My eight year tenure as SBA Advocate and experience since in private law practice confirm that regulatory problems continue to be a major negative factor for small business.

The particular requirements of the Regulatory Flexibility Act are ably described by Tom Sullivan, the SBA's Chief Counsel for Advocacy. I had the opportunity to lobby the initial passage of the Regulatory Flexibility Act, as legislative counsel to the NFIB at the time. At that point there was actually broad support for the concept of regulatory reform. Many of the regulatory agencies that daily impact small business, including the Environmental Protection Agency, Occupational Safety and Health Administration, and the Federal Trade Commission, had either been created in the 1970's or had been "reinvigorated" with regulatory zeal. Even the *Washington Post*

described the FTC at the time as the "national nanny." It was clear there had to be a counterweight to this increased meddling by federal government in the daily lives of business.

In 1980 the Congress enacted two major laws to address this problem. To provide some assistance to individual businesses fighting off unjustified government action, it enacted the Equal Access to Justice Act. Controversial at the time, it has proven to be a key tool to somewhat balance the power of an overbearing government. The Regulatory Flexibility Act took a different approach. It was, at the time, one of several proposals which the Congress was considering which would require the government to reform itself, essentially by creating administrative and review screens through which regulations would have to pass. There were many in the Congress, and even in the Carter administration, who believed that getting some regulatory coordination and review outside the immediate agencies was essential to overall rational regulation. There were somewhat grand proposals for creating regulatory review panels and requirements which would apply cost benefit and other criteria, and have various powers to stop certain regulations.

The irony is that a quarter century later, there is still only one regulatory review statute enacted by Congress that impacts all agencies, and that is the Regulatory Flexibility Act. While various major players inside and outside the government were debating the merits of "generic regulatory reform," the small business community came together with the Congress to achieve consensus on Regulatory Flexibility. Later President Reagan and other Presidents attempted to effect by Executive Order various regulatory reforms, proposed but not enacted by the Congress. And later the Congress did give some important statutory underpinnings to OMB's Office of

Information and Regulatory Affairs, (OIRA). The Small Business Agenda and Executive Order 13272 issued by President Bush is particularly noteworthy, as it links the review authority of the Office of Management and Budget to the ongoing SBA Advocacy efforts at enforcement of Regulatory Flexibility.

To be sure, the Regulatory Flexibility Act was a compromise on several points. The most immediate issue was that the program did not have very strong enforcement mechanisms, aside from the hortatory powers of the SBA Chief Counsel. If we saw an agency flaunting the Regulatory Flexibility Act, we could essentially stand up and holler and try to embarrass the agency into compliance. But our ability on either private parties or the SBA Chief Counsel to directly challenge non-compliance with Regulatory Flexibility was severely limited, until the enactment of the Small Business Regulatory Enforcement Fairness Act (SBREFA) in 1996.

There remain, however, obvious problems "at the front end," at the point at which agencies make a threshold decision which of their rules will undergo the analysis required by the Regulatory Flexibility Act. And as the enforcement power of private parties has effectively increased, in my opinion the temptation for agencies to define away certain Regulatory Flexibility analytic requirements has increased.

HR 2345 attempts to address several types of situations in which federal agencies take regulatory action which has a significant impact on a substantial number of small entities, without admitting that the rules or the regulatory choices require or would profit from analysis. During my tenure as Chief Counsel there were examples in each of these categories. I have also had direct

experience in more recent years with regulatory situations in which agencies slide around to avoid the RFA requirements.

For example, the Internal Revenue Service plainly considers its mission of administering the tax laws to often be above the Regulatory Flexibility Act requirements. Admittedly, the Congress (and the tax paying community) do not make the IRS mission any easier by regularly changing and adjusting the tax laws. Nevertheless, implementation of the laws through regulatory decisions often has a very direct impact on smaller firms. I use the term "regulatory decisions" intentionally, as the IRS makes most administrative policies without the formal Administrative Procedures Act rulemaking process which normally triggers the Regulatory Flexibility Act. The Service and the Treasury Department have, over the years, made many arguments, almost theological in their complexity, as to why the IRS need not regularly perform an analysis of the small business impacts of their decisions. Congress clearly has the right and the obligation to clarify the situation, and to unambiguously impose a regulatory analysis requirement, which most other agencies routinely live with and discharge, on the Internal Revenue Service.

