DOCUMENT RESUME

07049 - [B2427450]

[Regulatory Flexibility and Reform Act]. August 23, 1978. 12 pp.

Testimony before the Senate Committee on the Judiciary: Administrative Practice and Procedure Subcommittee; the Senate Select Committee on Small Business; by Morton A. Myers, Deputy Director, Program Analysis Div.

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Congressional Relevance: Senate Committee on the Judiciary: Administrative Practice and Procedure Subcommittee; Senate Select Committee on Small Business.
Authority: Regulatory Flexibility and Reform Act; S. 3330 (95th Cong.). Administrative Procedure Act. Employee Retirement Income Security Act. 5 U.S.C. 553.

Because the burdens of Government regulation frequently fall relatively heavily on individuals of limited means and on small businesses, small organizations, and small governmental jurisdictions, alternative regulatory methods which would reduce these burdens without loss of regulatory efficiency and effectiveness are suggested. The objectives of S. 3330 are similar to those of the President's March 1978 Executive Order on Improving Government Regulation, particularly with regard to reducing the paperwork burden and soliciting early public participation in agency rulemaking. The bill does not require agencies to sacrifice regulatory goals in order to lighten the regulatory burden. However, poorly conceived and designed regulations could create unintended incentives for institutions to become or remain small in order to escape vigorous or costly regulation. Agencies may have some difficulty in choosing among alternative regulatory methods as suggested by the proposed legislation. The role of the General Accounting Office needs to be clarified, and the sunset provision of the legislation requires more consideration. Alternative regulatory methods include: less or no regulation imposed on individuals, businesses, organizations, and governmental jurisdictions of limited means; grants or subsidies to assist smaller organizations in complying with costly regulations; progressive regulation offering a choice of when to comply; and performance oriented regulations allowing firms to choose how to comply with performance goals. Uniform regulation may be justified if it does not place smaller businesses or governments at a disadvantage or if important policy goals are at stake. (RRS)

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Before the Subcommittee on Administrative Practices and Procedure
of the
Committee on the Judiciary

and the

Select Committee on Small Business
United States Senate

EXPECTED DELIVERY
10:45 a.m.
August 23, 1978

Mr. Chairman and Members of the Committee. We welcome this opportunity to discuss with you S.3330, the "Regulatory Flexibility and Reform Act."

There is evidence that small firms are disproportionately adversely affected by many government regulations and paperwork requirements. Many regulations and paperwork requirements are more efficiently met by larger scale enterprises, because, as some recent studies have suggested, compliance with both technological and paperwork requirements are subject to economies of scale. Failure to account for the regulatory burdens imposed on smaller businesses and institutions can lead to unexpected, unintended, and undesirable results. For example, the Employee Retirement Income Security Act (ERISA) was intended to protect employee pension plans by establishing certain minimum financial requirements. GAO found that ERISA has contributed to the abandonment by many small firms of their private pension plans, which was certainly not the intent of the Act.

Thus, we recognize that the burdens of regulation frequently fall relatively heavily on individuals of limited means and on small businesses, small organizations, and small governmental jurisdictions, and we support any alternative regulatory methods which would reduce those burdens without undesirable loss of regulatory efficiency and effectiveness.

We note that some of the objectives of S. 3330 are similar to those of the President's March 23, 1978 Executive Order on Improving Government Regulation, particularly with regard to reducing the paperwork burden, and soliciting early public participation in agency rulemaking. One major difference between the two is that the Executive Order does not consider the issue of tiered, or flexible regulation. Another difference is that the Executive Order does not cover the independent regulatory agencies, while S. 3330, amending the Administrative Proceedures Act, would cover those agencies.

In the remainder of our testimony, we will first raise several concerns over the implications and the administration of the bill, and then turn to a discussion of some alternative methods of regulation which we feel might help achieve the goals of S.3330.

AREAS OF CONCERN

1. It is important to stress that the bill does not require agencies to sacrifice regulatory goals in order to lighten the regulatory burden.

