A Smart Regulatory Process for Entrepreneurs and Small Businesses

By Anna M. Williams, Keith B. Belton, and John D. Graham

School of Public and Environmental Affairs (SPEA), Indiana University (IU)

Pareto Policy Solutions, LLC, Washington, DC

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Table of Contents

Executive Summary

Small businesses and entrepreneurs have a significant impact on innovation, productivity, economic growth, and job creation. These economic benefits are impacted significantly by government regulation. Although the purpose of regulation is to provide important public protections, regulation also imposes costs, akin to a tax on small business. The magnitude of this "tax" is a matter of genuine uncertainty and legitimate academic debate, but there is no doubt that its magnitude is significant.

A worthy public policy goal is to reduce this tax on small business, without diminishing regulatory benefits—a goal we refer to as "smart" regulation. The intent of this white paper is to stimulate thinking among legislators, regulators, and stakeholders about how to enhance the climate for entrepreneurship and small business development through smart regulation.

To elucidate a path forward, we undertook four separate, but linked, exercises: a wide-ranging review of the national and international literatures on this topic (1990 – 2016); interviews with a dozen experts on regulatory reform; five case studies of successful burden-reducing reforms of specific federal regulations; and a categorization of proposals to reform the federal regulatory process that seem worthy of consideration.

Our literature review establishes that regulatory burdens on business are substantial and increasing, and that small businesses are disproportionately impacted by regulation. Of particular interest is the relationship between regulation and the rate of new firm formation. Numerous studies across developed and developing countries (and within the USA) have concluded that regulation has a negative impact on entrepreneurship, an important conclusion given the crucial role new firms play in job creation, innovation, productivity, and economic growth. The USA currently enjoys a leading position internationally on key measures of entrepreneurship, but this placement may be in jeopardy because the rate of new firm formation in the USA has been declining since the 1970s.

Faced with this information about the burden of regulation, policy makers often seek regulatory exemptions for small business. We found, however, that the small business exemption is an overrated construct: it does not apply to many regulations (e.g., IRS regulations), and it does not shield small businesses from the indirect costs of regulation (e.g., the rising costs of health insurance under the Affordable Care Act hurt small businesses, even though small businesses are exempt from Act's employer mandate). Furthermore, a blanket exemption of small businesses may not be justified on the basis of cost-benefit analysis, since small businesses – like their larger counterparts – may require regulation to ensure safe and clean operations. We find that smarter regulation is more promising than regulatory exemptions.

Of the approximately 3,200 new final regulations issued every year by federal agencies, relatively few are categorized as de-regulatory in nature. Nevertheless, regulatory reform efforts are not unheard of. From a compiled list of potential burden-reducing rules finalized over the past decade, we chose five that reduced regulatory burden on small businesses, imposed no loss of societal benefits or increased net social benefits, and were issued by a range of agencies.

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From these case studies of smart regulation and other information, we drew the following conclusions:

- Opportunities for smart regulatory reforms are available at a wide range of federal regulatory agencies (e.g., eliminating outdated or duplicative requirements, and eliminating requirements that fail a cost-benefit test) and can be accomplished without reducing significant regulatory benefits.
- Existing reform mechanisms (e.g., retrospective review planning, the Regulatory Flexibility Act, and the Paperwork Reduction Act) are making a positive difference.
- When regulatory reforms are adopted, agencies do not always know the possible impacts on small businesses, but smart reforms that broadly benefit the business community often have specific, meaningful benefits for small businesses.
- Reforms that result in small reductions in compliance costs may nevertheless be relatively impactful in terms of reducing barriers to entry for nascent firms.

To enable policy makers to evaluate or tailor regulatory reform proposals for small businesses, we recommend using the following criteria: (1) consideration of benefits as well as costs (or a focus on cost-effectiveness), (2) leveraging established processes and institutions, and (3) leveraging the expertise of small business to identify problems/solutions.

In recent decades, several reforms designed to lessen or minimize regulatory burden on small business have been adopted, including the Regulatory Flexibility Act and various presidential executive orders. Although these legislative and administrative reforms have had a positive effect, they have not fully met the initial expectations of the small business community. Academic studies have concluded that regulations and policies designed specifically to help small businesses do not always have the intended effect—either because the policies end up benefiting larger competitors as much as (or even more) than they do small businesses or because they fail to meet their objectives entirely. Only rarely do the reforms focus specifically on the fate of entrepreneurs.

When asked open-ended questions about promising reforms to the regulatory process that would benefit small businesses and entrepreneurs, respondents identified more than twenty such reforms, which we arranged into nine categories. For each category, we identified pros and cons. For example, by establishing a commission to review and identify existing rules for elimination, Congress would allow for a relatively "surgical" approach to reform (pro) but would not change incentives for agencies to issue better regulations (con).

To enable policy makers to evaluate or tailor regulatory reform proposals for small businesses, we recommend using the following criteria: (1) consideration of benefits as well as costs (or a focus on cost-effectiveness), (2) leveraging established processes and institutions, and (3) leveraging the expertise of small business to identify problems/solutions.

Each of the nine categories of reform can be tailored along these lines to best advance smart regulation. Particularly valuable are reforms that aim to eliminate barriers to entry for nascent firms. Such a targeted policy is likely to benefit "opportunity" entrepreneurs and yield economic gains that have a positive effect on the broader economy and enhance US competitiveness.

An issue of such importance and with positive economic benefits can best be advanced through bipartisan collaboration. We cite the enactment of the 2012 **Jumpstart Our Business Startups Act** (JOBS Act 2012), wherein Congress authorized the Securities and Exchange Commission to streamline its regulations relating to the initial public offering (IPO) process for startups, as a recent example of exemplary bipartisan collaboration, even though it is too early to make a definitive assessment of this legislation.

Introduction

Small businesses have a significant impact on innovation, productivity, economic growth, and job creation. They are responsible for 54% of all U.S. sales, 55% of all U.S. jobs, and 66% of all net new jobs since 1970 (SBA OA 2016a). For the purposes of this study, we define small business as an independent business with fewer than 500 employees, a definition consistent with federal classifications. Entrepreneurship is defined as any attempt to establish a new business or venture by an individual or team of individuals (GEM 2017).

