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REGULATORY FLEXIBILITY ACT

Key Terms Still Need to Be Clarified

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I am pleased to be here today to discuss the implementation of the Regulatory Flexibility Act of 1980 (RFA), as amended, and the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).[1] As you requested, I will discuss our work on the implementation of these two statutes in recent years, with particular emphasis on a report that we prepared for this committee last year on the implementation of the acts by the Environmental Protection Agency (EPA).

The RFA requires federal agencies to examine the impact of their proposed and final rules on "small entities" (small businesses, small governmental jurisdictions, and small organizations) and to solicit the ideas and comments of such entities for this purpose. Specifically, whenever agencies are required to publish a notice of proposed rulemaking, the RFA requires agencies to prepare an initial and a final regulatory flexibility analysis. However, the RFA also states that those analytical requirements do not apply if the head of the agency certifies that the rule will not have a "significant economic impact on a substantial number of small entities," or what I will—for the sake of brevity—term a "significant impact." SBREFA was enacted to strengthen the RFA's protections for small entities, and some of the act's requirements are built on this "significant impact" determination. For example, one provision of SBREFA requires that before publishing a proposed rule that may have a significant impact, EPA and the Occupational Safety and Health Administration must convene a small business advocacy review panel for the draft rule, and collect the advice and recommendations of representatives of affected small entities about the potential impact of the draft rule.[2]

We have reviewed the implementation of the RFA and SBREFA several times during recent years, with topics ranging from specific provisions in each statute to the overall implementation of the RFA. Although both of these reform initiatives have clearly affected how federal agencies regulate, we believe that their full promise has not been realized. To achieve that promise, Congress may need to clarify what it expects the agencies to do with regard to the statutes' requirements. In particular, Congress may need to clearly delineate—or have some other organization delineate—what is meant by the terms "significant economic impact" and "substantial number of small entities." The RFA does not define what Congress meant by these

[1]The RFA is codified at 5 U.S.C. 601-612 and took effect on January 1, 1981.

[2]This provision of SBREFA is codified at 5 U.S.C. 609 and took effect on June 29, 1996.

terms and does not give any entity the authority or responsibility to define them governmentwide. As a result, agencies have had to construct their own definitions, and those definitions vary. Over the past decade, we have recommended several times that Congress provide greater clarity with regard to these terms, but to date Congress has not acted on our recommendations.

The questions that remain unanswered are numerous and varied. For example, does Congress believe that the economic impact of a rule should be measured in terms of compliance costs as a percentage of businesses' annual revenues or the percentage of work hours available to the firms? If so, is 3 percent (or 1 percent) of revenues or work hours the appropriate definition of "significant?" Should agencies take into account the cumulative impact of their rules on small entities, even within a particular program area? Should agencies count the impact of the underlying statutes when determining whether their rules have a significant impact? What should be considered a "rule" for purposes of the requirement in the RFA that the agencies review rules with a significant impact within 10 years of their promulgation? Should agencies review rules that had a significant impact at the time they were originally published, or only those that currently have that effect?

These questions are not simply matters of administrative conjecture within the agencies. They lie at the heart of the RFA and SBREFA, and the answers to the questions can have a substantive effect on the amount of regulatory relief provided through those statutes. Because Congress did not answer these questions when the statutes were enacted, agencies have had to develop their own answers. If Congress does not like the answers that the agencies have developed, it needs to either amend the underlying statutes and provide what it believes are the correct answers or give some other entity the authority to issue guidance on these issues.

Proposed EPA Lead Rule

The implications of the current lack of clarity with regard to the term "significant impact" and the discretion that agencies have to define it were clearly illustrated in a report that we prepared for this committee last year.[3] One part of our report focused on a proposed rule that EPA published in August 1999 that would, upon implementation, lower certain reporting thresholds for lead and lead compounds under the Toxics Release Inventory program from as high as 25,000 pounds to 10 pounds.[4] EPA estimated that approximately 5,600 small businesses would be affected by the rule, and that the first-year costs of the rule for each of these small businesses would be between $5,200 and $7,500. EPA said that the total cost of the rule in the first year of implementation would be about $116 million. However, EPA certified that the rule would not have a significant impact, and therefore did not trigger certain analytical and procedural requirements of the RFA.