The bill would require agencies to perform an analysis when the small business impact is positive. This again has been an excuse used to avoid Regulatory Flexibility analysis. An agency would assert that by establishing a threshold or taking other action it was helping small business. If that were accurate, how could any observer calculate how much more might be done? Agencies might make even bolder decisions, if forced to perform better analysis.

That point is closely connected to another positive of the bill, the requirement that agencies quantify the impacts of the proposed rule and its alternatives. We are in a much different social science era than 1980. The ability of economists and policy analysts to measure and quantify regulatory impact is so much more sophisticated, as are our computer and other tools to perform this analysis. What might have been a good guess years ago can be precisely analyzed today. And indeed this is the responsibility of an agency making and enforcing a rule, if the rule is to be effective. This is a welcome clarification.

Another important improvement is the requirement that agencies analyze indirect impact of their regulations. Many times agencies close their eyes to clear, predictable impacts of the rules, which are not "direct." The IRS in 2002 made a proposal to eliminate the category of "mobile machinery" from fuel tax exemption, which I described more fully to the Committee last year. Aside from the direct tax costs to small businesses if this were done, the proposal would clearly have significant effects on fuel usage, vehicle design and environmental emissions. None of these issues were even acknowledged by the IRS as a potential consequence of their proposed action, yet the effects may be very economically and environmentally significant. To be sure, the impacted entities have some responsibility for raising these issues with the agency, and offering to assist the agency in analysis. But agencies should not be able to completely ignore important and predictable regulatory impact, simply because it is designated as "indirect."

HR 2345 includes many other positive reforms of the process, reforms whose need is apparent after two decades of experience with a very important law. The success of the Regulatory Flexibility Act is a tribute to the Congress and to this Committee's continuing interest in small

business regulatory reform, as well as the SBA Chief Counsel for Advocacy's monitoring efforts. I am absolutely sure that small business has been saved billions of dollars in unnecessary regulatory costs, because of this law. The proposed set of improvements will ensure that this record continues and is improved.

Statement of James Morrison, Ph.D.

President, Small Business Exporters Association
Senior Advisor, Small Business Technology Coalition

BEFORE THE

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

5 MAY 2004

Regarding H.R. 2345 and Proposed Changes in the Regulatory Flexibility Act

Chairman Manzullo, Representative Velazquez, members of the Committee, thank you for asking me to appear here today. I am James Morrison.

I serve as the President of the Small Business Exporters Association and as a Senior Advisor to the Small Business Technology Coalition, both of which are Councils of the National Small Business Association. NSBA is the nation's oldest nonprofit advocacy organization for small business, and serves some 150,000 smaller American companies.

But although I have notified those organizations that I am testifying at this hearing, I am here today more as a private citizen than as an association official.

I was closely involved in drafting and passing the Regulatory Flexibility Act (RFA) and the Small Business Regulatory Enforcement Fairness Act (SBREFA).

I have been asked to comment on H.R. 2345 in the light of the history of the RFA and SBREFA. So I will try to address how the bill fits in with that historical context and how well it addresses various issues that have arisen under those laws.

I hope this information will be helpful to you as you go forward.

Background

By way of background, I took up the "cause" of the RFA in April of 1977, on the basis of a suggestion by Mr. Milt Stewart. Mr. Stewart was then the President of the National Small Business Association and was later to be confirmed by the Senate as the first Chief Counsel for Advocacy at the Small Business Administration.

I was a Senate staffer. At different points in the late 1970's, I worked for the Senate Small Business Committee and the personal staff of the Committee's then Chairman, Sen. Gaylord Nelson (D-WI). I thought Stewart's idea of having differing regulations for smaller and larger businesses was interesting and might be achievable.[1]

I discussed the concept with Sen. Nelson and he agreed to consider it further. He assigned me to work on developing a bill. With his help, we recruited Sen. John Culver (D-IA) and Strom Thurmond (R-SC) as our lead sponsors on the Senate Judiciary Committee, Rep. Bob Kastenmeier (D-WI) as our top House Judiciary Committee sponsor, as well as several staffers to work on the bill. (In this Committee, of course, our foremost champion was Rep. Andy Ireland, who recruited himself. He contributed immeasurably to the bill's passage.) Senator Nelson introduced the first version of the RFA on August 1st, 1977. By early 1978, advancing the proposed law became almost my full-time occupation.