The economic benefits of entrepreneurship and small business are impacted significantly by government regulation. Although the purpose of regulation is to provide important public protections, it also imposes costs, akin to a tax on small business. The magnitude of this "tax" is a matter of academic debate (see the next section), but there is little doubt that its magnitude is significant and growing.

A worthy public policy goal is to reduce this tax, this burden of regulation, without diminishing its benefits—a goal we refer to as "smarter" regulation. The intent of this white paper is to stimulate thinking among policy makers, stakeholders, and the public about how to enhance the regulatory environment for entrepreneurship and small business development through smarter regulation.

To elucidate a pathway toward smarter regulation at the federal level (with some appreciation of multi-lateral complexities), we undertook four separate, but linked, exercises:

1. A review of publicly available national and international literature (1990- 2016) on this topic, drawn largely from academic publications and government reports.
2. Interviews with more than a dozen experts on regulatory reform. The interview questions focused on the impact of regulation on small business, the contribution of established reform mechanisms, and the promise of reform proposals.
3. A classification of the major categories of proposed process reforms and a comparison based on pros and cons.
4. We further identified five case studies of successful reforms to existing regulations in recent years selected from a longer list (see Appendix A) of such reforms. These case studies cover multiple agencies and multiple reform mechanisms.

The Cost of Regulation

There are two main approaches to quantify the total cost of regulation and/or the overall impact of regulation on economic growth: "bottom-up" approaches, such as that employed by OMB (2016), and "top-down" approaches, such as that employed by Crain and Crain (2010 and 2014), Dawson and Seater (2013), and Coffee et al. (2016). Under the bottom-up approach, individual regulations are identified and the estimated costs are added. Under the top-down approach, the total cost of regulations is estimated by modeling the relationship between the size of the economy, its growth, and a proxy measure for the level of regulation.

The Congressional Research Service (2016) compared the two approaches, detailing pros and cons for each. The bottom-up approach is based on a priori estimates of costs and benefits of individual regulations, making its estimates amenable to verification through retrospective review and conclusions can be drawn about net social benefits. The disadvantage being that it only covers a subset of regulations and does not account for any synergistic effects. By contrast, the top-down approach is not based on estimates from individual rulemakings, meaning its estimates are not amenable to verification and conclusions cannot be drawn about net social benefits. Its advantages include investigation of cumulative burden from all federal regulation, including synergistic effects of multiple regulations in the same area. However, it is difficult to find a good proxy measure for all regulation using a top-down approach.

We analyzed the publicly available studies utilizing these approaches to compare estimates of the annual regulatory costs. The estimates span from a low of $7.5 – 11.3 billion (OMB 2016) to a high of $2030 billion (Crain and Crain 2014). Two other studies employing a top-down approach, by Coffee et al. (2016) and Dawson and Seater (2013), estimated annual reductions in GDP at -0.8% (based on regulations issued from 1980 – 2012) and -2% (based on regulations issued between 1949 - 2005), respectively. Care must be taken as these studies utilized different methods, differ in scope, and are based on different time periods. For example, the OMB estimate represents the **incremental** cost of new major federal regulations in 2015, whereas the other estimates represent **cumulative** cost of all regulation (over the time period of interest) in 2015. Perhaps a prudent conclusion can be borrowed from economist Michael Greenstone (2011), who testified that federal regulations impose "hundreds of billions of dollars" in annual cost, which we note is roughly of the same magnitude as annual revenue from US corporate income taxes.

Studies on the relationship between economic growth and regulation have not been confined to the United States. Researchers (e.g., Djankov et al. 2006, Haidar 2012, and Messaoud and Teheni 2014) have employed the top-down approach to study the impact of regulation across countries (the findings consistently show a negative impact) and also to evaluate the effectiveness of smart regulatory reforms (generally show a positive impact).

Some experts are not comfortable with estimates based on a top-down approach. Parker and Kirkpatrick (2012) observed that (1) regulations are context specific and can both hinder economic growth and also bolster it; (2) it is difficult, if not impossible, to provide robust quantitative evidence of a causal relationship between regulation and economic growth; and (3) most quantitative studies give little or no attention to quantifying benefits. Sunstein

CASE STUDY ONE. EPA. Air Quality: Widespread Use for Onboard Refueling Vapor Recovery and Stage II Waiver. 77 FR 28772. May 16, 2012.

The Clean Air Act (CAA) imposes numerous requirements on states and on businesses to ensure that all areas of the country adhere to the National Ambient Air Quality Standard for ozone. For example, gasoline-dispensing facilities (i.e., gasoline stations), known as GDFs, must equip gasoline pumps with vapor controls to capture volatile organic compounds (VOCs)—a precursor to ozone—that escape from a vehicle's gas tank during refueling. This requirement is known as Stage II. Automakers must also equip new motor vehicles with on-board refueling vapor recovery (ORVR) systems to reduce VOCs during refueling. The CAA allows EPA to eliminate the requirement for Stage II in certain nonattainment areas if ORVR technology is in widespread use. In 2012, EPA finalized a rule to do just this, reducing compliance costs for GDFs.

Reduces Regulatory Burden: ☑

All new cars and light trucks were equipped with ORVR as of 2006. Over the next few years, more than 75% of nationwide gasoline refueling happened with an ORVR-equipped vehicle (Dail and Passavant 2012). As a result, Stage II control systems provided increasingly less air pollution reduction beyond what was already provided via ORVR, and thus Stage II was increasingly less cost-effective. Moreover, Stage II system efficiency had an annual estimated efficiency of 86% while ORVR efficiency is 98% (Fung and Maxwell 2011). In 2012, the EPA determined that the use of ORVR technology was sufficiently widespread for capturing gasoline vapor when gasoline-powered vehicles are refueled. Thus, the EPA identified Stage II and ORVR emission control compliance as redundant and the EPA waived the requirement for states to fulfill Stage II. States could elect to opt out of the Stage II program by seeking approval from EPA through its State Implementation Plan (SIP).

Small Business Benefits: ☑

This rule permitted states to discontinue the implementation of Stage II controls in an effort to ensure refueling vapor control regulations are not unduly burdensome for American businesses. Congress permitted EPA to issue exemptions from Stage II systems for private entities that had throughput less than 10,000 gallons or independent small business marketers with throughput less than 50,000 gallons/month. Of the total number of states and areas impacted, less than 10 percent of total throughput was accounted for by small GDFs. This action did not impose additional requirements on small entities but rather reduced redundant regulatory requirements.

