

Office of Advocacy

**TESTIMONY**

of

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before the

**SUBCOMMITTEE ON GOVERNMENT PROGRAMS  
and  
SUBCOMMITTEE ON REGULATORY REFORM AND PAPERWORK  
REDUCTION**

**COMMITTEE ON SMALL BUSINESS  
United States House of Representatives  
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on

**Small Business Involvement in the Regulatory Process  
and Federal Agencies' Compliance with the Regulatory Flexibility Act**

Good morning Chairman Bartlett and Chairwoman Kelly and members of the Committee. I am Jere W. Glover, Chief Counsel for Advocacy of the U.S. Small Business Administration. I am pleased to appear before your subcommittees to discuss the role of small businesses and the Office of Advocacy in the regulatory process and Federal agencies' compliance with the [Regulatory Flexibility Act](#). In addition, I will address the effects of the [Small Business Regulatory Enforcement Fairness Act \(SBREFA\)](#) of 1996 on compliance with the Regulatory Flexibility Act. With me today are Kevin Bromberg and Anita Drummond, representatives of the best and most dedicated staff in the government.

The Small Business Regulatory Enforcement Fairness Act was a tremendous victory for small business and common sense government. The new law reinforces and strengthens the Regulatory Flexibility Act-one of the most important laws for assuring regulations are developed in an environment that welcomes small business participation. SBREFA codifies many of the Vice President's reinventing government initiatives. For the Office of Advocacy, the amendments of the Regulatory Flexibility Act have provided new leverage in our efforts to change the regulatory culture of Federal agencies.

## [Regulatory Flexibility Act](#) Amendments

In 1996, the small business community successfully convinced Congress and the Administration that a new law was needed to reinforce and strengthen the Regulatory Flexibility Act (RFA).

The Regulatory Flexibility Act, originally passed in 1980, requires Federal agencies to evaluate the impact of regulations on small business and to offer flexible regulatory alternatives when a rule is being developed. The 1996 amendments allow small businesses adversely affected or aggrieved by a final action to challenge an agency in court for failure to comply with the Regulatory Flexibility Act. The [SBREFA](#) also clarified the Chief Counsel for Advocacy's authority to file *amicus curiae* briefs in court appeals.

In the beginning, some in the Administration resisted the idea of judicial review. But the Office of Advocacy, backed by the recommendation of delegates from the White House Conference on Small Business of 1995, and the Vice President's recommendations in the National Performance Review, continued to work within the Administration to emphasize that a regulatory process with integrity can withstand challenges. Without a tool for small businesses to assure the law is followed, the system is vulnerable. I am very proud that both Congress and the President agreed that small businesses should have the right to seek judicial review of agency compliance with RFA.

Aside from the general requirements of the SBREFA, special requirements were imposed on specific agencies. The 1996 amendments expand the coverage of the Act to the interpretative rulemakings promulgated by the Internal Revenue Service (IRS) that have information collection requirements. The Occupational Safety and Health Administration (OSHA) and Environmental Protection Agency (EPA) were given new responsibilities for soliciting the input of small entities early in regulation development.

The passage of [SBREFA](#) was a single step towards regulatory fairness for small businesses and good government. Agencies' compliance with the Regulatory Flexibility Act although improved, remains the greatest challenge for small businesses. Compliance varies not only agency-by-agency, but within agencies. The [Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Calendar Year 1996](#) [PDF File] provides a discussion of specific regulations and Federal agencies. We submitted 92 comments to federal agencies, almost twice the Office's historical average. Clearly, the Office of Advocacy continues to work towards agency compliance.

## **Regulatory Development and the Role of the Office of Advocacy**

Traditionally, America's small businesses have been concerned that government does not fully understand and appreciate the cost and burden of regulations on

their sector. With passage of the Small Business Regulatory Enforcement Fairness Act, Congress and the Administration reaffirmed a commitment to address small business concerns about regulatory and paperwork burdens.

The Office of Advocacy has a very important role in advancing a cultural change in Federal agencies. Advocacy strives for an environment in which agencies thoughtfully consider the affects of regulation on small entities at the earliest stage of the process. As the Chief Counsel for Advocacy, I am charged by Congress to represent the interests of small businesses before the Federal government. A significant part of that mandate is improving the process of rulemaking. Advocacy encourages compliance with the RFA through a variety of methods, only one of which is the formal submission of comments on published regulatory proposals.

Increasingly, the Office of Advocacy is involved in the rulemaking process at the very outset, raising issues about the potential impact of a rule on small entities and recommending modifications before it is formally proposed. Advocacy offers consultation to agencies on small business impact and assists with outreach. We find agencies are more likely to meet their regulatory objectives and minimize the burden on small entities if they involve small businesses and the Office of Advocacy early in the rulemaking process.

One of Advocacy's most important jobs is to contribute to the integrity of the regulatory process. We emphasize the importance of:

- a culture that fully engages the regulated sectors, including small businesses, in the regulatory process;
- critical evaluations of the underlying data that supports a rulemaking;
- identifying the contribution specific industries and different sized businesses make to the problem that the agency is trying to solve;
- evaluation of the feasibility of implementing the regulation in different industry settings;
- comprehensive economic analyses that include data on various industries and businesses of differing sizes;
- aggressive outreach to small businesses to identify concerns and solicit recommendations; and
- fully developed regulatory alternatives to the proposed rules that would minimize the impact on small businesses, when appropriate.

In this process, Advocacy performs outreach to small businesses to encourage them to participate in and contribute to regulation development. Moreover, Advocacy has the ability to flag major concerns, often long before the agency or the small business community recognize them. Let me provide you with an example.

The Office of Advocacy is engaged in a major undertaking that involves small businesses in the heartland and telecommunications. In response to a rule implementing one aspect of the Telecommunications Act of 1996, Advocacy has submitted multiple filings to the Federal Communications Commission, concerning our views on the expected high cost of telephone service to both rural businesses and residents as a result of an FCC order. The FCC proposes to cut universal telephone service support for all high-cost (i.e., rural) small businesses. Small businesses with multi-line phone service would lose all support immediately. That means a business with a facsimile machine or modem would no longer receive universal service support and their telephone rates could skyrocket in the next few years. The total estimated cost to small businesses for implementing this rule is estimated between \$1-3 billion annually. The Office of Advocacy has recommended various alternatives for exempting entities from any reduction in universal service support. We also alerted the Small Business Committees of the House of Representatives and Senate of the possible impact of the regulation.