After we began to achieve some breakthroughs in the Senate, I was hired by this Committee, as consultant, to help move the legislation through the House.

[1] Mr. Stewart and his team at the Office of Advocacy, including Jere Glover, Dave Voight, Susan Walthall, Jody Wharton and others, later contributed significantly to the enactment of the RFA.

From early 1979 through final passage of the RFA in September of 1980, I was in more or less daily contact with a number of Senators and Representatives who had taken an interest in the legislation and with the senior staff working on it. I also met frequently with various organizations favoring and opposing it. As the legislation evolved in the House and Senate, I was closely involved in designing (and sometimes brokering) the wording of the revisions. Later, I was asked to draft major sections the official reports on the RFA. After the bill passed, I felt quite honored to take part in President Carter's signing of the bill, in the East Room of the White House, on September 19th, 1980.

However, within a few years, reports from the Chief Counsel for Advocacy and several early court tests showed that the reach of the RFA was less than ideal. As early as 1985, this Committee gave serious consideration to revising the RFA to address various issues that had arisen under it. A series of hearings followed, demonstrating the need for action.[2]

In 1993, a number of small business associations created the Regulatory Flexibility Act Coalition, whose purpose was to strengthen the original RFA. As the founder and head of the coalition, I worked very closely with Congress in developing SBREFA. During this period, I concentrated on a set of high-priority changes that our coalition wanted in the RFA, on obtaining endorsements from the 1995 White House Conference on Small Business and from the Commission on Re-Inventing Government, on resolving various conflicts over the wording of the legislation, and on helping craft the floor statements that were offered during final passage in both chambers. All of us who worked on this effort were elated when SBREFA passed on March 29th, 1996.[3]

Yet there is still work to be done. That's why we're here today. As a final note on this, I would like to again emphasize that my views on the RFA and SBREFA are those of one person only. Dozens of people were involved in both legislative efforts. Since then, many more people in Congress and the SBA Office of Advocacy have observed the operation of the laws at close range. No doubt most of these individuals have views on the strengths and weaknesses of the statutes and on the issues that the laws touch upon. I hope the Committee will carefully consider all of these views.

H.R. 2345

Perhaps I can offer my best contribution to the Committee's work by commenting on the bill before us today.

First of all, I commend H.R. 2345 for grasping two key concepts behind the law: the need for process change and cultural change at the agencies, and the basic analogy between the RFA and the National Environmental Policy Act (NEPA). Surprisingly few commenters on the RFA have fully internalized either notion. Yet I believe they are the heart of what Congress intended the RFA to achieve.

Both Senator Nelson and Senator Culver were noted environmentalists.[4] Several of their staff attorneys were steeped in environmental law. We had many, many conversations about developing parallel tracks for NEPA and the RFA.

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[2] Rep. Ike Skelton (D-MO) and his staffer Russ Orban, as well as Rep. Ireland (R-FL) and his staffer, the late Steve Lynch, spearheaded these important hearings.

[3] Major figures in that effort included Sen. Kit Bond (R-MO) and Rep. Tom Ewing (R-IL). Staffers Keith Cole and Harry Katrichis (of the Senate and House Small Business Committees, respectively), Eric Nicoll (with Rep. Ewing) and Alan Coffey (of the House Judiciary Committee) played important roles, as well.

[4] Among many other achievements, Senator Nelson was the creator of Earth Day, the author of the legislation establishing the Appalachian Trail, and a principal author of the Wilderness Act (PL 88-577) and the National Wild and Scenic Rivers Act (PL 90-542). After leaving the Senate, he went on to lead the

The consensus view was that NEPA offered a proven process for sensitizing agencies to a set of external considerations, that the NEPA experience would help the RFA to be an understood quantity by the courts and the administrative law bar, and that a parallel RFA process could be successfully integrated into agency rulemaking under the Administrative Procedure Act, the law that we had always intended to amend with the RFA.