Quantified Net Benefits: ☑

Upon identifying the ORVR as 'widespread', states are able to petition the EPA for an exemption from Stage II requirements. GDFs in 20 areas—19 states and the District of Columbia— sought decommission and removal of Stage II systems. EPA projected first year savings of $10.2 million, second year savings of $40.5 million, and third year savings of 70.9 million. The Agency projected an annual nationwide savings as high as $91 million for the 30,600 GDFs outside of California that are required to have Stage II systems. EPA estimated recurring cost savings of about $3,000 per year for a typical gasoline dispensing facility, no significant emissions increase or decrease was expected from this action.

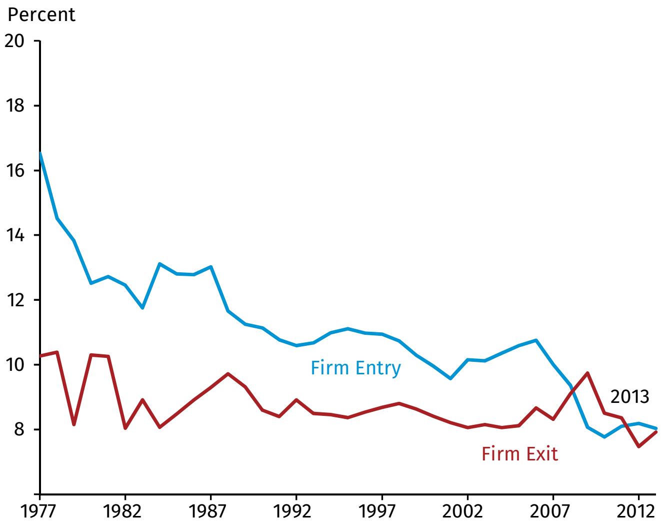
(2011) criticized Crain and Crain's (2010) $1.75 trillion regulatory cost figure, citing "numerous problems" with the underlying methodology He acknowledges that regulations have costs, but also highlights benefits, and argues that excluding benefits is a mistake.

Entrepreneurs and Small Businesses are Important to a Vibrant Economy

Small businesses are a key source of jobs and economic prosperity. According to the Small Business Administration (SBA OA 2016a), small businesses account for more than 99% of all firms, nearly two-thirds of net new private sector jobs, and half of all private sector jobs. Small businesses are also important drivers of innovation—about 96% of firms in high-patenting manufacturing industries are small businesses (SBA OA 2016a).

Startups (new firms) are an important subcategory. Today, new businesses account for nearly all net job creation and about 20% of gross job creation (Wiens and Jackson 2015).

Figure 1: Firm Entry and Exit Rates in the United States, 1977-2012



Source: *Council of Economic Advisors, 2016*

Unfortunately, the number of new firms has been on the decline since the 1970s (Figure 1).

New products and services are often brought to the market by startups and have led to long-run productivity growth (King and Levine 1993). Startups not only help to commercialize innovative ideas, but also help to motivate established businesses to innovate continuously to improve their existing products. For example, Seamans (2012) showed that the possibility of entry by a city-owned cable system is enough to induce product upgrades by incumbent cable systems. According to the President's Council of Economic Advisors (CEA 2016), this dual role of startups helps to improve consumer welfare.

Startups are a particular source of strength of the United States compared to other countries. The Global Entrepreneurship Institute (GEI) ranks the USA #1 out of 60 countries that it subjected to its ranking system (Acs et al.

CASE STUDY TWO. USDA AMS. Removal of Mandatory Country of Origin Labeling (COOL) for Beef and Pork Muscle Cuts, Ground Beef, and Ground Pork, 81 FR 10755. March 2, 2016. (Congress repealed this program; hence, this action.)

The 2002 and 2008 Farm bills required retailers to notify their customers of the country of origin for certain covered commodities, including beef and pork. Some consumers desired information about country of origin but a scientific link to safety was never established. The Consolidated Appropriations Act of 2016 removed COOL for beef and pork, and USDA followed suit with this final rule to eliminate the regulatory requirements on retailers and others in the beef and pork supply chain.

Reduces Regulatory Burden: ☑

USDA estimated that this statutory requirement, known as country of origin labeling (COOL), would impose substantial costs throughout the supply chain and non-quantified benefits to consumers. USDA concluded that the costs are likely to exceed the benefit because the lack of voluntary COOL at the retail level suggests consumers do not value such information more than the costs of producing it. USDA found no tangible safety benefits due to COOL.

Small Business Benefits: ☑

USDA believes removing this regulatory burden will yield significant economic savings for a substantial number of small retailers, suppliers, and wholesalers. Of the 2,162 meat and meat product wholesale firms counted in the 2012 Economic Census, 2,043 or 95% are considered small firms (having less than 100 employees). Of the 2,629 livestock processing firms in operation in the same census, 90% qualified as a small business under the SBA definition. Similarly, 95 percent of beef and 80 percent of hog farms were classified as small businesses. The economic savings from removing these commodities from federal COOL requirements will result from reductions in recordkeeping costs and changes to business practices.

Quantified Net Benefits: ☑

On a total cost savings basis, forecasts include savings up to \$451.0 million for producers, \$613.7 million for intermediaries such as handlers, processors and wholesalers, and \$767.2 million for retailers, for a grand total of \$1.832 billion in cumulative savings. These figures are an upper bound because some of these avoided costs are sunk costs and not all regulated entities will choose to change their operational practices.

2017). Other ranking systems place the USA lower due to different weighting factors, most notably by giving a greater weight to necessity entrepreneurship than opportunity entrepreneurship. That is, necessity entrepreneurs start their own business because it is the only choice they have to make a living. Uganda leads the world in necessity entrepreneurs. Opportunity entrepreneurs typically have job opportunities but forego those to start their own business in order to make a profit.

> According to the Small Business Administration, small businesses account for more than 99% of all firms, nearly two-thirds of net new private sector jobs, and half of all private sector jobs. … Unfortunately, the number of new firms has been on the decline since the 1970s.

