"The Regulatory Costs for Small Business and Our Economy, and the Need for Regulatory Transparency"

Testimony by
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On Behalf of the Center for Regulatory Solutions

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The Honorable David Schweikert, Chairman
The Honorable Suzanne Bonamici, Ranking Member

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Protecting small business, promoting entrepreneurship

Chairman Schweikert, thank you for hosting this important hearing today on the need for making the science EPA uses to justify regulatory costs on businesses and the economy, including small enterprises and ultimately consumers, more open and accessible to the public. This will help in holding EPA more accountable to stakeholders of all kinds—most especially the workers who ultimately have to comply with new regulations. Those on both sides of the political aisle and the regulatory debate should support transparency of the underlying data, science and analysis used to justify government regulation. It's certainly an imperative for small businesses, given that regulatory costs disproportionately harm smaller firms.

The Small Business & Entrepreneurship Council (SBE Council) is pleased to submit this testimony on behalf of our Center for Regulatory Solutions.

My name is Raymond Keating, and I am the chief economist for SBE Council, as well as serving as an adjunct professor in the Townsend Business School at Dowling College where I teach a variety of courses in the MBA program; a weekly newspaper columnist for *Long Island Business News*; and author of several books, with the latest being *Unleashing Small Business Through IP: Protecting Intellectual Property, Driving Entrepreneurship*.

SBE Council is a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship. With nearly 100,000 members and 250,000 small business activists nationwide, SBE Council is engaged at the local, state, federal and international levels where we collaborate with elected officials, policy experts and business leaders on initiatives and policies that enhance competitiveness and improve the environment for business start-up and growth. The Center for Regulatory Solutions is a project of SBE Council.

The Costs of Regulation

In 1986, President Ronald Reagan declared, "Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it." President Reagan had a way with words – in this case, an ability to drive home an economic fact of life about the serious costs of various government actions, including regulation – in an amusing way.

The costs of regulations are real and significant facts of economic life about which small business are too often painfully aware. Economics 101 tells us what to expect from increased regulation – that is, higher costs for businesses and consumers, reduced market exchanges and expanded political control, resources allocated based on political dictates and influences (such as rent seeking) rather than via competition and consumer sovereignty, and therefore, diminished economic growth.

For example, economists John Dawson at Appalachian State University and John Seater at North Carolina State University recently looked at the impact of federal regulation on economic growth ("Federal Regulation and Aggregate Economic Growth," January 2013). Their findings were striking. They reported:

> “Regulation’s overall effect on output’s growth rate is negative and substantial. Federal regulations added over the past fifty years have reduced real output growth by about two percentage points on average over the period 1949-2005. That reduction in the growth rate has led to an accumulated reduction in GDP of about $38.8 trillion as of the end of 2011. That is, GDP at the end of 2011 would have been $53.9 trillion instead of $15.1 trillion if regulation had remained at its 1949 level.” The authors added: “Our results are qualitatively consistent with those obtained from studies using the various cross-country and panel data sets on regulation. Quantitatively, our estimated impact of regulation on aggregate output, large as it is, is similar to or lower than the micro-level impacts estimated in the cross-country and panel data studies. The cross-country and panel data are constructed very differently from our data, covering a subset of total regulations but over an array of countries. It thus seems that regulation has strong and robust negative effects on aggregate output.”

Another look at the state and costs of federal regulations was provided in the twentieth anniversary edition of “Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State,” published in 2013. The author, Clyde Wayne Crews Jr., reported, “For the first time in history, the estimated cost of regulation exceeds half the level of the federal budget itself.” It cost Americans an estimated $1.806 trillion to comply with federal regulations in 2012. Combine federal spending with these estimated regulatory costs, and “the federal government’s share of the entire economy now reaches 34.4 percent.” That’s a serious drain and drag on the private sector.

How do recent regulatory costs compare to the past? According to Crews, the *Federal Register* serves as government’s “depository of all proposed and final federal rules and regulations,” and its number of pages has long served as a rough measure of the scope of federal regulation. Crews pointed out, “Three of the four all-time high counts have occurred during the Obama administration.”