Mr. Chairman, last year you asked us to review the methodology that EPA used in the economic analysis for the proposed lead rule and describe key aspects of that methodology that may have contributed to the agency's conclusion that the rule would not have a significant impact. You also asked us to determine whether additional data or analysis could have yielded a different conclusion about the rule's impact on small entities. Finally, you also asked us to describe and compare the rates at which EPA's major program offices certified that their substantive proposed rules would not have a significant impact. We did not examine whether lead was a persistent bioaccumulative toxic or the value of the Toxics Release Inventory program in general.

EPA's current guidance on how the RFA should be implemented gives the agency's program offices substantial discretion with regard to certification decisions but also provides numerical guidelines to help define what constitutes a significant impact. For example, the guidance indicates that a rule should be presumed eligible for certification as not having a significant impact if it does not impose annual compliance costs amounting to 1

[3] *Regulatory Flexibility Act: Implementation in EPA Program Offices and Proposed Lead Rule* (GAO/GGD-00-193, Sept. 20, 2000).

[4] The proposed lead rule was published at 64 Fed. Reg. 42222 (1999). Toxics Release Inventory reporting is required by section 313 of the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) (42 U.S.C.11001-11050, 11023). Reporting is also required under the Pollution Prevention Act of 1990 (42 U.S.C. 13101-13109, 13106), which added reporting requirements to EPCRA's reporting requirements in 1991.

percent of estimated annual revenues on any number of small entities. However, if those compliance costs amount to 3 percent or more of revenues on 1,000 or more small entities, the guidance indicates that the program office should presume that the rule is ineligible for certification.

These numerical guidelines establish what appears to be a high threshold for what constitutes a significant impact. For example, an EPA rule could theoretically impose $10,000 in compliance costs on 10,000 small businesses, but the guidelines indicate that the agency can presume that the rule does not trigger the requirements of the RFA as long as those costs do not represent at least 1 percent of the affected businesses' annual revenues. The guidance does not take into account the profit margins of the businesses involved. Therefore, if the profit margin in the affected businesses is less than 5 percent, the costs required to implement a rule could conceivably take one-fifth of that profit and, under EPA's guidelines, still not be considered to have a significant impact. Neither does the guidance take into account the cumulative impact of the agency's rules on small businesses. Therefore, if EPA issued 100 rules, each of which imposed compliance costs amounting to one-half of 1 percent of annual sales on 10,000 businesses, the agency could certify each of the rules as not having a significant impact even though the cumulative impact amounted to 50 percent of the affected businesses' revenues. Consideration of cumulative regulatory impact is not even required within a particular area like the Toxics Release Inventory program. Each toxic substance added to the approximately 600 substances already listed in the program, or each change in the reporting threshold for a listed toxin, constitutes a separate regulatory action under the RFA.

An agency's conclusions about the impact of a rule on small entities can also be driven by the agency's analytical approach. In its original economic analysis for the proposed lead rule, EPA made a number of assumptions that clearly contributed to its determination that no small entities would experience significant economic effects. For example, to estimate the annual revenues of companies expected to file new Toxics Release Inventory reports for lead, EPA assumed that (1) the new filers would have employment and economic characteristics similar to current filers, (2) different types of manufacturers would experience similar economic effects, and (3) the revenues of the smallest manufacturers covered by the proposed rule could be exemplified by the firm at the 25th percentile of the agency's projected revenue distribution for small manufacturers. As a result of these and other assumptions, EPA estimated that the smallest manufacturers affected by the proposed lead rule had annual revenues of

$4 million. Using that $4 million revenue estimate and other information, EPA concluded that none of the 5,600 small businesses would experience first- year compliance costs of 1 percent or more of their annual revenues. Therefore, EPA certified that the proposed lead rule would not have a significant impact.