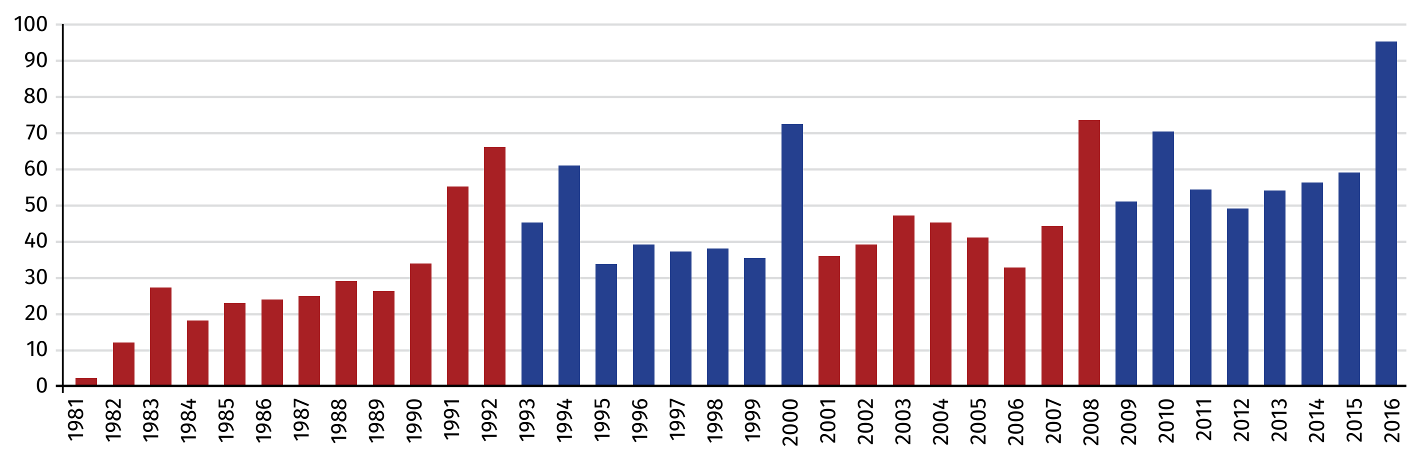
The USA leads the world in opportunity entrepreneurs. For example, the United States is ranked #51 out of all countries in the Starting a Business Ranking by the World Bank Group (2017), and #24 out of 65 countries in the Global Entrepreneurship Monitor, or GEM (Kelley et al. 2015). Opportunity entrepreneurship, which is the focus of the GEI ranking, is thought to provide a much greater economic boost than necessity entrepreneurship. The metric, Total Entrepreneurial Activity (TEA), encompasses both types of entrepreneurship, and is the reason why some international rankings (GEM) do not have the USA near the top.

The Growing Complexity of Regulatory Systems

Multiple lines of evidence indicate that regulatory burdens are substantial and increasing:

- At the federal level, the *Code of Federal Regulations*, the compendium of all federal regulation, has continuously increased for decades, as have quantitative estimates of federal regulatory burden (OMB 2016). Since 2000, 34 new federal rules with compliance costs of $1 billion or more have been issued by executive branch agencies (U.S. Chamber of Commerce 2017).
- Of the thousands of new federal regulations issued every year, only a small percentage reduce regulatory burden (i.e., are categorized as “de- regulatory”); thus a federal rulemaking activity is much more likely to add burden than reduce burden.
- Longitudinal surveys of businesses across all sectors of the economy (e.g., Wade 2016, Pareto Policy Solutions 2017) show that regulatory burden is increasing, and that the issue of “cumulative burden” (i.e., the burden associated with all government regulations affecting a business) is a high priority issue, especially to small businesses. According to every one of the experts interviewed for this project, the regulatory burden on small business is increasing. This perception is supported by data showing that the numbers of economically significant rules (i.e., those imposing costs or benefits of more than $100 million in any single year) are increasing over time (see Figure 2). Worth noting, the number of economically significant rules tends to rise in the last year of a presidential administration.

Figure 2: Economically Significant Final Rules by Presidential Year, 1981 – 2016



Source: *George Washington University Regulatory Studies Center*

CASE STUDY THREE. DOT FAA. Reciprocal Waivers of Claims for Licensed or Permitted Launch and Reentry Activities. 81 FR 55115. August 18, 2016.

The Commercial Space Launch Act of 1984 (CSLA) authorizes the Federal Aviation Administration to oversee, license, and regulate commercial launch and re-entry space activities. With this discretionary rule, FAA amended some of its paperwork requirements (relating to reciprocal waiver claims) to minimize confusion and compliance cost arising from increasingly complex contractual arrangements between a licensee or permittee, its first-tier customers (which could be a federal government agency), and their customers (which could be a small business).

Reduces Regulatory Burden: ☑

Effective August 2016, the FAA amended its regulations to now require all parties involved in a commercial space launch to waive claims against all customers involved in a launch or reentry, including those signing a different set of reciprocal waivers. To achieve this, and with specific consideration for industry comments, the FAA amended the rule to extend to any customer that does not qualify as a first-tier customer—their contractors, and subcontractors. The amendments include an appendix that provides an example of a Waiver of Claims and Assumption of Responsibility for Permitted Activities with No Customer.

Small Business Benefits: ☑

This rule provides that first-tier customers – that is, one who has a contractual relationship with a license or permit holder to obtain launch or reentry services—are responsible for implementing a reciprocal waiver of claims with its customers. A contract template is provided that can be easily modified and represents $185 in estimated cost that can be completed in a 'short period of time' by the company's 'in-house lawyers', thereby reducing the paperwork burden for all affected entities, including small businesses.

Quantified Net Benefits: ☑

The changes will result in cost savings to the licensee or permittee, government, and customers at an estimated $292,000 annually. Minimal costs to first-tier customers are expected if it has customers to the launch. The rule will additionally result in cost savings for licensees and permittees that no longer have to seek and obtain signatures on the reciprocal waiver of claims. The FAA estimates marginal savings from decreased burden that allows last-minute customers to sign a new and separate waiver of claims agreement. The template provided in the rule will also provide nominal cost savings.

