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BY ELECTRONIC MAIL

Dr. John D. Graham, Ph.D.
Administrator, Office of Information and Regulatory Affairs
Office of Management and Budget
Eisenhower Executive Office Building, Room 262
17th Street and Pennsylvania Avenue, NW
Washington, DC 20503
Electronic Address: OIRA_BC_RPT@omb.eop.gov

Re: Comments on OMB's Draft 2005 Report to Congress on the Costs and Benefits of Federal Regulations

Dear Dr. Graham:

The U.S. Small Business Administration's (SBA) Office of Advocacy (Advocacy) is pleased to submit the following comments on the Office of Management and Budget's (OMB) *Draft 2005 Report to Congress on the Costs and Benefits of Federal Regulations*.¹ Advocacy supports continued research into the development of effective methodologies to measure the costs and benefits of Federal regulations, including the use of *ex post* validation studies to confirm the impact of regulations after they actually take effect. Advocacy believes this is particularly important given the disproportionate burden of Federal regulations on small business.² Advocacy also believes that requiring *ex post* validation studies may help improve agency compliance with Section 610 of the Regulatory Flexibility Act (RFA).³

Office of Advocacy

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before Federal agencies and Congress. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of SBA or the Administration. The RFA, as amended by the Small Business Regulatory

¹ *Draft 2005 Report to Congress on the Costs and Benefits of Federal Regulations*, Office of Management and Budget, 70 Fed. Reg. 14735 (March 23, 2005) (herein *OMB Report to Congress*).

² See, W. Crain and T. Hopkins, *The Impact of Regulatory Costs on Small Firms*, Report RFP No. SBAHQ-00-R-0027 for the Office of Advocacy, U.S. Small Business Administration (July 2001) (herein *Crain-Hopkins Study*), page 3.

³ 5 U.S.C. § 610.

Enforcement Fairness Act of 1996 (SBREFA),⁴ gives small entities a voice in the rulemaking process. Moreover, on August 13, 2002, President Bush signed Executive Order 13272,⁵ which requires Federal agencies to give every appropriate consideration to any comments on a proposed or final rule submitted by Advocacy. The agency must include, in any explanation or discussion accompanying publication in the *Federal Register* of a final rule, the agency's response to any written comments submitted by Advocacy on a proposed rule.

Advocacy and OMB's Office of Information and Regulatory Affairs (OIRA) perform complimentary functions in the regulatory process. For example, Advocacy oversees agency compliance with the RFA⁶ (which requires agencies to analyze the impact of proposed regulations on small business, and to consider less burdensome alternatives), while OIRA reviews agencies' compliance with Executive Order 12866⁷ (which requires agencies to assess the expected costs and benefits of proposed regulations).⁸ The two offices work together in reviewing regulatory proposals and recommending alternatives that make regulations more cost effective and less burdensome. Both offices also work closely with Federal agencies in developing data, evaluating costs and benefits, and considering alternative approaches to regulations.

Advocacy's principal interest in the regulatory process is ensuring that regulations do not unduly burden small business. As such, Advocacy supports the use of analytical tools, such as cost/benefit and regulatory impact analyses, to better understand the impact of regulations on small business and to develop feasible alternatives that reduce unnecessary burdens while still meeting the agency's statutory objectives. Advocacy understands that forecasting future regulatory impacts is difficult; however, Advocacy believes that the quality of agency rulemakings would be improved if *ex post* validation studies were performed on selected regulations.

Advocacy Supports the Concept of Ex Post Validation Studies

As indicated above, Advocacy supports the concept of requiring *ex post* validation studies of regulations and encourages OMB to continue its efforts in this area. Validation studies could be useful to both the public and regulators to better understand what actually happens after a regulation takes effect, and whether initial agency cost/benefit projections were accurate. Because the regulatory process is so frequently mired in controversy over the projected costs and benefits of new regulations, validation studies could help demonstrate that initial agency forecasts were sound, thereby engendering greater public confidence in the regulatory process. In addition, validation studies could

⁴ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

⁵ 67 Fed. Reg. 53461 (August 16, 2002).

⁶ 5 U.S.C. § 601 et seq.

⁷ Executive Order 12866, Regulatory Planning and Review, 58 Fed. Reg. 51735 (October 2, 1993)

⁸ Advocacy and OIRA also participate in SBREFA review panels, which are required for any proposed regulations by the U.S. Occupational Safety and Health Administration or the U.S. Environmental Protection Agency that are expected to have a significant economic impact on a substantial number of small entities. See, 5 U.S.C. § 609(b).

allow regulators to reassess their earlier assumptions and evaluate whether alternative approaches should be considered.