In some cases, the regulatory burden on individuals, and small businesses, organizations, and governmental jurisdictions can be eased only by compromising some regulatory goal. In some areas this tradeoff may be acceptable if the reduced regulatory burden results in more vigorous competition from the small business sector. In other areas the regulatory objective should not be compromised.

We recognize that the bill is passive in wording, and "empowers and encourages" agencies to consider rules which would fit the scale

of those being regulated. Still, in certain regulatory areas such as consumer and worker safety and health, we would stress that it would be a mistake to relax regulation on any segment of society judged solely on size, or resources available. In fact, evidence indicates that workers in small businesses are exposed to serious workplace hazards. Similarly, we think that it could be an error to exempt smaller drug manufacturers from the rigorous testing required by the Food and Drug Administration. Thus, agencies must carefully evaluate:

--when regulatory burdens can be eased without sacrificing the regulatory goals;

--when the basic regulatory goal cannot be compromised to benefit small businesses and institutions; and

--when the benefits of easing the regulatory burden would warrant some sacrifice in the regulatory goal.

2. Care should be taken that tiered or progressive regulations do not encourage firms to be inefficiently small, or erect barriers to growth.

Poorly conceived and designed regulations may create unintended incentives for institutions to become or remain small in order to escape more vigorous or costly regulation. A current GAO draft study has indicated one unintended consequence of the crude oil entitlements program. Since 1973 the Federal Energy Administration (now part of the Department of Energy) has enabled smaller refineries to purchase crude oil at up to $1.89 per barrel less than larger refineries. This attempt to protect smaller refineries has contributed directly to the fact that 37 of the 38 new refineries built in the US in the period January 1974 to September 1977 were tiny,

all less than 40,000 barrels per day capacity compared to the technologically efficient size of 175,000 barrels per day.

We also feel that, in general, regulations should be avoided which tie firms to a particular technology, and thus discourage innovation. Moreover, tiered regulation requiring or promoting different technology for different sized firms can limit a firm's growth opportunities, since a larger size would require a different technology.

3. Agencies may have difficulty in choosing among alternative regulatory methods.

In section 3, amending 5 U.S.C. 553 (c), the bill directs agencies to solicit from the public alternative methods of achieving the stated regulatory goals. In selecting the final rule, the agency must explain why any method less costly than the chosen one, was not chosen. This makes sense in theory. The public deserves to know what the agency found objectionable with any alternative claiming lesser adverse economic impact. However, difficulties arise in defining adverse economic impact. It is possible that several alternative methods submitted to the agency for consideration will make the claim that they each minimize adverse economic impact. The trouble is that economic impact has many dimensions, and the agency will have to weigh all of the different adverse economic impacts. For example, many regulations which impose costs on one segment of the economy merely transfer costs from one segment to another. From society's point of view these regulations do not create additional social costs, although

they will be perceived as additional costs by individuals who now have to pay them. Thus, it will be very hard to say whether the agency has done a good job in selecting the most effective rule with the least adverse economic impact.

Nevertheless, we see merit in the concept contained in S.3330 which would encourage agencies to solicit alternative regulatory methods before they are implicitly or explicitly committed to any particular form of regulation. We recognize, however, that the privilege of interested persons to submit alternative regulatory proposals could be abused by swamping an agency with proposals which, under Section 3 amending 5 U.S.C. 553 (c) of the bill, would have to be analyzed.

4. The role of the General Accounting Office must be clarified.

Section 3 of the bill, adding 5 U.S.C. 553 (h) authorizes the Comptroller General to furnish, upon request, advice and assistance to any agency promulgating rules under this section. The GAO, as a part of the legislative branch of the government, generally furnishes advice and assistance to the Congress. An appropriate role, consistent with GAO's mandated responsibilities, would be, upon request, to assist Congress in reviewing agency promulgation of rules under this Act, rather than to provide direct assistance to the executive branch. Such authority for GAO to assist the Congress already exists.