When asked about whether the concern about regulatory burden is primarily due to new or existing regulations, some of the interviewed experts preferred using the term "cumulative burden," which encompasses a tangled web of regulatory requirements:

- Multiple layers of government, acting in an often uncoordinated and fragmented manner, may regulate the same business activity. For example, it is not unusual for municipal, state, and federal regulators to differentially set standards for the management of storm water.
- Harmonization of regulatory requirements across states is sorely needed (e.g., occupational licensing requirements), yet even when harmonization occurs, it is imperfect. For example, all fifty states have adopted the Uniform Commercial Code (UCC), which regulates commercial transactions, but implementation of the UCC often varies from one jurisdiction to another.
- Additional compliance challenges arise as regulations (a form of administrative law) are layered on top of America's strict liability system (a form of common law) and unpredictable and inconsistent patterns of litigation and enforcement.
- As small businesses increasingly engage in global trade (enabled in large part by the Internet), they are subject to US trade regulations and regulation by other countries, adding to the multi-layered complexity.

From a theoretical perspective, it is expected that regulation will have a larger adverse effect on small businesses than large businesses (Huffman 2000, Bradford 2004). Economies of scale create a disproportionate burden on small businesses because fixed compliance costs are spread out across a smaller number of employees or goods.

This theory is backed by a wealth of empirical evidence (Dean et al. 2000, Hopkins 1995, Microeconomics Applications 1998, Crain and Hopkins 2001, Kauffman-RAND 2007, Crain and Crain 2010, Crain and Crain 2014). These studies find that smaller firms experience a greater regulatory burden per employee than larger firms. The US is not unique in this respect—differences in burden between small and large firms have been found in multiple countries (e.g., Klapper et al. 2006).

Experts interviewed for this report were asked about the opportunity cost of regulation—that is, how a small business would expend compliance resources in the absence of regulation. The general consensus was that innovation and growth are sacrificed when resources for discretionary activities are sacrificed to ensure compliance with mandatory requirements. One respondent provided the following example:

> The OSHA silica rule and the EPA MACT standard will hurt small brick makers. These recent rules require capital expenditures that will put companies out of business because they won't be able to get a loan for compliance (because there is no pay back). Their employees are in rural areas and they don't have options. *It is hard to get capital for regulatory compliance*—access to capital is adversely affected. There will be a larger concentration of business because the large firms have access to capital and the smallest firms won't survive. And a high barrier to entry has a chilling effect on new businesses.

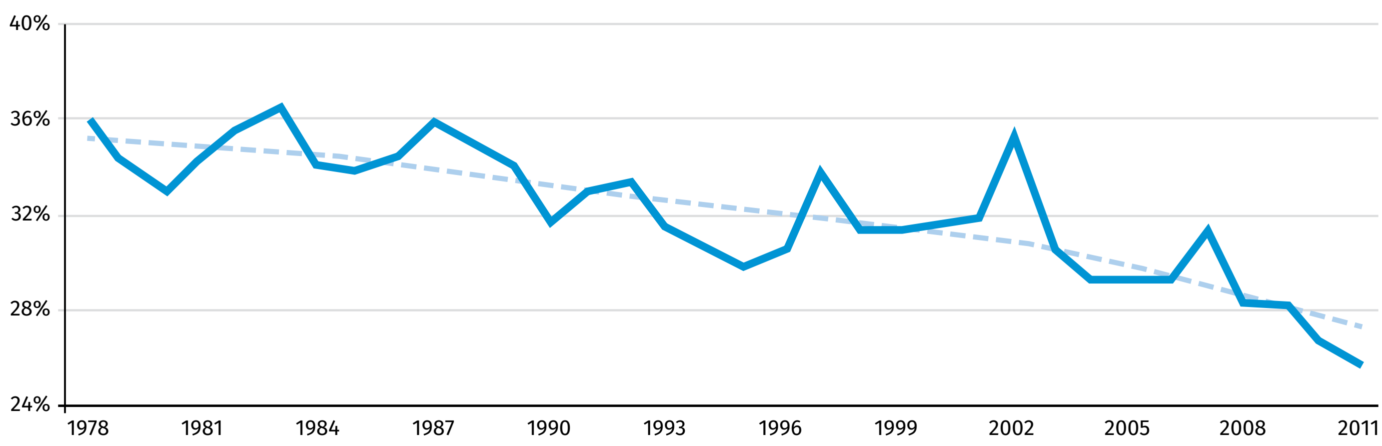
A recent survey of U.S. manufacturers (Pareto Policy Solutions 2017) reached a related conclusion. The opportunity cost of regulation is primarily reduced market innovation—such as foregone capital investment opportunities that would either improve operational efficiency and/or improve the products offered to customers. When asked how their company would re-direct resources if regulatory compliance costs were reduced significantly and permanently, nearly two-thirds of respondents said their firm would increase investment in capital equipment or in R&D/new products. Empirical evidence aligns with these survey results; for example, economic growth is adversely affected by regulation at a macro level (e.g., Coffee et al. 2016) and regulated businesses show a decline in economic activity compared to non-regulated businesses (e.g., Greenstone 2002).

If this loss in innovation is partly a consequence of regulation, it could help explain a troubling trend:

- The rate of new firm formation and share of patenting by new firms in the United States has been in persistent decline since the late 1970s (Council of Economic Advisors 2016).

> If regulatory compliance costs were reduced, nearly two-thirds of respondents said their firm would increase investment in capital equipment or in R&D/new products.

Figure 3: Business Dynamism in the USA, 1978-2011



Source: *Hathaway and Litan, 2014*

- Business dynamism (which reflects both the creation of new firms and the destruction of existing firms), which is critical to increasing productivity and rising standards of living, has also been in decline in recent decades (Figure 3). Hathaway and Litan (2014) found that this decline does not vary by geography; it is prevalent throughout all 50 states and in all metropolitan areas.
- Over the last twenty years, the lowest level of the Kauffman Index of Startup Activity (Figure 4) occurred in 2014 (Fairlie et al. 2015). The Index, which measures startup activity in the U.S., is composed of three components: the rate of new entrepreneurs, the opportunity shares of new entrepreneurs, and the startup density (which is the number of new businesses divided by the total number of businesses). Although the index has jumped up the last two years (due to the recent economic recovery), the long-term decline in the startup density remains a significant concern.