Even with early identification of an adverse small business impact by the industry and the agency, the process does not always provide the results we want. For instance, last summer, the Office of Advocacy became involved during the Office of Management and Budget's review of a draft final rule to be published by OSHA. Concerns had been raised by the manufacturing and other industries about OSHA's anticipated final rule for lowering the occupational exposure limit for methylene chloride. The Office of Advocacy reviewed the draft final regulatory flexibility analysis and submitted its concerns to OSHA and OMB on [August 27, 1996](#). OSHA failed to use the correct definition of small business for all industries in its analysis, and therefore, minimized the characterization of the rule's impact on small business. The agency did not consider significant, viable alternatives to the rule for the small business sectors which raised concerns about the feasibility (both technical and economical) of complying with the rule.

Following a meeting with staff from the Office of Advocacy, representatives from the manufacturing sector and OMB, OSHA returned to develop more extensive data on the manufacturing sector most affected and to consider alternatives to be included in the final rule. While the Office of Advocacy is of the view that OSHA did not thoroughly examine all of the feasible alternatives to its proposed rule, it recognizes that the agency provided some relief to the affected micro businesses, including a phase-in period for manufacturing firms with fewer than 100 employees. However, because of the extensive concerns on the record from small entities, we supported consideration of more significant alternatives.

In all of our regulatory activities, Advocacy endeavors to provide a critical review of the agency's rulemaking, the underlying reasoning, and the impact on small businesses. Many times the effects of the rule seem a long way off, but Advocacy must be assertive now to prevent harm to small businesses in the long run while still accomplishing the objectives and statutory goals. The 1996 legislation,

coupled with earlier administrative efforts, have helped to shift Federal agencies' attention to the disproportionate regulatory burdens shouldered by small businesses.

The Office of Advocacy is an active participant in interagency deliberations about rulemakings. To solidify this role, the Office of Advocacy and Office of Information and Regulatory Affairs exchanged letters of agreement in January 1995. The objective of the agreement is to maximize efforts to monitor agency compliance with [Regulatory Flexibility Act](#). The agreement allows Advocacy to go directly to the Office of Information and Regulatory Affairs if we feel an agency is not responding to our concerns about a specific regulation covered by [Executive Order 12866](#) [PDF File]. (Many rules are covered by the RFA that are not covered by the order.) Under the agreement, Advocacy also shares with OIRA correspondence and official comments sent to agencies about regulations to keep them abreast of our concerns. These cooperative efforts have laid a solid foundation for the accelerated activity as a result of the SBREFA.

Since the passage of the [SBREFA](#), the Office of Advocacy held a refresher course for Federal agencies on the Regulatory Flexibility Act. Last summer, Advocacy briefings were attended by over 600 Federal regulators on the amended Act. Agencies have taken a renewed interest in the 16 year-old law that requires them to consider small business. A special session was held for agency economists. During sessions with agency policy makers, regulation writers, general counsels and economists, Advocacy went through each requirement of the Regulatory Flexibility Act and explained that boiler plate approaches to economic analyses and regulatory assessments would not be acceptable. To help small business understand what we expect of the agencies, we had a briefing yesterday with 30 association executives on the Regulatory Flexibility Act and the SBREFA.

In our role in regulatory development, the Office of Advocacy uses both policy and economic resources.

### **Economic Research**

Economic research has become more critical than ever. Staff from the Advocacy's Office of Economic Research emphasized during agency briefings that ignorance of small business economics will contribute to poor policy making. Advocacy counseled agencies on the importance of measuring costs accurately and understanding that different industries have different capabilities of accommodating new expenses. For instance, economic research staff discussed the theory that costs can be simply "passed along" to customers. Industry competition, especially from larger firms, often prevents small firms from recouping costs through price increases.

Agencies' misunderstanding of the economic realities of regulations is wide spread. The Office of Advocacy has emphasized this fact for years. In addition to

numerous studies on small business characteristics, capital needs and other trends in small business, evidence of regulatory burdens has been continuously documented by the Advocacy's Office of Economic Research. We have performed over 30 studies on the impact of regulations on small firms. A 1994 study commissioned by Advocacy revealed that small firms are disproportionately burdened by the cost of regulatory compliance. In fact, firms with 20-49 employees reported spending nearly 20 cents of every revenue dollar to pay for the paperwork and operating costs attributable to regulations. In fact, the burden of compliance is as much as 50 percent more for small businesses than their larger counterparts.

The costs of regulations are exacerbated when regulations require high up-front expenditures in order to come into compliance. (Agencies generally estimate annualized costs over a given number of years which minimizes the evident impact.) The Office of Advocacy has looked at the accessibility of capital to small businesses. Most small firms start out with less than \$10,000 in owner's equity and continue to rely on founders, family and friends. Generally, commercial bank loans only begin after a new business owner has accumulated \$50,000 in equity. For the micro-businesses, there simply are few financing source available to pay for new regulatory compliance. (Investor are attracted to financing opportunities for productive investments and not operating or regulatory compliance costs.)

The [SBREFA](#) is clearly driving a renewed interest and urgency for reliable data on small business, and the Office of Advocacy is focusing its resources on research on measuring the impact of regulations on small firms.

As Advocacy's contribution to the regulatory process, we want to present agencies and small businesses with valid, defensible criticism of analyses and provide data. But our first priority is to institutionalize the concept of effective small business analysis within the agencies. After all, if agencies have identified a problem that needs to be addressed through regulations, agencies theoretically should know the structure and economics of the industries to be regulated. Renewed efforts began with the forums on the SBREFA attended by Federal agency economists in 1996 and continues with individual agency counseling.

Every published rulemaking comes with a plethora of documents that agencies present to support their actions. These documents often contain only glints of the evidence that agencies attempted to consider small business. As a foundation for our own policy analyses, we rely on our own economic staff to provide us with guidance in evaluating agencies' economic analyses. The need for economic expertise has escalated with the passage of the SBREFA. As the prospect of judicial review looms, it is mandatory for Advocacy comments on agency rules and the economic analyses to be substantiated with economic authority.

Because of the diversity of regulations that are reviewed (matters varying from agricultural marketing orders, transportation, telecommunications, environmental,

food, safety and health, taxes, etc.), Advocacy uses outside contractors to serve as experts in both subject matter and economic analyses. We rely on these experts to provide unbiased reviews of the data that agencies publish to support rulemakings. This process helps us to identify how small businesses are contributing to the problem that agencies are trying to solve and how they are affected by the mandates of the rule. Just as important, outside experts help us identify regulatory alternatives that agencies often neglect to investigate.