EPA revised these and other parts of the economic analysis for the proposed lead rule before submitting it to the Office of Management and Budget (OMB) for final review in July 2000. According to a summary of the draft revised economic analysis that we reviewed, EPA changed several analytic assumptions and methods, and revised its estimates of the rule's impact on small businesses. Specifically, the agency said that the lead rule would affect more than 8,600 small companies (up from about 5,600 in the original analysis), and as many as 464 of them would experience first- year compliance costs of at least 1 percent of their annual revenues (up from zero in the original estimate). Nevertheless, EPA again concluded that the rule would not have a significant impact. During our review, we discovered that the agency's revised estimate of the number of small companies that would experience a 1 percent economic impact was based on only 36 of the 69 industries that the agency said could be affected by the rule. EPA officials said that the other 33 industries were not included in the agency's estimate because of lack of data.

We attempted to provide a more complete picture of how the lead rule would affect small businesses by estimating how many companies in these missing 33 industries could experience a first-year economic impact of at least 1 percent of annual revenues. We obtained data from the Bureau of the Census for 32 of these 33 industries and estimated that as many as 1,098 additional small businesses could experience this 1-percent effect. If EPA had used this analytic approach in combination with its own studies, it would have concluded that as many as 1,500 small businesses would experience compliance costs amounting to at least 1 percent of annual revenues. Therefore, using its own guidance, EPA could have concluded that the rule should not be certified, prepared a regulatory flexibility analysis, and convened an advocacy review panel for the rule. However, we ultimately concluded that the agency's initial and revised analyses and the conclusions that it based on those studies were within the broad discretion that the RFA and the EPA guidance provided in determining what constituted a "significant economic impact" on a "substantial number of small entities."

In the final lead rule that EPA published in January 2001, EPA set the new reporting threshold for lead at 100 pounds—up from 10 pounds in the proposed rule.[5] However, just as it did for the proposed rule, EPA concluded that the final rule would not have a significant impact. EPA said that it reached this conclusion because it did not believe the rule would have a significant economic impact (defined as annual costs between 1 and 3 percent of annual revenues) on more than 250 of the 4,100 small businesses expected to be affected by the rule. EPA also illustrated what it viewed as nonsignificant impact in terms of work hours. The agency said that it would take a first-time filer about 110 hours to fill out the form. Because the smallest firm that could be affected by the rule must have at least 20,000 labor hours per year (10 employees times 50 weeks per year per employee times 40 hours per week), EPA said that the 110 hours required to fill out the Toxics Release Inventory form in the first year represents only about one-half of 1 percent of the total amount of time the firm has available in that year.

EPA' determination that the proposed lead rule would not have a significant impact on small entities was not unique. Its four major program offices certified about 78 percent of the substantive proposed rules that they published in the 2 1/2 years before SBREFA took effect in 1996 but certified 96 percent of the proposed rules published in the 2 1/2 years after the act's implementation. In fact, two of the program offices—the Office of Prevention, Pesticides and Toxic Substances and the Office of Solid Waste—certified all 47 of their proposed rules in this post-SBREFA period as not having a significant impact. The Office of Air and Radiation certified 97 percent of its proposed rules during this period, and the Office of Water certified 88 percent. EPA officials told us that the increased rate of certification after SBREFA's implementation was caused by a change in the agency's RFA guidance on what constituted a significant impact. Prior to SBREFA, EPA's policy was to prepare a regulatory flexibility analysis for any rule that the agency expected to have any impact on any small entities. The officials said that this guidance was changed because the SBREFA requirement to convene an advocacy review panel for any proposed rule that was not certified made the continuation of the agency's more inclusive RFA policy too costly and impractical.