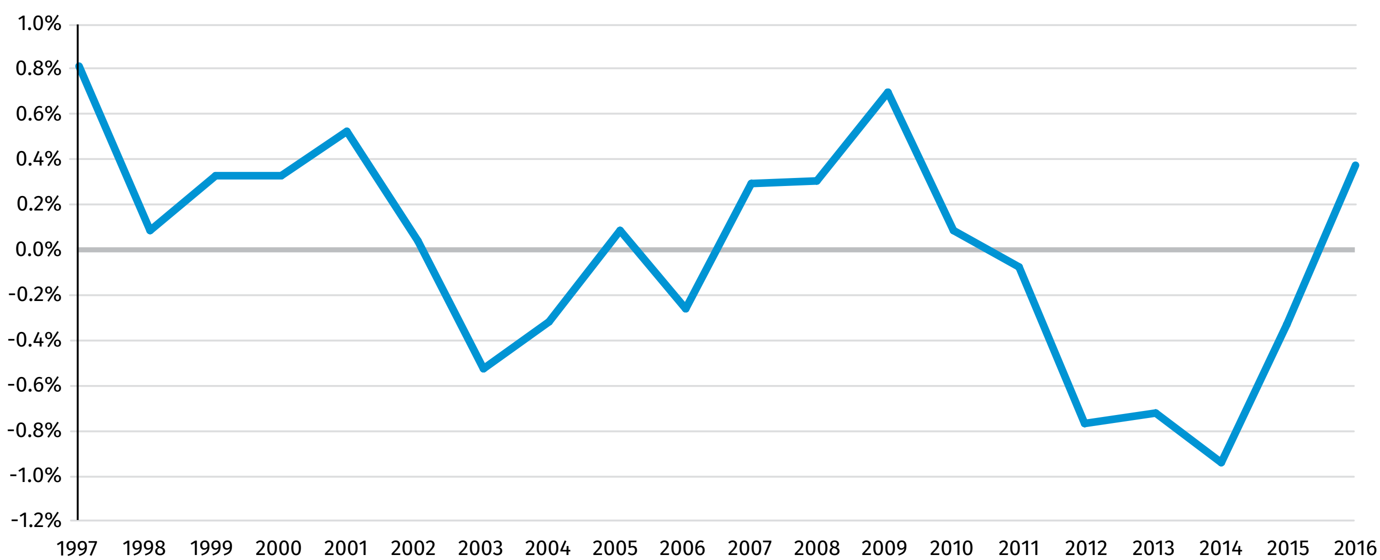
According to the President's Council of Economic Advisors (2016), the reasons for declining firm entry rates are not well understood: "A partial explanation is that barriers to entry have increased in many industries. For some industries, these barriers could be in the form of occupational licenses. In other cases, these barriers could be in the form of Federal, State, or local licenses or permits."

> Although dissonance remains about the intention of regulatory reform and the actual outcomes, the reality is that reforms have been somewhat trial and error.

Another explanation for the decline in US firm entry is greater competition from existing firms. Hathaway et al. (2014) analyzed Census data and concluded that, over the last three decades (1978-2011), new establishments and the jobs they created have been provided by existing firms expanding into new locations over new firms. (This is true across many sectors, not just retail.) They hypothesize the reason is due to information and communication technologies, which make coordination across multiple establishments easier. No matter the explanation, the declining trend in the rate of new firm formation and business dynamism is a serious problem because it portends slower economic growth for the future (Hathaway and Litan 2014).

Regulation may play a role in this disturbing trend. Research shows that regulation has a negative impact on entrepreneurship in both developed and developing countries (Klapper et al. 2006, Van Stel et al. 2007, Nystrom 2008, Dreher and Gassebner 2013). Within the USA, those particularly impacted include the poor (Noonan 2014) and those 25%-30% of US workers subject to occupational licensing requirements at the state level (Kleiner 2015, Slivinski 2015). Some researchers (Nystrom 2008, Wiens and Jackson 2015) recommended regulatory reform to increase entrepreneurship. For example, Wiens and Jackson (2015) recommended policies that welcome immigrants, remove regulatory barriers (sunset provisions, regulatory reform commission), simplify tax codes,

Figure 4: Kauffman Index of Startup Activity, 1997-2016



Source: *Fairlie et al., 2015*

CASE STUDY FOUR. DOT FMCSA. Inspection, Repair, and Maintenance: Driver-Vehicle Inspection Report (DVIR). 79 FR 75437. December 18, 2014.

In 1939, the Interstate Commerce Commission (ICC) required every cargo-carrying motor vehicle (CMV) driver to submit a written report of the condition of his vehicle at the end of each day's work, with specific attention to any defect or deficiency that would likely impact the safe operation of the vehicle. Following issuance of Executive Order 13563 – "Improving Regulation and Regulatory Review"—the Department of Transportation requested comments for ineffective, insufficient, or excessively burdensome DOT rules for review. The Federal Motor Carrier Safety Administration (FMCSA) received comments on the duplicative requirements for CMV drivers. As a result, FMCSA removed the rule.

Reduces Regulatory Burden: ☑

This action eliminates commercial cargo-carrying motor vehicle (CMV) drivers' need to file a no-defect report at the end of each tour of duty, even when there is no defect to report; however, passenger-carrying CMVs must still file reports. This rule eliminates the need to prepare a written report for each vehicle operated at the end of each workday that lists any defect that could result in mechanical malfunction. Eliminating this rule reduces a significant time and paperwork burden on the trucking industry, without sacrificing any discernible safety benefit. The Agency also made a technical change to § 396.11 to eliminate redundant language.

Small Business Benefits: ☑

This elimination of unnecessary time and paperwork burdens benefits small businesses by saving the industry 46.7 million hours of driver time. These benefits will mostly accrue to small carriers, estimated to comprise 98.9% of overall carriers in the industry.

Quantified Net Benefits: ☑

By eliminating the no defect DVIR requirement, FMCSA saves non-passenger carrying CMV drivers an estimated 46.7 million annual hours formerly devoted to completing no- defect DVIRs. This time, monetized at an estimated $1.7 billion per year, can now be dedicated to other purposes, thereby realizing opportunity costs formerly spent on regulation. Firms could receive as high as $3,000 per entity in regulatory relief.

remove occupational licensing, and cultivate human capital through higher education.