Advocacy's economic research staff also works with outside experts to help us identify trends in regulatory analysis of small business impacts. For example, we have an on-going economic research study to evaluate the impact of 12 specific regulations from OSHA, EPA, IRS and the Food and Drug Administration. Our preliminary findings conclude that agencies are not using any logical or consistent criteria to determine if an impact is significant. Some agencies use percentage of sales and others use profit statistics to determine, somewhat arbitrarily, if a given regulation has significant economic impact on small firms. This begs the question of what is significant when the agencies have not fully developed a defensible methodology for determining the definition of a significant economic impact for any given industry. Instead, the agencies are using anecdotal information to determine the cost of regulations which may and has understated the impact on thousands of firms in any one industry.

Finally, to facilitate increased compliance with the Regulatory Flexibility Act, we are currently finalizing a compliance guide for Federal agencies.

### **Small Business Advocacy Review Panels**

The SBREFA amended the Regulatory Flexibility Act by requiring the Environmental Protection Agency (EPA) and the Occupational Health and Safety Administration (OSHA) to convene Small Business Advocacy Review Panels. Specifically, the Act requires that the agencies convene a panel before publishing a proposed rule with an initial regulatory flexibility analysis. The Office of Advocacy has the role of identifying small business and other small entity representatives for the panel to consult.

The EPA or OSHA convenes a Small Business Advocacy Review Panel with employees from the agency, the Office of Advocacy, and the Office of Information and Regulatory Affairs of OMB. The panel is tasked with reviewing the draft proposed rule and economic or scientific analysis developed by the agency. The panel also is required to collect the advice and recommendations from small business representatives and complete a report on its findings. The agency must use the report to help determine the impact on small businesses and when appropriate make revisions to the rule. This process is an important addition to the Regulatory Flexibility Act because it inserts small businesses into the process early and the panel report becomes a part of the public record.

One OSHA Small Business Advocacy Review Panel has been completed since the passage of the SBREFA. Based on our very limited experience to date, Advocacy has found that the panel process has enhanced the interagency decision making process. With both Advocacy and OIRA participating and holding face-to-face discussions about serious policy decisions, the agency was confronted directly with significant concerns from the regulated sectors, as well as Advocacy and OIRA. The process was an eye-opener for participants, and Advocacy believes the process was a useful in identifying the small business concerns early in the process.

Significantly, on November 12, 1996, the first Small Business Advocacy Review Panel completed a report and presented it to OSHA. The panel considered a draft proposed rule for occupational exposure to tuberculosis. The affected sectors included nursing homes, emergency medical services, in-home care services, and homeless shelters. The panel considered the economic data and the draft proposed rule and the advice and recommendations of each small entity representative before completing the report. Major concerns were raised about the need for the rule, the complexity of the regulatory text, the feasibility, especially in homeless shelters, and the costs to sectors funded by Medicaid and Medicare. OSHA is expected to issue the proposed rule in the coming weeks, and we reserve our judgment on the agency's analysis of the input it received from the panel and small entity representatives until the agency has acted. We do expect, at the very least, the initial regulatory flexibility analysis will be improved. Small businesses, as well as the Office of Advocacy have an additional opportunity to comment on the proposed rule when it is published.

One of the major problems with the first review panel experience was the fast-track approach taken by the agency. The Office of Advocacy requested that convening the panel be delayed to allow more time for the panel members and the representatives to review the documents. The panel and small entity representatives were required to consider a lot of documentation in a short period of time. While OSHA did not agree to a delay, in the end, those on the panel agreed that the short time frame was a problem. Another issue raised by some was the need for the rule. A great deal of energy was spent by OSHA trying to justify the rule to the small entities.

Some small entity representatives withdrew from the process because of the sheer volume of work involved. This experience supports the need for Advocacy's access to data to provide a critical evaluation of the economic impact of a rule. The panel process needs to overcome and address the fact that small businesses generally lack the resources to evaluate rules thoroughly.

The Office of Advocacy anticipates panels will be held for OSHA's safety and health program and permissible exposure limit standards this year.

At the EPA, the first Small Business Advocacy Review Panel will be convened on April 22, for a draft proposed rule for control of emissions of air pollution from nonroad diesel engines. Before the panel was to be convened, we raised concerns that substantive materials have not been provided to panel nor the entities for constructive input. It presented the small businesses with a copy of the EPA draft proposal, with no regulatory alternatives, and no explanation of the potential costs, benefits, or emission reductions. As a result, EPA received very few written comments, which were not as helpful as they might have been otherwise. After we objected to this procedure, EPA provided additional information about other regulatory alternatives, and a brief discussion of the pros and cons of those alternatives. EPA's current plan is to convene the panel on April 22. (It is our hope that the panel will be able to receive more informed advice from the small business representatives.) This illustrates the difficulty of implementing SBREFA panels, where the law is not specific regarding what materials should be provided to the small entity representatives or the review panels.

In addition, the Office of Advocacy objected to the EPA's decision that the recent proposal to revise the National Ambient Air Quality Standards for ozone and particulate matter (NAAQS) was not covered by the requirements of the SBREFA. The EPA refused to prepare a regulatory flexibility analysis or convene a Small Business Advocacy Review Panel for the rulemaking. The EPA argued that the revised NAAQS will not have a significant economic impact on a substantial number of small entities. The agency argued that the rule, instead of establishing requirements applicable to small entities, establishes a standard of air quality for states to implement.

In November, we objected to this decision in a letter to EPA Administrator Carol Browner. Since then, EPA has agreed to hold a voluntary panel to address the small business impact of the implementation of this regulation. As you know, the Office of Advocacy has no authority to enforce the Regulatory Flexibility Act. However, we believe it is significant that the agency has re-evaluated its data and is coming to the table to meet with small firms, Advocacy and OIRA.

More panels are anticipated in the coming year on solid waste, air and water pollution rules.

## **Successes**

We are cautiously optimistic about the changes we can effect as a result of increased interagency cooperation that has resulted from both the SBREFA and our separate actions. Recent activities of Advocacy are documented in the [Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Calendar Year 1996](#)[PDF File]. Let me highlight a few examples of Advocacy's activities on behalf of small business.

### Meat Processors

In 1995 and 1996, the Office of Advocacy commented three times on a proposed rule issued by the Food Safety and Inspection Service (FSIS) that would implement, for meat and poultry inspection, a sevenstep process to prevent foodborne pathogens, the hazard analysis and critical control points (HACCP) system. Because of an increasing number of *E. coli* and salmonella outbreaks nationwide, the meat and poultry processing industry and the FSIS support significant change to the existing regulatory scheme. However, the FSIS failed to do a proper regulatory flexibility analysis and proposed a rule that would have put thousands of meat and poultry processors out of business without-the important point-necessarily making food safer for consumers.