Our major reservation about the NEPA analogy (even before the General Counsels of the affected federal agencies began vigorously voicing it) was the possibility that any provision permitting "interlocutory review" of agency actions, as NEPA had allowed, would be abused. We did not want litigants shutting down agency actions in "mid-stride". Some of us thought that "interlocutory review" was a fundamental mistake in NEPA. Others thought it was OK for NEPA but not for the RFA. But overall there was a strong consensus to keep it out of the RFA, since the RFA was never intended to be a fountain of litigation or a substantive statute that could trump the agencies' basic missions.[5]

In many other respects, the RFA and NEPA are strikingly similar. An agency certification of no small business impact, under §605(b) of the RFA, is meant to mirror the "Finding of No Environmental Impact" under NEPA. The Final Regulatory Flexibility Analysis (FRFA) under §604 of the RFA, parallels an "Environmental Impact Statement" under NEPA. And so on.

The point of emphasizing the RFA – NEPA relationship, then and now, was that both laws were designed to alter agency culture and agency process without overturning the agencies' statutory frameworks. There has been some progress in this area. The Office of Advocacy has done a very good job of training agency rule writers, at least those who are somewhat sympathetic to the RFA, in developing a culture and a process for thinking about small entities as they regulate. Compliance does appear to be improving in many areas.

Unfortunately, not all agencies and rule writers are sympathetic to the law. The sense that the RFA is every bit as much the "law of the land" as NEPA seems to be sorely lacking. That is why H.R. 2345's design, which makes the analogy more explicit and extensive, represents a major strengthening and improvement of the RFA. [6]

Even with the SBREFA amendments, an even deeper problem has been that many of the courts don't see or don't accept the RFA – NEPA analogy. To cite the most obvious example, the judicial scrutiny applied to Initial Regulatory Flexibility Analyses (IRFA's) and FRFA's is typically far below

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Wilderness Society. Throughout 1979, in the midst of his work on the RFA, Senator Culver served as lead sponsor and Senate floor manager for the reauthorization of the Endangered Species Act (PL 96-159).

[5] Eventually the courts restrained some of the NEPA "interlocutory review" excesses. But that was about the time that the RFA passed Congress. (See *Stryckers Bay Neighborhood Council v. Karlen*, 444 U.S. 223, 227 (1980).) During the 1970's, the government had lost numerous NEPA cases. By one count, there were over 600 NEPA cases brought during the law's first six years. The resulting concern about lawsuits "tying up the government" was so great, as the RFA was being developed, that its backers had to accept some very convoluted language on judicial review. The courts went on to interpret that language as prohibiting any form of judicial review. Predictably, agencies soon thereafter began to disregard the law. That became the central problem SBREFA then had to solve.

[6] The earliest drafts of the RFA gave the bill various working titles involving "small business", "tiering", "regulatory differentiation", etc. These titles were in some ways distractions from the guiding principle of the bill, which was succinctly expressed in its statement of purpose – to "fit" regulations "to the scale" of those being regulated. In other words, to regulate "flexibly" with an awareness of the capabilities of the regulated entities. That would require both cultural change and process change in agencies that were more accustomed to "one size fits all" rules and that tended to equate a lack of formal comments during their rulemakings with a lack of small entity impact. A personal note: Dissatisfied with the various working titles for the bill, I asked Senator Nelson, the night before the bill was first introduced, if I could change its name to the "Regulatory Flexibility Act" to more precisely capture this principle of cultural change. He agreed. Despite extensive later changes in how the bill was engineered, both the statement of purpose and the title stuck. H.R. 2345 harmonizes remarkably well with this guiding principle of "regulatory flexibility".

that given to Environmental Impact Statements. Congress can change this, and H.R. 2345 commendably attempts to do so.

Next, I would also commend H.R. 2345 for clarifying the lead role of the Chief Counsel for Advocacy in administering the RFA. Despite the fact that the RFA-related duties of the Chief Counsel are marbled throughout the statute, and were further enhanced by SBREFA, recent court decisions have perversely asserted that the Chief Counsel's views on agency compliance with the RFA carry no special weight.[7]

I cannot say emphatically enough how fundamentally this undercuts Congressional intent on both the RFA and SBREFA. Moreover, it endangers the entire architecture of the RFA, which is premised upon a federal official, the Chief Counsel, being able to "stand up" for the myriad small entities that are unaware of agency actions and unable to defend themselves from the needlessly adverse consequences of those actions. I strongly urge Congress to rectify this judicial error. One way would be for Congress to state in the law that agencies – and the courts -- should give deference to Advocacy's views. The approach offered in H.R. 2345 – having the Office of Advocacy write some basic rules for agency compliance with the RFA -- is also reasonable and could work, given sufficient resources for the Office of Advocacy.

