Testimony of

Karen Kerrigan
President & CEO
Small Business & Entrepreneurship Council

Midnight Regulations: Examining Executive Branch Overreach

Committee on Science, Space and Technology
United States House of Representatives

The Honorable Lamar Smith, Chairman
The Honorable Eddie Bernice Johnson, Ranking Member

301 Maple Avenue West Suite 100 • Vienna, VA 22180 • (703)-242-5840 • sbecouncil.org • @SBECouncil

Protecting Small Business, Promoting Entrepreneurship

Chairman Smith, Ranking Member Johnson and members of the committee, thank you for your invitation to testify on the issue of midnight regulations. My name is Karen Kerrigan and I am president & CEO of the Small Business & Entrepreneurship Council (SBE Council).

For nearly 24 years, SBE Council has worked to support policies and initiatives that promote entrepreneurship and small business growth. SBE Council is a nonprofit, nonpartisan advocacy, research and education organization with 100,000 supporters, members and activists throughout the United States. We are dedicated to strengthening the policy ecosystem and economic climate to enable healthy entrepreneurship and strong business growth.

Regulation and the threat of new regulation continue to be a major issue of concern for our members. Small businesses are challenged by having to absorb new regulatory costs as the economy continues to limp along at the same time revenue growth in their firms remains generally weak. The heightened level of regulatory activity obviously creates uncertainty for entrepreneurs, which limits risk-taking, investment and expansion. Another year of too much regulation from Washington means another year of lackluster growth for the economy. This is not what small business owners are hoping for or need.

A new survey released by OnDeck Capital on February 5, finds that the top issue for small business owners is the economy (56.6 percent) – and specifically “the need for economic growth” as “crucial for their firms.” Not surprisingly, concerns about tax policy, health care costs, and new or changing regulations round out the list. A stronger economy is especially critical for our small businesses. Beyond keeping up with costs and the competition in a tough economy, a mid-year report in 2015 from Bank of America found <u>that only one in five small business owners say they have completely recovered from the Great Recession</u> (Bank Of America Small Business Owner Report, Spring 2015). That’s more than a seven-year stretch of making ends meet, while navigating market changes, new technologies, capital access issues, human capital concerns and day-to-day challenges. New regulatory burdens have only added to pressures. And from our perspective, excessive federal regulation is a key reason why the economy has experienced lackluster growth. In order to have robust growth, strong investment, quality job creation and opportunity for more Americans, our entrepreneurs and small businesses have to move beyond survival-mode and the drag of the Great Recession, and towards vigorous growth.

Concerns About "Midnight Regulation"

As it is, we have largely found that the concerns of small businesses in the federal rulemaking process appear to not matter, are routinely ignored, or regulators claim small businesses will not be economically impacted by major rules where in fact the impact is quite clear. The Environmental Protection Agency's (EPA's) Waters of the U.S. (WOTUS) regulation is case in point. In the agency's fantasy analysis, the EPA certified that small businesses would not be impacted or subject to any new requirements of the rule. But in reality there is no way that small entities are going to be able to circumvent the conservative $158 million annual costs (EPA's estimate) that result from the newly required permits under the rule. In other words, the EPA's own analysis undercut their claim that the rule would not have an impact on small firms. Unfortunately, the entire process surrounding the WOTUS rule seemed rigged from the start, and represents why small businesses feel hopeless about the regulatory process. As they deal with the cost of new regulations in survival mode, they see many more regulations in the pipeline that will impact almost every aspect of their business operations.

From our perspective, the regulatory process is broken and we do not have faith that it will suddenly become more accountable, transparent and responsive to small businesses with a 2016 push by the Administration to complete its policy agenda through rulemakings and other means. In fact, the regulatory rush will likely lead to more shortcuts, flawed analysis and less transparency during this period. The Mercatus Center analyzed data from across Administrations (1975-2006) and found midnight regulations produced exactly this type of outcome: "During the surge, the agencies' regulatory analysis quality drops and regulatory oversight by the Office of Information and Regulatory Affairs (OIRA) weakens. As a result, federal agencies produce ineffective regulation and waste public resources." (Beware the Surge of Midnight Regulations, July 2012.)

Another Mercatus Center study noted the cost impact of this regulatory drive, as "rushed midnight regulations proposed during the second half of a presidential election year have lower-quality regulatory analysis, and agencies are less likely to use the analysis to make decisions about the regulation. These regulations are more likely to be ineffective or excessively costly." (Midnight Regulation: Decisions in the Dark? August 2012.)

And make no mistake; these costs are significant for businesses and our economy. Especially small businesses and manufacturers that are disproportionately impacted by regulation – and more so by environmental regulation. The National Association of Manufacturers (NAM) reports that small manufacturers with 50 employees or less pay an estimated $34,671 per employee per year to comply with federal regulation. Environmental regulatory costs account for $20,361 of the total. And for all other firms with 50 employees or less, the full regulatory burden per employee is $11,724 with environmental regulatory costs totaling $3,574. (The Cost of Regulation to the U.S. Economy, Manufacturing and Small Business, September 2014.)

EPA's possible midnight regulatory activity is of particular concern given the agency's history of improper certification of proposed rules when it comes to small business impact. On several high-profile major rulemakings, the SBA's Office of Advocacy made it clear that EPA's certification of rules did not comply with the Regulatory Flexibility Act. This was the case for example, with greenhouse gas rules, a pesticide rule, and of course the WOTUS rule. In each of these cases, EPA's own analysis contradicted its certification.

Small Businesses Dominate Most Sectors

Regulators need to approach each rulemaking with an understanding that small businesses make up the largest share of businesses in almost every sector of our economy. As noted above, this reality is simply not embedded into the thinking of most regulators, especially at the EPA that seems to find justification for dismissing the hard facts or their own analysis.