Largely because of our initial comments on the proposed rule which harshly criticized the FSIS for failure to comply with the RFA, the Office of Advocacy was able to accomplish a number of significant changes. The letter received the attention of the Secretary of Agriculture and the agency subsequently reconsidered the impact of its proposed regulation on small processors.

Advocacy was involved in OMB's review of the draft final rule. The HACCP final rule, published in 1996, reflected a number of major revisions requested in the Office of Advocacy's comments. Cooling requirements, antimicrobial treatment requirements, and daily perspecies salmonella testing requirements were removed from the final rule. Most significantly, the FSIS adopted the SBA's size standard for small processors and extended the implementation date for some small businesses to a maximum of 42 months.

#### Electronic Tax Filing for All Small Businesses

In early 1996, small businesses were concerned about a new law that would require them to pay federal withholding taxes electronically by January 1, 1997, or face financial penalties. (Unlike the common perception, many small businesses are not necessarily computer-literate, often due to inadequate resources.) To help the Internal Revenue Service (IRS) identify the severity of small business concerns, Advocacy directly contacted Commissioner Margaret Richardson and provided IRS with a list of small business representatives to consult. Delegates targeting tax issues from the White House Conference on Small Business also became involved and provided input. Within a short time, the IRS decided to delay the implementation date until small businesses could be educated about the new requirements. (Congress subsequently amended the law to delay the implementation date further.)

#### Shark Fishing Industry

On [February 6](#) of this year, Advocacy submitted comments to the National Marine Fisheries Service raising criticism about the agency's noncompliance with RFA in combination with the rule that would reduce the commercial quotas for Atlantic coastal sharks. The agency certified that the rule would not have a

significant economic impact on small businesses, yet Advocacy pointed out that a 50 percent reduction in catch quotas would result in a significant reduction in revenue. This letter prompted both agency officials and the Department of Justice's office that handles the agency's litigation to contact Advocacy and resolve the issues. In response to Advocacy's comments, the agency completed a regulatory flexibility analysis and published a revised final rule on sharks this month.

### Mergers and Small Cable Companies

In [August 1996](#), the Office of Advocacy submitted a letter to the Federal Trade Commission (FTC) expressing its concerns about the widely publicized merger between Turner Broadcasting and Time Warner. In the letter, Advocacy questioned whether the proposed merger would violate section 7 of the Clayton Act, which prohibits anti-competitive activities. The Office of Advocacy based its concern on documented incidents of Time Warner's prior discriminatory behavior toward small cable operators. The Office of Advocacy also questioned whether the new entity would use its market dominance to bundle programming, practice price discrimination in wholesale cable programming rates, and adversely affect competition from direct-to-home satellite services.

On September 12, 1996, the FTC released its proposed decision approving the proposed Turner-Time Warner merger. To overcome anti-competition concerns, the Commission proposed a consent order that required the parties to agree to certain conditions.

The Office of Advocacy's intervention in the Time-Warner proceedings did not focus on regulatory flexibility issues, but on the impact of the merger on small entities. As a result of Advocacy's intervention, the Commission's order bars price discrimination and program bundling. It also ensures that the additional market power of the merger will not result in higher prices for new entrants and that cable operators will not be forced to purchase unwanted programming. In addition, the agreement provides for conduct and reporting requirements to ensure that Time Warner Cable does not discriminatorily deny program access to unaffiliated programmers.

### Small Manufacturers

In June 1996, EPA promulgated the accident release prevention and emergency response requirements for facilities that possess certain regulated chemicals above specified threshold quantities. The Office of Advocacy met with EPA and OMB during the interagency review process, and suggested several significant revisions that EPA adopted in the final rule. Among the revisions were: (1) a reduction in the scope of the accident history requirements (description of accidental releases over the past five years); (2) reduction in the number of alternative release

scenarios required to be analyzed for the prevention plan; and (3) reductions in the compliance certification requirements.

These examples provide you with some idea of the breath of our activities and how we impact regulations on both a small and large scale. Most importantly, our involvement focuses on issues where there is real value added and where we can make a difference on the substance of the rule and increase compliance with the RFA.

### **Advocacy's Outreach to Small Businesses**

Small businesses have been empowered under the SBREFA, and Advocacy is helping small businesses assert their rights to participate in the regulatory process.

This is not a new fight for me. In 1980, while serving as Deputy Chief Counsel in the Office of Advocacy, I had the privilege of working on passage of the Regulatory Flexibility Act. In my confirmation statement before the Senate in 1994, I shared my priorities for the Office of Advocacy - and I quote "Number one. Reduce the regulatory burden on small business by enforcing and strengthening the [Regulatory Flexibility Act](#)..."

I am extremely proud that the [SBREFA](#) was passed. However, even before its passage, the Office of Advocacy dedicated its resources to campaigning for a cultural change in Federal agencies. Early in this Administration, I made repeated efforts during the events leading up to the White House Conference on Small Business of 1995 to seek out the primary regulatory barriers for small businesses. At every stop during state and regional meetings, I would ask small businesses to tell me about their problems with regulations. The result was a list of 60 recommendations calling for a change in the way the Federal government deals with small businesses.

The White House Conference on Small Business memorialized the urgency for a new approach. The recommendations focused both the Congress and the Administration on the small business agenda and illuminated the issues of greatest importance to small businesses. With the direct support and leadership from the President and his staff, we worked with agencies to implement the White House Conference recommendations. Our reports on implementation of the WHCSB recommendations document the progress made by both the Congress and the Administration.

The White House Conference on Small Business was only the beginning. Through various efforts, the Office of Advocacy remains in touch with the everyday concerns of small businesses and the impact of regulatory proposals. Advocacy maintains regular communications with delegates from the 1995 Conference and regularly communicates with small businesses through our newsletter, *The Advocate*.

Networking with trade associations and other small business representatives is an important function of the Office. Advocacy regularly conducts roundtable meetings on issues in the areas of procurement, telecommunications, environment, transportation and occupational safety and health. For instance, Advocacy met with trade associations to discuss a rule that would alleviate some of the burden on businesses that carry small quantities of hazardous materials. In the meeting, we identified one serious concern for sectors that were previously exempted under state laws that would now be covered. The Department of Transportation amended to rule to provide relief to that sector.