Other researchers have noted a critical distinction between entrepreneurs who are motivated by opportunity versus those motivated by necessity (because they have no other job options). Opportunity entrepreneurship, in which the USA holds a leadership position, is seen as contributing more to productivity and economic growth. Unlike opportunity entrepreneurship, necessity entrepreneurship rises during economic downturns (e.g., Fairlie 2011). Policy makers would be wise to consider the lessons learned from this body of research:

- Ardagna and Lusardi (2008, 2009, 2010) investigated the relationship between regulation and entrepreneurship across 40 developed and developing countries using multiple data sets. Irrespective of data set and measure of regulatory activity, they found regulation to be detrimental to entrepreneurial activity, particularly for those who become entrepreneurs to pursue a business opportunity, i.e. opportunity entrepreneurs.
- Using data from 63 countries over a substantial time period (2005-2012), Fuentelsaz et al. (2015) found that that an increase in business freedom (including less regulation) benefits opportunity entrepreneurs and hurts necessity entrepreneurs (presumably because they have additional options for work).
- Block and Wagner (2010) studied German firms and found that opportunity and necessity entrepreneurs differ in socioeconomic characteristics, earnings levels, and determinants of success. They concluded that German policies to subsidize necessity entrepreneurs would be improved by targeting such subsidies to specific human capital requirements correlated with entrepreneurial success (e.g., a record of labor market success in a specific field of a venture).

- Acs and Szerb (2007) concluded that removing regulatory barriers to entry likely impact opportunity entrepreneurs more than necessity entrepreneurs but have little effect on "high-growth" opportunity entrepreneurs, who overcome regulatory obstacles.

Established Reforms Have Fallen Short of Expectations

Faced with information about the burden of regulation, policy makers often seek regulatory exemptions for small business. We found, however, that the small business exemption is an overrated construct: It does not apply to many regulations (Dixon et al. 2007) such as IRS regulations. It does not shield small businesses from the indirect costs of regulation (e.g., Miller and Willie 2016); for example, the rising costs of health insurance under the Affordable Care Act hurt small businesses, even though small businesses are exempt from Act's employer mandate (K. Kerrigan 2016). Furthermore, a blanket exemption of small businesses may not be justified on the basis of cost-benefit analysis (Gates and Leuschner 2007) because small businesses –like their larger counterparts – may require regulation to ensure safe and clean operations. We find that smarter regulation is more promising than regulatory exemptions.

According to Gates and Leuschner (2007) and Dixon et al. (2007), "there is little quantitative evidence to demonstrate the specific impacts of policies and regulations on small businesses; nor has there been much evidence showing whether rules and exemptions designed to benefit small businesses actually have that effect. Additionally, there is little evidence that small-business exemptions are crafted in a way that appropriately balances the costs and benefits of regulation."

After an examination of special small business provisions across four regulatory areas, Gates and Leuschner (2007) offered the following insights: (1) Small firms often respond differently than large firms to the substance of regulation; (2) Regulations and policies designed specifically at helping small businesses do not always have the intended effect—either because the policies inadvertently afford competitive large businesses as many or more benefits than the small businesses for which they are intended or because they fail to meet their objectives entirely; (3) Policies specific to small-businesses may be better suited to balance the interest between regulatory restrictions on firm behavior and the desire to encourage small businesses and entrepreneurs (e.g., through the exercise of enforcement discretion on startups); (4) When evidence shows that small-business legislation is not having the desired effect, policymakers might choose to monitor the law's effect over time, modify

the law, provide support to help small businesses comply, or rescind the legislation entirely.

Although dissonance remains about the intention of regulatory reform and the actual outcomes, the reality is that reforms have been somewhat trial and error. The most significant laws and reforms seeking to change the regulatory process for small business are as follows, in chronological order.

The 1980 **Regulatory Flexibility Act** (RFA 1980) requires federal agencies to consider the impact of their regulatory proposals on small entities, to analyze effective alternatives that minimize small entity impacts, and to make their analyses available for public comment. It requires agencies to analyze the economic impact of regulations when there is likely to be a "significant economic impact on a substantial number of small entities." In 1996, Congress amended the RFA with the Small Business Regulatory Enforcement and Fairness Act (SBREFA), which requires that additional analyses be taken to minimize a regulation's impact on small business, also provides for judicial review for some provisions, and requires that small business panels analyze and make cost-saving recommendations for OSHA, EPA, and CFPB covered rules. SBA OA (2016) estimates that, since the Act's inception, annual savings (in terms of burden reduction) to small business have exceeded $128 billion.

Evaluations of RFA implementation have provided mixed reviews. GAO (2006) found variable RFA compliance within and across agencies and a lack of consistent interpretation of key requirements. Microeconomics Applications (2013) found that independent agencies implement the RFA less rigorously than executive-branch agencies. GAO (2016) interviewed panel participants from CFPB rulemakings; although most agreed the process was constructive, most disagreed with the final rulemaking outcome. Experts interviewed for this report drew similar conclusions. Said one, "The RFA as amended by SBREFA has made agencies more sensitive to small businesses. But agencies don't always fully comply with the law." Said another, "The RFA worked because there are parts of government that have connected small business stakeholders with regulators with the purpose of identifying constructive solutions."

The 2002 **Small Business Paperwork Relief Act** (2002) amended the 1980 Paperwork Reduction Act (PRA), which required all proposed regulations be assessed for their paperwork burden and mandated that paperwork be kept to a minimum. New paperwork requirements had to receive clearance from the Office of Management and Budget (OMB). The 2002 amendment further required federal agencies to establish a single point of contact for small business paperwork concerns, and to make further efforts to reduce paperwork burden on small entities with 25 or fewer employees. OMB was also directed to publish an annual list of compliance assistance tools for small business.

Some of the experts interviewed for this report acknowledge that the PRA has been helpful in reducing paperwork burden on small business because agencies are forced to be transparent and quantify the paperwork burden, which allows for public discussion about ways to lessen it. However, none of those interviewed said that the PRA has lived up to the initial expectation of significantly reducing the aggregate level of federal paperwork.

Issued in 1993 by Bill Clinton, **Executive Order 12866** addresses regulatory planning and review. Aside from establishing centralized review of significant regulations by OMB/OIRA, this EO also states that each covered agency shall tailor its regulations to account for businesses of different sizes and taking into account the cumulative burden of regulation. Two of the experts interviewed for this report indicated that centralized review under OMB/OIRA was a success because it forced agencies to be transparent about costs and benefits and allowed for some degree of enforcement. Indeed, lack of centralized review can lead to suboptimal regulatory outcomes (Graham 2016).