For example, the energy industry, which is the target of many EPA rules, is largely populated by small to mid-size businesses. According to the U.S. Census Bureau (2012):

• 90.7% of employer firms among oil and gas extraction businesses have less than 20 workers, and 98.5% less than 500 workers;

• 78.1% of firms among drilling oil and gas wells businesses have less than 20 workers, and 97.2% less than 500 workers;

• 81.5% of firms among support activities for oil and gas operations businesses have less than 20 workers, and 98.6% less than 500 workers;

• 60.5% of firms among oil and gas pipeline and related structures construction businesses have fewer than 20 workers, and 95.5% less than 500 workers;

• 54.7% of firms among oil and gas field machinery and equipment manufacturing businesses have less than 20 workers, and 91.4% less than 500 workers.

The manufacturing sector, as noted previously, is also dominated by small businesses with 193,108 of firms within the industry (out of 256,363 total) having fewer than 20 employees, according to NAM. Another 47,443 have 20 to 99 employees, and 12,186 have 100-499 employees. Again, manufacturing is disproportionately hit by environmental regulation, and will certainly feel the impact of newer EPA regulations recently finalized, as well as others in the pipeline to reduce greenhouse gas emissions.

Higher compliance and energy costs put smaller firms at a disadvantage to bigger businesses. Smaller businesses simply cannot absorb these costs as "easily" as larger businesses, which makes growth, job creation, and survival much more difficult. So, in addition to competitive pressures from larger businesses and firms in the international marketplace, a costly regulatory environment works against the very small businesses that are needed to enhance our nation's innovative and job-creating capacity.

Again, the NAM study on regulation demonstrates that the per-employee cost of regulation decreases in bigger businesses, and dramatically so. For example, as noted above, while small firms with less than 50 employees face per-employee regulatory costs of $34,671 (with environmental regulations making up $20,361 of those costs), the total per-employee cost of regulation for firms with 100 employees or more is $13,750 (with costs associated with environmental regulation being $6,239.)

The bottom line is that small businesses remain very concerned about what's ahead in the coming year on the federal regulatory front. With an economy that lacks strong traction, and with indications that economic growth may slow further, regulations from Washington that raise compliance and energy costs and make it more difficult to compete only create more headwinds and uncertainty for small businesses.

SBE Council will be keeping an eye out on all federal regulatory activity in 2016, including those related to energy and the environment because these impact so many of our members. For example, continued efforts underway at the EPA to reduce greenhouse gas emissions will have widespread impact. New initiatives talked about in the media related to "light pollution" will impact small businesses across the board, and we will be on the lookout for regulatory activity that comes through other means like guidance and general statements of policy.

The Competitive Enterprise Institute, which author Wayne Crews calls "regulatory dark matter", has comprehensively reported upon this "off book" activity in a new study. (Mapping Washington's Lawlessness 2016: A Preliminary Inventory of Regulatory Dark Matter, December 2015.) For years our members have warned us about the uptick in federal agency actions outside of the official regulatory process – that is, guidance letters, advisory notices interpretive rules, general statements of policy – which lead to new rulemakings, but where the public has no input. So, in addition to the potential threat of midnight regulation and new regulatory activity that ignores small business impact despite significant public comment by the small business community pointing this out, regulators could simply issue guidance or interpretive rules, where Administrative Procedure Act rules do not generally apply.

Conclusion

The gamesmanship that comes with midnight regulation is really appalling in light of the massive regulatory burden faced by small businesses and our economy. It is simply not acceptable that any Administration game the system to ensure their agenda is complete before the stroke of midnight, particularly if the market is not broken or the rush to regulate is not called for. Such political regulation is why the public is so cynical about our government institutions, including the regulatory process.

In a State of Regulation survey released by SBE Council's Center for Regulatory Solutions in 2014, 67 percent of the public said that regulations "mostly hurt" America's competitiveness in the world, and 66 percent believe regulations "mostly hurt" people like them. An overwhelming number, 84 percent, believe too many special interests are involved in shaping government regulations; and 72 percent believe that regulations are created in a "secretive" rather than "open" process. Furthermore, 68 percent say regulations are created by "out-of-touch" people, with 64 percent agreeing that regulations do not consider "real world impact." In terms of what level of government they trust most to regulate business, 74 percent say state (41 percent) and local (33 percent) government, while 17 percent believe the federal government. (America the Regulated Survey, February 2014.)

Thankfully, both sides of the political aisle recognize that we have a regulatory problem. There are solid bipartisan solutions that have been proposed in the House and Senate that begin to chip away at unaccountability, lack of transparency and giving small businesses a greater voice in the regulatory process. Presidential candidates out on the campaign trail are hearing from voters and small businesses about over regulation, and the candidates are responding. Democrat candidate and Former Secretary of State Hillary Clinton has said the climate for small business has "become more difficult, more expensive" with "more red tape, unnecessary regulation," which has dampened economic growth. (Hillary Clinton Talks Middle Class Roots in Pitch to Iowa Small Business Owners, Washington Post, April 15, 2015.)

Again, and as a reminder, the effect of energy and environmental regulations pile on top of other regulatory costs. Small businesses are facing new costs and are looking at more regulation in the future that will affect the workplace and human capital costs, health coverage costs, access to capital and finance, employee benefits, and government contracting to touch upon just a few key areas. The current one is not one that favors robust entrepreneurship. Indeed the World Bank Doing Business report puts the United States at 46th in the world in terms of ease of starting a business.

Thank you for your attention and interest on the issue of midnight regulation and the regulatory burden on small businesses in general. I look forward to our discussion and your questions.