In response to the SBREFA, Advocacy has done a tremendous amount of training and outreach. In April 1996, Advocacy held a session with over 60 trade association representatives on effectively using the Regulatory Flexibility Act. To encourage compliance with the RFA, small businesses and their representatives were urged to assess regulations and the accompanying economic analysis. To assist in that effort, Advocacy immediately published *A Guide to the Regulatory Flexibility Act* about small businesses' rights under the amended law.

Following the April briefings and publication of the guide, Advocacy has held a series of meetings and roundtables with industry on specific regulations in the areas of telecommunications, procurement, utility, environmental, safety and health and tax regulations. Just yesterday we met with 30 association executives to brief them on how to use RFA and the SBREFA.

One of the most important tasks during the regulatory process is building a record on agencies' compliance. With every regulation, Advocacy and small business asked: Did the agency comply with the Regulatory Flexibility Act? Too many times the answer was no. However, Federal agencies are beginning to listen seriously because of the passage of the SBREFA.

The Office of Advocacy and the small business community continue to identify and communicate with Federal agencies on specific regulations. Under the amended Regulatory Flexibility Act, the stakes are higher for Federal agencies and small business to make the law work.

### **Small Businesses Must Participate**

Participating in the development of regulations is an important right of small businesses. The Regulatory Flexibility Act guarantees that Federal agencies must fully consider the impact of regulation on small businesses. In addition, the Administration has encouraged Federal agencies to develop regulations in a cooperative environment. The passage of the Small Business Regulatory Enforcement Fairness Act has cemented the important role of small businesses.

Small businesses' most significant mechanism for influencing the development of Federal regulations is the Regulatory Flexibility Act. The purpose of the

[Regulatory Flexibility Act](#) is to assure Federal agencies endeavor to fit regulations to the scale of the affected businesses. Agencies are required to perform economic and regulatory analyses, solicit and consider flexible regulatory proposals from small businesses, and to explain the rationale for their regulatory actions.

Recognizing that small business is a major source of competition and economic growth, Congress established through the RFA a process to be followed by agencies in analyzing how to design regulations that will help achieve statutory and regulatory goals efficiently without harming or imposing undue burdens on the major source of competition in the nation's economy - small business.

The RFA does not seek preferential treatment for small businesses. Nor does it mandate that agencies adopt regulations that impose the least burden on small entities. Nor does it require exemptions for small entities. Rather it establishes an analytical process to be followed in determining how public policy issues can best be resolved without erecting barriers to competition. The law seeks a level playing field for small business, not unfair advantage. It calls for regulations that are "rightsized" -regulations that require small business compliance only to the extent to which small businesses contribute to the problem the regulation is designed to eliminate or control.

When Congress passed the original act, it declared many reasons why regulations simply should not be applied uniformly to all businesses. In fact, some of the best reasons were not simply for the benefit of business, but for the advantage of the public. The Congressional findings concluded that the failure to recognize differences in the scale and resources of regulated entities has in many cases discouraged innovation that leads to beneficial products and processes, restricted improvements to productivity, adversely affected competition in the marketplace, and created barriers to entry in many industries.

In a study performed by the Office of Advocacy, small business focus groups identified regulations as one of the major barriers to small business market entry and an inhibitor to company growth. The Office of Advocacy, in cooperation with the White House Conference on Small Business, held a series of 15 focus groups between October 1994 and January 1995 to assess the future of small business and entrepreneurship in the 21st century. The extent, complexity, and uncertainty associated with regulations were identified by the panel as a major barrier to growth over the coming decade. Regulations at all levels of government were singled out as examples that impede the establishment and growth of businesses. There was significant agreement that simplified and flexible regulations should be sought using better cost-benefit analyses and risk assessments.

Many regulations have been applied uniformly to small and large businesses alike even though the problems that gave rise to the government action may not have been caused by the small firms. Uniform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and

disproportionately burdensome demands upon small businesses with limited resources. The Regulatory Flexibility Act imposes specific processes on Federal agencies to fully analyze the impact of regulations on small businesses, to seek the assistance of small business in the development of rules, and to review current regulations periodically.

### **On-going Challenges**

The Office of Advocacy has many irons in the fire. Some are receiving a lot of attention and others are rather quiet struggles. Here are a few examples.

Procurement reform continues to be major effort that we expect to harm small businesses if it proceeds on the its current track. As we testified on April 10 before the full Committee, Advocacy is actively participating on a variety of fronts. We are trying to persuade the Office of Federal Procurement Policy to adopt higher small business goals and increase outreach to small business. We are working within SBA to improve the electronic listing of small businesses to allow Federal and other government agencies to identify small business partners. We are very concerned about bundling of contracts that will minimize small business opportunities and support Congressional efforts to address this problem.

At OSHA, we are urging the agency to allot small businesses more than one token seat on a Standards Advisory Committee for development of a metalworking fluid rule that will apply to far more small companies than large. This issue is just one of many in the works that will significantly affect small firms. For instance, we are monitoring the development of anticipated proposed rules for permissible exposure limits for air contaminants that will cut across most businesses. We have asked OSHA to hold a meeting with small business interests to explain the agency's methodology for identifying the risks and setting proposed thresholds.

The Office of Advocacy submitted comments in September in response to the EPA's June 1996, proposal to expand the Toxic Release Inventory (TRI) reporting requirements to seven classes of additional industrial facilities. These industry groups are coal mining, metal mining, electric utilities, commercial hazardous waste treatment, chemicals and allied products (wholesale), petroleum bulk stations (wholesale), and solvent recovery services. This rule is a major expansion of the current communityrighttoknow regulations. Advocacy continues to work with the agency to look for ways to preserve the right-to-know regulation, while saving substantial compliance costs.

The Office of Advocacy has had the same position about small sources and the Toxic Release Inventory since 1988. In 1988, we supported exempting certain facilities with less than 50 employees for TRI reporting. In 1991, we supported exempting reports from facilities that emitted less than 5000 pounds per years of listed toxic chemicals, and in 1994, EPA enacted this exemption. Recently, with the proposal of TRI Phase II, this office also supported eliminating from reporting

requirements industry sectors with small releases. Thus, the Office of Advocacy adheres to a standard that maximizes the impact of regulations on a problem while minimizes the impact on small firms that contribute little to the problem.

Access to capital is a chronic problem for small business and Advocacy has engaged in several efforts to ameliorate the problem. We have published a banking study each year for three years, ranking the nation's commercial banks on their lending patterns to small business. The data is gleaned from reports submitted by banks to regulatory agencies. The value of the information is, first, it is not otherwise available in the marketplace; and, second, it helps both banks and small business-banks to compete for small business credit and small business to identify banks likely to make small business loans. We now have anecdotal evidence that banks are beginning to use the data as a marketing tool. If so, this is good news for small businesses.