The Obama years have been particularly troublesome in terms of “economically significant” rules, that is, those that impose an annual cost on the economy of at least $100 million. As noted in the report, “when it comes to economically significant rules at the completed and active stage … the current administration is in a class by itself when one looks at the year-end flow.” Economically significant rules have been higher in each year during the Obama administration versus each year during the Bush administration. In fact, the highest annual level under Obama was 24 percent higher than the peak level under Bush.

Crews also broke out regulations by departments of the federal government. He found that the departments of the Treasury, Commerce, the Interior, Agriculture, and Transportation accounted for 1,730 rules, or 42.6 percent of all rules in the agenda pipeline. The Environmental Protection Agency (EPA) came in sixth, and once the EPA’s 223 rules are factored in, those six departments tallied up to 1,953 rules, or 48 percent of all rules in the pipeline.

The Small Business Administration’s Office of Advocacy periodically estimates regulatory costs, obviously with an eye towards the burdens imposed on smaller businesses. In September

2010, the Office of Advocacy published an updated study estimating the costs of complying with federal regulations. The study – "The Impact of Regulatory Costs on Small Firms" by Nicole V. Crain and W. Mark Crain from Lafayette College – provided details regarding the burdens of federal regulatory costs. For example:

• The annual cost of federal regulations registered $1.75 trillion in 2008.

• For firms with less 20 employees, the per-employee cost registered $10,585, which was 42% higher than the $7,454 per employee cost for firms with 20-499 employees, and 36% higher than the $7,755 for firms with 500 or more employees.

• On the environmental front, per employee regulatory costs for firms with less than 20 employees came in at $4,101, which topped the $1,294 cost for firms with 20-499 employees by 217% and the $883 cost for businesses with 500 or more workers by 364%.

• Small manufacturers get hit particularly hard. Per employee regulatory costs for manufacturers with fewer than 20 employees came in at $28,316, which was 110% higher than the $13,504 for manufacturers with 20-499 employees and 125% more than the $12,586 burden on companies with 500 or more employees. Again, serious cost differentials came in the area of environmental regulation, where per employee costs for manufacturers with fewer than 20 employees came in at $22,594, which topped the $7,131 for firms with 20-499 employees by 217% and exceeded the $4,865 for firms with 500 or more workers by 364%.

Of course, it needs to be pointed out that small and mid-size businesses – that is, those with less than 500 workers – are central to economic growth and job creation. As the SBA's Office of Advocacy has summed up ("Frequently Asked Questions About Small Business," September 2012), small businesses account for 46 percent of private-sector output, and 98 percent of firms exporting goods. As for jobs: "Small firms accounted for 64 percent of the net new jobs created between 1993 and 2011 (or 11.8 million of the 18.5 million net new jobs). Since the latest recession, from mid-2009 to 2011, small firms, led by the larger ones in the category (20-499 employees), accounted for 67 percent of the net new jobs."

Given the formidable costs of regulation, including on small businesses, the need for the regulatory process to be transparent should be supported, again, by both sides of the political aisle, and by both sides of the regulatory debate.

The issue of transparency regarding the science being used to support regulation is not some esoteric academic or political point. It has very real world consequences in terms of costs imposed on small businesses, and the resulting fallout for economic growth and job creation.

Secret Process: Social Cost of Carbon

One of the most glaring cases of regulatory secrecy relates to President Obama's climate agenda. In a secretive process, several agencies dubbed the "Interagency Working Group" established a highly speculative cost estimate called the "social cost of carbon" (SCC) to measure the benefits of reducing carbon emissions.

As described in a May 2013 document from the White House, “The SCC is an estimate of the monetized damages associated with an incremental increase in carbon emissions in a given year. It is intended to include (but is not limited to) changes in net agricultural productivity, human health, property damages from increased flood risk, and the value of ecosystem services due to climate change.”