We do not wish to jeopardize either the substance or the appearance of the GAO's objectivity in evaluating regulatory agencies

by becoming directly involved in promulgating their regulations.

5. The sunset provision of S.3330 requires more consideration.

Section 4 of the bill provides that 7 years after the date of enactment, all regulations not promulgated in accordance with the provisions of this Act, expire.

GAO has long supported the intent of efforts to strengthen and improve the effectiveness and accountability of Federal programs. The GAO has worked closely with various Congressional Committees in developing and reviewing sunset proposals, such as S.2. We feel that it is important to apply sunset provisions to broad programs as well as to individual rules and regulations. The re-evaluation of specific rules provided for by the sunset provision in S.3330 might usefully be changed instead to require an evaluation of the programs which gave rise to those rules.

However, we are concerned about the potential workload that would be generated by the simultaneous re-evaluation of every rule or program of every Federal agency.

ALTERNATIVE REGULATORY METHODS

We support efforts to adopt alternative regulatory methods whenever possible, which would ease compliance and paperwork for individuals of limited means, and small businesses, organizations, and governmental jurisdictions. Because of the vast number and types of regulations in existence, it is difficult to compile one list of alternative methods. Obviously, all methods

are not practical for all situations, but we hope that the following list will shed light on some of the alternatives available.

1. Uniform regulation may be justified if it does not place smaller businesses or governments at a disadvantage, or if important policy goals are at stake.

As noted above, where certain vital policy goals, such as health and safety, are involved, uniform regulation may be warranted.

Also, there may be no need to adopt alternative, flexible rules which ease compliance for smaller businesses and governments, if a regulation falls proportionally on organizations of various sizes. For example, assuming other things equal, if a uniform regulation created a certain cost for each unit of output regardless of a firm's size, then all businesses in a market, large and small, would be equally adversely affected. Of course there still may be room for regulatory reform which will leave all of those subject to a regulation better off.

2. Less, or no regulation imposed on individuals, businesses, organizations and governmental jurisdictions of limited means, is one alternative to uniform regulation.

Exemptions or reduced regulation of one sort or another have already been adopted on a voluntary basis by many Federal agencies, including DOE, EPA, ICC, and IRS. This approach applies particularly well to much of the paperwork burden facing individuals and businesses. The Internal Revenue Services's short form for filing income tax returns is a good example of the successful reduction in the paperwork burden for individuals with limited means.

In some data gathering, not all organizations, large or small, need to supply responses. Sampling techniques can be used to collect sufficient data to address the questions at hand.

When compliance with substantive, or technical regulations in critical areas is involved, we would prefer to see exemptions from or reductions in regulation be based on an organization's performance, rather than its size alone.

3. Agencies could offer grants or subsidies to assist smaller organizations in complying with costly regulations.

Subsidies could clearly ease the burden of smaller firms and governments in complying with regulations, although they carry the danger that they create an advantage to being inefficiently small, as in the case of the small refiner bias in crude oil pricing policy. The potential bias created by a subsidy which would promote the creation of new small entities would be avoided, if subsidies were only made available to individuals or organizations which qualify at the time the regulation is adopted. However, subsidies would still provide an incentive for existing firms and organizations to remain small, and pose a potential barrier to growth.

4. Progressive regulation offers those who are regulated a choice of when to comply.

The type of progressive regulation described in section 3, adding 5 U.S.C. 553 (b)(6)(C), of the bill specifies that those who are regulated may be exempted from more rigorous requirements upon satisfactory performance of less rigorous requirements. This type of progressive regulation contains a

potential bias against smaller organizations.

Assuming that the progressive regulation would apply to organizations of all sizes, larger, and stronger organizations might be able to comply more quickly, taking advantage of less rigorous requirements. Smaller organizations with limited means might have to delay, falling under the more rigorous rules.