Most recently, we have been developing a computer based system to help accredited investors ("angels") identify investment opportunities nationwide. This initiative resulted from Advocacy research showing that an equity investment gap exists between investments of \$250,000 and \$5,000,000-a gap not being filled by established equity markets, including venture capital firms, but rather being met by "angels", however, in an inefficient manner. The computer based Internet system will significantly reduce investors' search costs and help meet the needs of entrepreneurs for investment capital. With this project, we are seeking to reduce the regulatory burden that state "blue sky" laws and the Securities and Exchange Commission place on raising capital for small businesses.

## CONCLUSION

The mission of Advocacy is broad. Some of our resources focus on identifying market imperfections that adversely affect small business which need to be addressed by policy makers. The bulk of our resources is devoted to ensuring compliance with [RFA](#)-my number one priority. The [SBREFA](#) amendments have both strengthened and complicated our task. Data is essential to rational impact analyses. Advocacy needs to obtain the data and statistics necessary to make logical, substantiated decisions and to share the information with regulatory agencies and our constituencies. We take our mission seriously and are keenly aware of the important role our regulatory comments and economic analyses will play in achieving compliance with SBREFA, both in the regulatory development process and in regulatory appeals by small businesses.

## APPENDIX A

### OFFICE OF ADVOCACY

#### **Economic Research Studies: Regulatory Impact on Small Business**

## **On-Going Economic Research**

**Studies of the Impacts of Federal Regulations, Paperwork, And Tax Requirements for Small Business** (Draft final, May 1997), Henry Beale, Microeconomic Applications, Washington, D.C. The studies examines the relative cost of regulations in small vs. large firms in a representative group of regs from EPA, OSHA, EPA, and the IRS. Cost ratios are expressed on a common basis.

**Contract Bundling and Small Business: Effects of the Federal Acquisition Streamlining Act on Small Business** (Draft final February 1997), Eagle Eye Consulting, Arlington, VA. This study concluded that while the dollar volume of federal awards to small firms has risen slightly from FY91-FY95, the number of small firms receiving awards is declining. However, awards to 8(a) firms have been rising.

### **Enforcement Penalties Against Small Businesses**

Kelly Lear, Bloomington, Indiana (Ph.D Dissertation). (To be completed in 1997). This thesis is examining the size of the penalties on businesses by firm size to determine if any systematic relationships exist between the size of the penalties by government regulators and the size of the business they are regulating.

## **Published Economic Research**

**Utility Deregulation and the Effects on Small Business**, J.W. Wilson and Associates, Washington, D.C. (1996). This study concluded that small firms will be adversely effected by stranded costs as the result of competition in the market for electricity. Because of their lack of bargaining power, small firms may not be able to bid for the lower cost electric rates of alternative suppliers.

**A Survey of Regulatory Burdens**, Diversified Research, Irvington, N.Y. (June, 1995). This nationally representative study surveyed 360 firms in 15 industries to determine the regulatory burden across 4 firm sizes. It concluded that firms with 1-4 employees could be spending up to \$32,000 per employee for regulatory costs, compared with \$17,000 per employee for firms with more than 50 employees. IRS paperwork burden accounted for much of the differential.

**Profiles of Regulatory Costs**, Thomas D. Hopkins, Rochester, N.Y. (November, 1995). This study attempted to measure total regulatory costs on both households and businesses. It concluded that, despite data limitations, small firms face greater regulatory burdens. Process regulation accounted for some 40 percent of regulatory costs, while environmental regulations accounted for about a quarter of regulatory costs.

**Cost-Effective Regulation by EPA and Small Business Impacts**, Christopher R. Allen, Henry B.R. Beale, Robert E. Burt, Cynthia Pantazis, and Kathleen A. Shaver (1992), Microeconomic Applications, Inc., Washington, D.C. The Regulatory Flexibility Act requires the Environmental Protection Agency and other federal agencies to consider reasonable alternatives that may minimize burdens on small entities while achieving statutory objectives. For various reasons, effects on small entities may not be adequately addressed through cost-effective regulatory alternatives. This research, which focuses on eight case studies involving EPA regulations, explores factors and problems contributing to this outcome, and also provides examples of successful EPA regulatory flexibility analysis.

**The Impact of Telephone Deregulation on Small Business**, J.A. Montanye (1988), Cornell University Group, Inc., Falls Church, VA. This study looks at prevailing regulatory issues at the state and federal levels in the telecommunications industry in the late 1980s. It attempts to assess

the potential impact of regulatory reform on the price and availability of telecommunications services used by small businesses. Case studies of the telecommunications regulation experiences of Nebraska, Vermont, and Colorado are included.

**An Analysis of Closures of Industries in SIC 24 and 25 As a Result of Proposed OSHA Regulations**, Policy Planning and Evaluation, Inc. (1988), Vienna, VA. Regulations proposed in 1988 by the Occupational Safety and Health Administration to revise standards for air contaminants would require many industries to purchase and install air pollution control equipment. Some firms may be excessively burdened by the costs of complying with the regulations, even to the point of closing down. This paper focuses on the tests used to determine the financial ability of firms in SIC 24 (lumber and wood products) and SIC 25 (furniture and fixtures) to bear the costs imposed by the proposed OSHA regulations.

**Pension Laws and Regulations Affecting Small Business Plan Decisions**, Anthony J. Sulvetta, Christopher M. Niemczewski, and Martha A. Solt (1986), Jutin Research Associates, Washington, D.C. This study finds that frequently changing pension laws and regulations require small firms to hire specialists, which increases costs and deters firms from offering pension plans. Burdensome regulations include reporting and disclosure requirements; top-heavy rules; and fiduciary, funding, and vesting requirements.

**Comments on the Environmental Protection Agency's Effluent Limitation Guidelines for the Organic Chemicals, Plastics, and Synthetic Fiber Industries**, Charles Marshall (1985), JACA Corporation, Fort Washington, PA. The analysis shows that 23 percent of 636 affected facilities would close as a result of these effluent guidelines, compared to the Environmental Protection Agency's estimate of 15 percent. The difference was largely due to EPA's failure to consider financial variability within categories and its overstatement of affordability.

**Comments on EPA's Effluent Limitation Guidelines for the Pesticide Chemicals Industry**, Charles Marshall (1984), JACA Corporation, Fort Washington, PA. The report recommends that the Environmental Protection Agency adopt alternatives to the zero discharge rule for the pesticide formulation and packaging industry. Suggested spray treatment is not widely available. In addition, compliance costs are more than double the EPA estimates.