From 2010 to 2013, the administration’s SCC estimates, according to various models, jumped markedly, with the four SCC estimates (priced in 2007 dollars per metric ton of CO_2 at various discount rates) for 2020 moving from \$7, \$26, \$42 and \$81 in the 2010 analysis to \$12, \$43, \$65, and \$129 in the latest assessment. That’s quite a leap higher in a short period of time.

In a September 2013 letter, a coalition of business groups pointed out, rightly, that the Administration’s SCC estimates “are the product of an opaque process, are fraught with uncertainties, and any pretensions to their supposed accuracy (and therefore usefulness in policy-making) are unsupportable.” To date, the Administration has not been forthcoming about who specifically participated in the process and whether the IWG adhered to federal guidelines in crafting the SCC estimate. The Administration’s stonewalling prompted two members of Congress to seek a Government Accountability Office investigation to uncover key information related to the IWG process. To be sure, this is not, as the President promised, “the most transparent Administration in history.”

It turns out that the IWG was secretive because they had something to hide, including the fact that models the group used to calculate the SCC estimate are effectively worthless. This is not just my opinion, but that of Professor Robert Pindyck of the Massachusetts Institute of Technology, an expert on these specific models. In a September 3, 2013, *Wall Street Journal* article, it was reported:

> “Robert Pindyck, an economics professor at the Massachusetts Institute of Technology, slams the models in a coming paper to be published by the National Bureau of Economic Research, saying they use essentially arbitrary inputs and give a misplaced illusion of scientific certainty. Though his work has given ammunition to skeptics of global-warming science, Mr. Pindyck said his point is really about the difficulty of modeling possible catastrophic impacts of climate change. ‘We know there's a social cost of carbon, and we know it's above \$0,’ he said. ‘If anything, the cost of carbon could be higher’ than the administration's models suggest.”

Pindyck’s point, again, is that this kind of modeling is effectively bogus. It offers nothing scientific – no matter which side of the debate you happen to be on.

This issue of the “social cost of carbon” is critical, given that EPA’s greenhouse gas regime will eventually cover the entire economy, covering a wide array of industries, including pulp and paper, cement, oil and gas, chemicals manufacturing, mining, and many more.

As is the case throughout the U.S. economy, industry after industry in these cases overwhelmingly is about small and midsize firms. For example, 76 percent of U.S. manufacturing employer firms had less than 20 workers in 2010 (latest Census Bureau data), and 98.6 percent had less than 500 workers. Or, consider that within the mining, quarry, and oil and gas extraction sector, 85 percent of employer firms had less than 20 workers, and 98.4 percent less than 500 employees.

When it comes to costly regulations being imposed based in part on faulty, speculative "social costs of carbon" models, small businesses will bear a heavy burden, thereby limiting investment, economic growth, job creation, and competitiveness in the global economy.

Hiding Science at the EPA

In August 2013, the House Science, Space, and Technology Committee Chairman Lamar Smith issued a subpoena to the EPA for the release of the science used as the basis for costly air regulations.

As noted in the accompanying release: "Over the past two years, the Committee has repeatedly requested the data the agency uses to justify virtually every Clean Air Act regulation proposed and finalized by the Obama administration. This was the first congressional subpoena the Science Committee has issued in 21 years."

It was also reported: "The two data sets in question are used to justify major costly new air regulations. As one example, by its own estimates the EPA's proposed limits on ozone will cost taxpayers $90 billion per year, making it the most costly regulation the federal government has ever issued. Some of the data in question is up to 30-years-old."

Getting the underlying data in question is critical to ensuring that EPA's upcoming ozone rulemaking—not to mention the entire suite of ambient air quality standards EPA will establish in the coming years—is based on the most rigorous science, and that the public has an objective, accurate assessment of the costs and benefits of this rulemaking.

The U.S. has made enormous progress in cleaning the air over the last 40 years, so much so that we now are talking about reducing very small increments of pollution. Achieving those tiny reductions will no doubt be very costly—as EPA itself admitted when it released its cost analysis for ozone in 2010. The question is: will they be worth it? We won't know that unless we have the scientific data in front of us, unless scientists from all over the country can attempt to replicate it and determine its validity. Without that, EPA is hiding the ball, and imposing costs without truly knowing what the benefits are. Workers at small firms have the right to know what they're paying for and complying with. Hopefully, it won't cost them their jobs.