Advocacy has no statutory authority to conduct benefit analyses of proposed regulations;⁹ therefore, its analyses do not provide a complete picture of how regulatory approaches affect the economy. High quality *ex post* validation studies could provide important benefits data that would help Advocacy and others understand the overall impact of regulations and how cost/benefit projections change over time. While Advocacy fully understands that requiring *ex post* validation studies would require additional staff time and resources, it seems that this expenditure would be justified by the important information that would be acquired in the process, especially for the most economically significant regulations.

Federal Regulations Have a Disproportionate Burden on Small Business

It is clear from research sponsored by Advocacy¹⁰ (and cited in the *OMB Report to Congress*¹¹) that small businesses bear a disproportionate share of the regulatory burden. In fact, the research indicates that businesses employing fewer than 20 employees face an annual regulatory burden of \$6,975 per employee, nearly 60 percent above that facing a firm employing over 500 employees.¹² Advocacy supports the use of *ex post* validation studies to find out whether initial cost projections by Federal agencies were accurate, and to assess whether less burdensome alternatives for small business are available. As OMB aptly notes:

... *ex ante* estimates are “pre-regulation” forecasts of what the agency expects will happen, with regard to both benefits and costs, if the rule takes effect. However, an *ex ante* estimate is no more than an informed guess and, like other forms of prospective modeling, the estimates may or may not prove to be accurate once real-world experience with the rule is accumulated and analyzed. Moreover, new data may become available after a rule is promulgated that renders the pre-regulation estimate outdated and erroneous.”¹³

Advocacy agrees, and given the disproportionate burden of Federal regulations on small businesses, supports targeting certain regulations for additional analysis. Given the required resources and difficult methodological issues, OMB might want to target several economically significant regulations to pilot test, with the goal of refining the methodologies needed to perform such analyses. Also, it would seem prudent to require these studies soon enough after a regulation takes effect (e.g., within five years) so that regulatory alternatives can be re-examined while it is still meaningful. With experience, Advocacy believes agencies will become more proficient in projecting regulatory

⁹ 15 U.S.C. § 643b(3).

¹⁰ *Crain-Hopkins Study*, page 3.

¹¹ *OMB Report to Congress*, page 28.

¹² *Crain-Hopkins Study*, page 3.

¹³ *OMB Report to Congress*, page 35.

impacts, and consequently better able to make regulatory decisions that are more cost-effective and less burdensome, especially to small business.

Ex Post Studies May Improve Agency Compliance with Section 610

Finally, Advocacy notes that there currently is no requirement to validate initial regulatory forecasts after regulations take effect. The closest requirement is Section 610 of the RFA.¹⁴ Section 610 requires Federal agencies to review the impact of their regulations on small businesses within 10 years of their taking effect to determine whether the regulation should be continued, amended, or rescinded. However, Section 610 applies exclusively to regulations that have “a significant economic impact on a substantial number of small entities.” There is no similar requirement for economically significant regulations subject to OMB review under Executive Order 12866. Advocacy strongly supports Section 610 and believes that requiring *ex post* validation studies of economically significant regulations may help to improve agency compliance with Section 610. Under such a framework, agencies would conduct a five-year *ex post* validation study on the costs and benefits of a regulation, and then a ten-year review of small business impacts under Section 610. This would create a transparent framework for monitoring regulations, while building greater openness, accountability, and flexibility into the process.

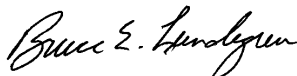
Conclusion

Advocacy supports continued research into the development of effective methodologies to measure the costs and benefits of Federal regulations, including the use of *ex post* validation studies. Advocacy believes these studies are particularly important given the disproportionate burden of Federal regulations on small business, and may help improve agency compliance with Section 610 of the RFA. Advocacy appreciates the opportunity to comment on this important topic, and encourages OMB to continue its work in this area. Please feel free to contact Bruce Lundegren of my staff at (202) 205-6144 (or bruce.lundegren@sba.gov) if you have any questions or require additional information.

Sincerely,



Thomas M. Sullivan
Chief Counsel for Advocacy



Bruce E. Lundegren
Assistant Chief Counsel for Advocacy

¹⁴ 5 U.S.C. § 610.