**Disproportional Burden of Regulations on Small Business** Economies of Scale in Regulatory Compliance: Evidence of the Differential Impacts of Regulation by Firm Size, Todd A. Morrison (1984), Jack Faucett Associates, Inc., Chevy Chase, MD. A disproportionate burden is placed on small business by federal regulations, according to this report. Studies of 14 regulations in 150 three-digit SIC code industries showed that the median small firm experiences an average cost per employee greater than three times the large firm.

**Comments on EPA's Effluent Limitation Guidelines Covering the Lead-Acid Battery Manufacturing Industry**, Charles Marshall (1984), JACA Corporation, Fort Washington, PA. The study recommends that the U.S. Environmental Protection Agency develop a regulatory flexibility analysis (RFA) for this standard due to the magnitude of differential control costs. The regulatory alternatives used in this RFA should include alternative discharge levels.

**Comments on the Environmental Protection Agency's Effluent Limitation Guidelines for the Metal Molding and Casting Industries**, Charles Marshall (1984), JACA Corporation, Fort Washington, PA. This study lists 13 processes which should be excluded from regulation. It recommends that sensitivity analyses should be conducted by the Environmental Protection Agency and that financial ratio thresholds should be tested. Zero discharge should not be required unless attainable.

**Comments on the Environmental Protection Agency's Effluent Limitation Guidelines for the Nonferrous Metals Manufacturing Industries**, Charles Marshall (1984), JACA Corporation, Fort Washington, PA. This study concludes that ammonia should not be included in the Environmental Protection Agency's effluent limitation guidelines. A requirement for filtration cutoff of 10,000 tons per year for secondary aluminum plants is recommended. No allowance is made in the study for the variation in cost structure between plants and industry types.

**A Preliminary Examination of the Quality and Performance of S-18 Offerings and Securities**, Alfred E. Osborne, Jr. (1983), A.E. Osborne Associates, Sherman Oaks, CA. In 1979, the Securities and Exchange Commission, through the adoption of Form S-18, announced simplified registration and reporting requirements for the sale of securities -- not to exceed \$5 million -- by certain small issuers. This preliminary study looked at the experiences of six companies that filed S-18 registrations and were subsequently listed in the Wall Street Journal. It sought to determine: (1) the investment quality of the issues; (2) the costs of effecting S-18 offerings of securities in contrast to comparable initial public offerings; and (3) the aftermarket performance of each company.

**The Relationship Between Asset Size and the Number of Shareholders for SEC Reporting Companies**, Alfred E. Osborne, Jr. (1983), A.E. Osborne Associates, Sherman Oaks, CA. For small firms, unlike for large firms, the costs of meeting SEC reporting requirements outweigh the benefit to shareholders of the reported information. This study recommends the establishment of exemptions from SEC reporting requirements based on asset size.

**Report of the Use of the Rule 146 Exemption in Capital Formation**, Ulysses Lupien and John Matthews (1983), Securities and Exchange Commission, Office of Economic Research, Washington, D.C. The Rule 146 exemption from registration requirements of the Securities Act of 1933 was available from 1974 to 1982. It was adopted to provide great certainty in exempted nonpublic offerings by establishing more objective standards upon which stock issuers could rely in raising capital.

**Asset Size and Alternative Policy Criteria in Securities Regulation**, Alfred E. Osborne, Jr. (1983), A.E. Osborne Associates, Sherman Oaks, CA. The study surveyed 265 firms, approximately 77 percent of all small high technology firms reporting to the SEC in 1977. Three-quarters of the firms had stock market values below their book values. The average value of holding per shareholder was one-tenth that of the New York Stock Exchange's average.

**An Estimate of Compliance Costs Under the Periodic Reporting Requirements of the Securities and Exchange Commission for Small High-Technology Companies**, Alfred E. Osborne, Jr. (1983), A.E. Osborne Associates, Sherman Oaks, CA. This study of 265 companies showed that reporting costs for quarterly 10-Q and annual 10-K reports were over \$50,000. The disclosure requirements impose a heavier burden on small companies than on large companies because the costs are largely fixed.

**Impact of Environmental Regulations on Small Business**, Nathaniel Greenfield (1982), Booz Allen and Hamilton, Inc., Bethesda, MD. As federal regulatory agencies have fulfilled their congressional mandates, some regulators, concerned about the disproportionate impact of regulation on small businesses, have designed special exemptions for small firms. The research described in this report attempts to ascertain whether government environmental regulations have in fact had disproportionate adverse effects on smaller manufacturing firms. The analysis examines a sample of industries to find out how well small firms have fared relative to larger firms over time.

**An Analysis of the Use of Regulation for Small Public Offerings**, William C. Dale, Ulysses G. Lupien, and Robert E. Zweig (1982), Securities and Exchange Commission, Directorate of

Economic Research, Washington, D.C. The Regulation A exemption from the registration provisions of the Securities Act of 1933 provides small stock issuers with a simplified procedure for selling a limited dollar amount of securities in a public offering without having to incur the full expense and delay of the complete registration process. Using data from SEC filings, this study examines the general operation of Regulation A by focusing on the characteristics of the issuers and offerings using the exemption. It also examines the effects of the increase in the Regulation A ceiling amount that came into effect in 1978.

**Federal Regulation of Small Business**, William A. Brock and David S. Evans (1982), Chicago Economic Research Association, Evanston, IL. As a result of legislation passed in the late 1960s and early 1970s, federal regulation of businesses increased dramatically. During the 1970s the federal regulatory budget grew sixfold and federal regulatory employment nearly tripled. Also during the 1970s, evidence indicated that uniform application of regulatory requirements increases the minimum size of firms that can compete effectively in the regulated market. This study describes small business' role in the economy and examines the impact of federal regulations and taxes on businesses of different sizes.

**Complying with Government Requirements: The Costs to Small and Larger Businesses**, Roland J. Cole and Paul Sommers (1981), Battelle Memorial Institute, Human Affairs Research Center, Seattle, WA. During the 1970s, government requirements increased the cost of doing business in all industries. Government requirements pose special problems for small businesses because they cost more per dollar of revenue than in moderate-sized or large firms. This report assesses the cost impact of government regulations on small business.