[5]66 Fed. Reg. 4500 (2001).

Previous Reports On the RFA and SBREFA

We have issued several other reports in recent years on the implementation of the RFA and SBREFA that, in combination, illustrate both the promise and the problems associated with the statutes. For example, in 1991, we examined the implementation of the RFA with regard to small governments and concluded that each of the four federal agencies we reviewed had a different interpretation of key RFA provisions.[6] We said that the act allowed agencies to interpret when they believed their proposed regulations affected small government, and recommended that Congress consider amending the RFA to require the Small Business Administration (SBA) to develop criteria regarding whether and how to conduct the required analyses.

In 1994, we noted that the RFA required the SBA Chief Counsel for Advocacy to monitor agencies' compliance with the act.[7] However, we also said that one reason for agencies' lack of compliance with the RFA's requirements was that the act did not expressly authorize SBA to interpret key provisions in the statute and did not require SBA to develop criteria for agencies to follow in reviewing their rules. We said that if Congress wanted to strengthen the implementation of the RFA, it should consider amending the act to (1) provide SBA with clearer authority and responsibility to interpret the RFA's provisions, and (2) require SBA, in consultation with OMB, to develop criteria as to whether and how federal agencies should conduct RFA analyses.

[6]*Regulatory Flexibility Act: Inherent Weaknesses May Limit Its Usefulness for Small Governments* (GAO/HRD-91-61, Jan. 11, 1991).

[7]*Regulatory Flexibility Act: Status of Agencies' Compliance* (GAO/GGD-94-105, Apr. 27, 1994).

In our 1998 report on the implementation of the small business advocacy review requirements in SBREFA, we said that the lack of clarity regarding whether EPA should have convened panels for two of its proposed rules was traceable to the lack of agreed-upon governmentwide criteria as to whether a rule has a significant impact.[8] Nevertheless, we said that the panels that had been convened were generally well received by both the agencies and the small business representatives. We also said that if Congress wished to clarify and strengthen the implementation of the RFA and SBREFA, it should consider (1) providing SBA or another entity with clearer authority and responsibility to interpret the RFA's provisions and (2) requiring SBA or some other entity to develop criteria defining a "significant economic impact on a substantial number of small entities." In 1999, we noted a similar lack of clarity regarding the RFA's requirement that agencies review their existing rules that have a significant impact within 10 years of their promulgation.[9] We said that if Congress is concerned that this section of the RFA has been subject to varying interpretations, it may wish to clarify those provisions. We also recommended that OMB take certain actions to improve the administration of these review requirements, some of which have been implemented.

Last year we convened a meeting at GAO on the rule review provision of the RFA, focusing on why the required reviews were not being conducted. Attending that meeting were representatives from 12 agencies that appeared to issue rules with an impact on small entities, representatives from relevant oversight organizations (e.g., OMB and SBA's Office of Advocacy), and congressional staff from the House and Senate Committees on Small Business. The meeting revealed significant differences of opinion regarding key terms in the statute. For example, some agencies did not consider their rules to have a significant impact because they believed the underlying statutes, not the agency-developed regulations, caused the effect on small entities. There was also confusion regarding whether the agencies were supposed to review rules that had a significant impact on small entities at the time the rule was first published in the *Federal Register* or those that currently have such an impact. It was not even clear what should be considered a "rule" under RFA's rule review requirements—the entire section of the *Code of Federal Regulations* that was affected by

[8]*Regulatory Reform: Implementation of the Small Business Advocacy Review Panel Requirements* (GAO/GGD-98-36, Mar. 18, 1998).

[9]*Regulatory Flexibility Act: Agencies' Interpretations of Review Requirements Vary* (GAO/GGD-99-55, Apr. 2, 1999).

the rule, or just the part of the existing rule that was being amended. By the end of the meeting it was clear that, as one congressional staff member said, "determining compliance with (the RFA) is less obvious than we believed before."

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions.

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