The idea of progressive regulation is good in that it indicates to those regulated the future plans of the regulators. We suggest, however, that the method specified in section 3, adding 5 U.S.C. 553 (b)(6)(C), of the bill may not be the best form of progressive regulation. Rather than establishing progressively more rigorous rules, agencies could establish one rule and adopt a system of penalties for non-compliance which increase progressively until the date at which the rule becomes mandatory (that is, the penalties for non-compliance become prohibitive). This type of progressive regulation would still benefit individuals and organizations able to comply quickly, but would not exempt any organization from eventual compliance. All organizations, including small ones, have the advantage of being able to plan at their own pace when to comply.

5. Performance oriented regulations allow firms to choose how to comply with certain performance goals.

It may often be unnecessary to promulgate regulations in two or more tiers in order to ease the burden on smaller businesses. Instead of multi-tiered regulation, a single more flexible regulation could be promulgated, giving businesses and organizations

more options for compliance. So-called performance standards are regulations of this type. Performance standards specify a desired outcome, but leave to the firms or individuals the method of achieving that outcome.

In promulgating performance standards, it would be advisable for an agency to suggest at least one detailed, or technological solution which would meet the proposed goal, for the benefit of firms or organizations which are unable to find acceptable methods on their own.

Performance regulation has the advantage of encouraging innovative and inexpensive new ways of meeting regulatory goals, and allows firms to adopt whatever method of compliance they find least costly. If an organization already met a new regulatory performance goal, it would be required to do nothing additional.

6. Under one form of performance oriented regulation, agencies can not only give organizations a choice of how to comply, but also of whether to comply.

As many regulations are currently written, compliance must be absolute. That is, either an individual or organization is in compliance or not. An alternative is to establish a system of fines or penalties which would depend on the degree of non-compliance over some specified period of time. Such a system of penalties would provide those regulated with an incentive to comply to some extent, even if they did not comply absolutely. Such a system would also insure that those most easily able to comply would do so.

Sliding scale penalties are not universally applicable, but do make sense in some areas.

Environmental regulations, for example, are designed to reduce the aggregate quantity of certain pollutants in the environment. If the policy goal is to eliminate less than 100 percent of a particular pollutant, it makes sense to encourage those polluters who can eliminate their emissions most economically to do so through a periodic penalty for each unit of pollution. If large firms can control pollution more economically per unit than smaller firms, then large firms should, and would under this system, be encouraged to clean up their pollution first.

CONCLUSIONS

We fully support the effort for responsible regulatory flexibility and reform. The three alternative regulatory approaches specifically suggested in the proposed 5 U.S.C. 553 (b)(6)(A), (B), and (C) of the bill are useful alternatives to be considered by agency rule makers. In our testimony today, we have added a few more regulatory methods which could be considered, and have suggested a variation of progressive regulation which we prefer; but the list which we have presented is still not exhaustive. We believe that the proposed 5 U.S.C. 553 (b)(6)(E) should be expanded to advise agencies that there are many other methods of achieving social policy goals. We agree with this bill and the recent Executive Order, that agencies should consider any and all alternatives which would feasibly meet the desired policy goals.

We prefer that the part of Section 3, dealing with GAO, be deleted from the bill. We also believe that Sectior 4, the sunset provision, needs further consideration before inclusion in the bill, since, as noted, it creates uncertain agency workloads. Similarly, Section 3 amending 5 U.S.C. 553 (c), requiring agencies to justify new rules which they adopt, could also create burdensome workloads for agencies, and warrants further consideration.

Finally, in choosing among many alternative regulatory methods, Section 3 amending 5 U.S.C. 553 (c) directs agencies to try to minimize adverse economic impact on small entities, which is one very important consideration. In addition to adverse economic impact the bill might usefully note that regulators must also weigh other considerations, including:

--the extent to which alternative rules will achieve the desired goals, and the significance of those goals compared to other regulatory and governmental objectives;

--the possible creation of unintended and undesirable incentives; and

--the feasibility and cost under alternative rules of monitoring those being regulated so that the rules can be effectively and fairly enforced.