**The Impact of Federal Regulations on Small Firms in the New England Fishing Industry**, Catherine P. Wiggins (1981), University of New Haven, West Haven, CT. This study examined the effects of the Fishery Conservation and Management Act of 1976, and found that it reversed the decline of the New England fishing industry by reducing competition from foreign vessels. However, small fishermen did not have a voice in fishery management planning.

**Small Business and Motor Carrier Regulatory Reform**, Michael W. Pustay (1981), Texas A&M University, College Station, TX. This research explores the impacts on the small business community of U.S. Interstate Commerce Commission (ICC) regulation of the interstate motor carrier industry and recent reforms of ICC motor carrier regulation. Three areas are examined in depth: the provision of motor carrier service to small businesses in small communities, protection for small businesses from discriminatory pricing by ICC-regulated motor carriers, and ensuring equal access for small businesses to the services of small contract carriers.

**Improving Economic Impact Analyses of Government Regulations on Small Business**, Charles R. Marshall (1981), JACA Corporation, Fort Washington, PA. The study concludes that the costs of required reporting, recordkeeping, and testing should be included in cost estimates. These costs are higher per unit for smaller firms. The study recommends the model plant approach.

**Steps to Ensure the Viability of the Residential Fuel Oil Distribution System**, Peter Bos (1980), Resource Planning Associates, Cambridge, MA. In the 1970s, there were about 8,000 heating oil dealers in the United States, most of them small independent businesses. This study took a look at some of the problems then threatening the viability of these small firms -- such as tighter supplier credit, decreasing market share, and anticompetitive government regulation -- and offered some strategies to alleviate the negative impact of these trends.

**The Impact of Federal Regulations on the Small Coal Mine in Appalachia**, Bernard Davis and Raymond Ferrell (1980), Appalachian Development Center, Morehead, KY. This study addresses two specific issues influencing the production of coal from small mines: (1) the direct costs and

other effects of governmental regulation and deregulation on coal operators in general, and (2) the effects of governmental policies on the productivity by size class of small coal mines. Permitting costs, productivity data, and operating and compliance costs were examined for sample groups of small mines in Kentucky.

**Industry Rivalry and Strategy in the Regulatory Process**, Sharon Oster (1980), Yale University, New Haven, CT. The study shows how a firm might support regulations that differentially damage its rivals. A firm's incentive to engage in strategic regulatory investments depends on the nature of the proposed regulation and barriers to entry and mobility.

**Costs of Compliance in Small and Moderate-Sized Businesses**, Roland J. Cole and Paul Sommers (1980), Battelle Memorial Institute, Seattle, WA. This paper considers theoretical reasons for expecting small businesses to have more variable -- but on average proportionately higher -- costs of compliance with government requirements than moderate-sized businesses. Small businesses are more likely not to comply because they are less likely to be detected, but when they do comply, their costs are proportionately higher. Empirical tests of this theory for a Washington State sample of small- and moderate-sized businesses confirm that small businesses report higher mean costs but greater variability across firms.

**Analysis of Regulatory Cost on Establishment Size for the Small Business Administration**, Michael E. Simon and L. Ross Beard (1979), Arthur Andersen & Company, Washington, D.C. The purpose of this study was to analyze the cost impact of government regulation by size of business. The electrical machinery industry was selected as an industry that showed meaningful regulatory cost trends, incremental costs of regulations, as well as trends in regulatory costs, are shown by business size.

## **APPENDIX B**

### **OFFICE OF ADVOCACY**

#### **Economic Analysis: RFA Process**

An important element of an agency's compliance with the Regulatory Flexibility Act is its economic analysis and development of regulatory alternatives. If an agency determines that a rule will not have a significant economic impact on a substantial number of small entities, it must be able to justify its conclusion with a fact based, quantitative analysis. The agency must "certify" the rule and request public comment on its certification. The certification can be reviewed by the court.

If an agency determines that a rule will have a significant impact, it is mandated to complete a full regulatory and economic analysis and solicit small business review of its conclusions. Part of the analysis must be a serious consideration of alternative regulatory approaches that would relieve the burdens on small business. These analyses and conclusions, included in a final regulatory flexibility analysis, also are subject to judicial review.

One of the key questions that an agency must answer is: Will a regulation have a significant economic impact on a substantial number of small entities? Whatever an agency's answer, the data used for decision making may be critically reviewed

by a court. Commonly, agencies want a bright line definition of "significant impact" and "substantial number." This decision clearly lays with the courts. The agency will be challenged to demonstrate the integrity of its decision model.

Determining a rule's impact on small businesses and other small entities is an important part of the rulemaking process, and the integrity of the analysis for the Regulatory Flexibility Act will be a critical factor when determining an agency's compliance.

The process of analyzing the impact of regulations should be transparent. Assumptions should be fully revealed and terms clearly defined. President Clinton in 1993 directed executive agencies to restore the integrity and legitimacy of regulatory review and oversight and to make the process more accessible and open to the public (Executive Order 12866, Sept. 30, 1993). The Regulatory Flexibility Act extends these requirements to all Federal agencies, requiring them submit their analysis for public review and comment. With small business scrutiny, the analysis should be legitimate and defensible.

A meaningful analysis will include a critical evaluation of small businesses' contribution to the problem that an agency is trying to solve, the effectiveness of remedies, and the impact of the regulation on the affected parties. Useful data on industry characteristics becomes very important when agencies are assessing the varying effects of regulations on different industries. Any conclusions about the impact of regulations should be couched in a thorough assessment of the economies of scale of business. The smallest of businesses have fewer customers to pass along the cost of compliance. As a result, a small business with the same economic costs becomes uncompetitive because of higher prices or the company is less profitable with fewer options to react to market changes.

One common mistake in economic analysis is using the aggregate or mathematical average to determine the impact of a regulation on small business. The objectives of the Regulatory Flexibility Act will only be achieved if agencies complete thorough detailed analyses that break down sectors of the affected small businesses. Variables should include different size and industry classifications. For instance, a rule may have a very small impact on one sector, but a significant impact on another. If these impacts are evaluated together, an average would not accurately characterize the impact. An effective economic analysis will delineate the burdens placed on specific sectors of the small business community.

The definitions used in an economic analysis also must withstand critical review. For instance, agencies are compelled to use definitions for small business established by the U.S. Small Business Administration in their analyses for most cases. The SBA publishes size definitions for each industry in four digit Standard Industry Classification. The definitions are based on annual revenue or average employment. If an economic analysis uses alternative definitions, the agency must solicit the consultation of the Office of Advocacy and public review. This critical

definition question is one of several lynch pins in an agency's demonstration of compliance with the Regulatory Flexibility Act.

\* Last Modified: 6/18/01