The Incentives to Regulate

Regulation is economically dangerous because the costs are hidden from the eyes of the average person. People can see the bottom line on taxes, such as smaller take-home pay when income taxes climb or increased costs at the cash register when sales taxes rise. But the costs of regulation, while just as real and significant as taxes, are not so clear.

Therefore, politicians like to take credit for various initiatives through regulation, while leaving it to business owners and managers to wrestle with the commensurate costs, including, for example, having to raise prices, reduce payroll, rein in or eliminate expansion plans, or even close up shop.

For good measure, keep in mind that both the Congress and the president not only have incentives to issue regulations, but they also have every incentive to pass off the actual rulemaking to unelected bureaucrats. This is a toxic recipe for rising regulatory burdens, reduced accountability, and yes, less transparency.

This incentive structure is another reason why there should be no questions, or secrecy, regarding the data and the science that supposedly justify regulations.

The Public View on Regulation

Interestingly, a poll released in January 2014 by the Small Business & Entrepreneurship Council's Center for Regulatory Solutions revealed notable concerns among American adults regarding government regulation. For example, regarding the process of regulation:

• 68% said that government regulations on business are "created by out-of-touch people who are trying to push a political agenda."

• 72% said that government regulations are "created in a closed, secretive process."

• 64% said that government regulations on business are "created in a way that does not consider their real-world impact."

• 61% agreed that government regulations are "administered ineffectively without rhyme or reason."

As for the effects of regulation, consider:

• 53% agreed that there are too many regulations on business, while 19% said there are not enough and 25% said about the right amount.

• 61% believe that government regulations on business are more likely to "harm the economy by interfering with the free market, preventing businesses from growing and hiring new employees, and increasing prices for consumers."

• As for the overall effect of government regulations on business, it was found that 70% of Americans said that regulation "mostly hurt" the "American economy," 67% said they mostly hurt "America's economic competitiveness with the rest of the world," 66% said they mostly hurt "entrepreneurs and small business," 63% said they mostly hurt consumers, 64% said regulation mostly hurt employers, 66% agreed they mostly hurt "American workers," and 58% said "American companies' ability to innovate" was mostly hurt by regulation.

These findings on the process and costs of regulation should further push government officials to be transparent in all aspects of regulation, including how regulations are created, the scientific basis for regulation, and the true costs of regulation.

The Need for Transparency and Soundness When Regulating

In President Obama's Executive Order 13563 titled "Improving Regulation and Regulatory Review," it was stated:

> Our regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation. It must be based on the best available science. It must allow for public participation and an open exchange of ideas. It must promote predictability and reduce uncertainty. It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements.

That's a sound declaration, and steps obviously need to be taken to shift away from the unfortunate realties of regulation, and closer to this statement.

Clearly, the "Secret Science Reform Act of 2014" would be a straightforward, common-sense reform. As the bill requires, EPA "shall not propose, finalize, or disseminate a covered action unless all scientific and technical information relied on to support such covered action" is "specifically identified" and "publically available in a manner that is sufficient for independent analysis and substantial reproduction of research results."

That would be a valuable, simple reform measure that all in Congress and in the Obama Administration – based on the President's own Executive Order – should agree on, and that the American public apparently would embrace given their views on regulatory process and costs. And I can assure you that the members of the Small Business & Entrepreneurship Council embrace this reform, as it would take the scientific information EPA regulators use and send it into the public realm, where it can be properly debated and analyzed. As EPA's costly ozone rulemaking looms over our stagnant economy, it would be welcome indeed if EPA would be required to make public the all the data it intends to use. What do they have to hide? After all, wouldn't EPA want to be absolutely certain that a potentially $90 billion rulemaking is worth it? I know small businesses and their workers certainly would.

Thank you for this opportunity to address the Committee, and I will be glad to answer any questions.