The next aspect of H.R. 2345 that I would like to mention is its treatment of the indirect economic impacts of rules. In developing the RFA, we spent many hours and many meetings wrestling with that problem. We wanted indirect effects covered, but we just couldn't find the right statutory wording to accomplish it. So we tried to cover the concept in report language. This was a mistake; it cost us the Mid-Tex decision in 1985.[8]

Unfortunately, agency consideration of "indirect impacts" was also one of the issues that Congress did not fully address during consideration of SBREFA, due primarily to disagreements about it between the Senate Small Business and Government Affairs Committees.

I truly wish that one of us had hit upon the approach that H.R. 2345 uses: tracking the formulation used in the Council on Environmental Quality (CEQ) rules. I particularly like the concept of mandating that agencies consider the "reasonably foreseeable indirect economic effects of a rule". Since this parallels a settled principle of environmental law, including case law, expanding it to small entity law should not create any undue burdens on the agencies. I urge the Committee to include this provision in the bill it reports.

H.R. 2345 also addresses a bit of unfinished business in its attention to rules issued by the Department of the Treasury / Internal Revenue Service.[9] Along with judicial review, Treasury / IRS's failure to comply with the original RFA was one of the principal drivers of SBREFA. The wording of SBREFA relating to interpretive rules was designed for one and only one purpose: to draw Treasury / IRS rules into the RFA. The law clearly states that any "interpretive" rule creating a record keeping requirement for ten or more individuals must comply with the RFA. For years, Treasury / IRS has argued, somewhat preposterously in my opinion, that the RFA does not apply to its rules unless they entail the creation of an entirely new federal form to fill out. I am quite sure that this is not what Congress meant. To argue for this is to argue that Congress passed, in effect, two separate Paperwork Reduction Acts. The plain language of the RFA suggests otherwise. To largely exclude Treasury / IRS from the ambit of the law would be unconscionable; no other federal agency affects as many small entities and imposes more requirements. Here

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[7] Most notably, in *American Trucking Association v. EPA*, 175 F.3d 1027 (D.C. Cir. 1999).

[8] *Mid-Tex Elec. Coop. v. FERC*, 773 F.2d 327, 342-43 (D.C. Cir. 1985). Despite the report language, the court ruled that the RFA did not cover indirect economic impacts.

[9] In my personal experience in negotiating on this provision, I found that lawyers from the Treasury Department were far more resistant to this change than even senior IRS officials. To highlight this distinction, I refer to the rule-issuing agency as the *Federal Register* does: "Treasury / IRS."

again, I commend the H.R. 2345 for the precision with which it eliminates any possible loophole – an exercise that Treasury / IRS will perhaps appreciate.

The bill does many other good things. It reiterates that agencies have an affirmative obligation to seek beneficial impacts for their rules, and not simply to avoid adverse impacts. It greatly clarifies the definition of a rule, and the definition of a small organization. It clearly restates agency obligations to review existing regulations, under §610 of the RFA, which is long overdue. Numerous GAO and Committee Reports have criticized the agencies' decades of sluggishness in complying with this provision.

I do have some questions with respect to the Office of Advocacy. The bill would expand both the panel review process and the scope of legal interventions by the Chief Counsel. While I think both changes would be useful, I wonder whether Advocacy can sustain them, given its present levels of staffing and budgets.

Absent some additional structural changes, such as having authorizations and appropriations for the Office of Advocacy that are separate from SBA's, there could be downside risks to these additional responsibilities. Advocacy functions quite well now, but I would certainly hate to see it stretched too thin.

Finally, I am a little puzzled by the extensive land use provisions in H.R. 2345. I am certainly no expert on this area of law, but, at first reading, perhaps it might be possible to handle some of these concerns through report language rather than statutory language.

Overall, H.R. 2345 is an excellent bill. It's a thoughtful and ambitious effort to address all the key problems with the RFA as it is currently implemented. The Committee would be doing small businesses, small organizations and small governmental jurisdictions in the United States a huge favor by moving this legislation forward.

That completes my prepared remarks. I would be happy to take any questions at this time.

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