> Experts interviewed for this project suggested that these legislative and administrative reforms, although positive, have not fully met the initial expectations from the small business community.

The **Regulatory Right-to-Know Act** of 2000 requires OMB to submit to Congress each year "an accounting statement and associated report" of federal regulations for the previous year. The OMB report includes an analysis of impacts of federal regulation on small business, and an estimate of costs and benefits of "major" rules by agency and by agency program. While this report serves as a very useful informational mechanism, it does not directly reduce burden.

Issued in 2002 by George W. Bush, **Executive Order 13272** addresses the proper consideration of small entities in agency rulemaking. It delineates the responsibilities of SBA OA and regulatory agencies, and requires SBA OA to

CASE STUDY FIVE. HHS CMMS. Medicare and Medicaid Programs; Regulatory Provisions to Promote Program Efficiency, Transparency, and Burden Reduction, Part II. 79 FR 27106. May 12, 2014.

As part of Executive Order 13563— "Improving Regulation and Regulatory Review"—the Department of Health & Human Services (DHHS) solicited comment for ineffective, insufficient, or excessively burdensome requirements to review. This rule eliminates the need for Critical Access Hospitals (CAHs) to develop patient care policies with "the advice of at least one member who is not a member of the CAH staff". The rule also eliminated requirements for physicians to be present for "sufficient periods of time except in extraordinary circumstances".

Reduces Regulatory Burden: ☑

The requirement to obtain an opinion from a non-CAH staff member was challenging for the hospital, community, and provider. Deeming the original reasons for including the requirement for outside council (lack of local resources and in-house expertise) sufficiently satisfied by CAHs, DHHS eliminated this requirement, thereby reducing the time, information, and knowledge burden on CAH. DHHS also removed the "present for sufficient periods of time" so that physicians can have greater geographical access via telemedicine services.

Small Business Benefits: ☑

Congress created the CAH designation in 1997 to help small hospitals receive necessary funding to strengthen rural health care infrastructure. CAHs are normally limited to 25 inpatient beds and employ on average 127 individuals (Doeksen et al 2012). By removing the requirement for non-CAH advice, CAHs save time and improve team-based care. By removing the time minimum for physicians, requirements better comply with the policies of the CAH and the State's current standards of practice. It provides flexibility to patient care that allows CAH to maximize staff to provide the best quality care to rural and remote areas rather than being geographically bound.

Quantified Net Benefits: ☑

The elimination of CAH physician time requirements and CAH outside consultation requirements saved an estimated $76 million and <$1million annually, respectively.

submit an annual report to OMB on agency compliance with the executive order.

Issued in 2011 by Barack Obama, **Executive Order 13563** contains principles for regulatory review, which are borrowed heavily from EO 12866, with an emphasis on agency retrospective review plans to "look-back" to identify existing regulations that are outdated, ineffective, or in need of reform. It calls for each agency to tailor its regulations to account for the costs of cumulative regulation. It requires each agency to coordinate, simplify, and harmonize regulations to achieve regulatory goals while promoting innovation.

Issued in 2011 by Barack Obama, **Executive Order 13579** addresses regulation and independent agencies. This EO extends the Obama retrospective review process (in EO 13563) to independent agencies.

None of the experts interviewed for this report indicated that agency retrospective review plans have had a discernible impact in reducing regulatory burden. Recent surveys of small business (Wade 2016, Pareto Policy Solutions 2017) indicate rising concern about regulatory burden in recent years.

With enactment of the 2012 **Jumpstart Our Business Startups Act** (JOBS Act 2012), a bipartisan coalition in Congress authorized the SEC to streamline its regulations relating to the initial public offering (IPO) process for startups aiming to raise a few million dollars from investors.

Campbell (2014) evaluated the promise of the JOBS Act and determined— because it is not self-implementing— that it may not achieve its objectives because the SEC has to weigh greater incentives for capital formation against investor protections when issuing the implementing regulations. Newman (2016) provided his informed opinion about Title IV of the (seven-title) JOBS Act, described what Congress should have done (repeal SEC Regulation A entirely) and what is likely to happen (very little increased use of Regulation A by small firms). Chaplinsky et al. (2016) examined the impact of Title I of the JOBS Act on a sample of 312 emerging growth companies (EGCs) and found no reduction in the direct costs associated with issuance, accounting, legal, or underwriting fees for emerging growth company (EGC) IPOs. Dambra et al. (2016) investigated the behavior of investment analysts as a result of the JOBS Act. They concluded that forecasts from analysts affiliated with emerging growth companies became less accurate and more biased as a result of the JOBS Act.

With the possible exception of the JOBS Act, which is still in its early implementation stages (and the initial regulations were developed with significant input from small businesses), experts interviewed for this project suggested that these legislative and administrative reforms, although positive, have not fully met the initial expectations from the small business community.

> ... there is still an inadequate incentive for regulators to address burdens on small businesses, since regulators are rewarded for regulating more and not less.

Case Studies of Smart Regulatory Reform

Of the approximately 3,200 new final regulations that are issued every year by federal agencies, relatively few are categorized as de-regulatory in nature. Nevertheless, regulatory reform efforts are not rare. Process reforms put in place in recent decades have resulted in final rules that are less burdensome and more beneficial than they would otherwise be. Such process reforms include those initiated by the President, typically via executive order (e.g., centralized review of significant regulations by OMB/OIRA, retrospective review planning by regulatory agencies) and those initiated by Congress via statute (e.g., the Regulatory Flexibility Act, Paperwork Reduction Act, Unfunded Mandates Reform Act, the JOBS Act, etc.). Even in the absence of these process reforms, agencies sometimes use their discretion to reduce regulatory burden on small business. Appendix A presents a list of dozens of potential burden-reducing rules affecting small businesses over the past ten years.

From this compiled list of rules, we chose to highlight five that have reduced regulatory burden on small businesses, imposed no loss of societal benefits or actually increased net social benefits (i.e., smarter regulation), and arose from different agencies and reform processes. The chosen case studies include:

1. Environmental Protection Agency (EPA) waiving redundant gasoline vapor control requirements for gasoline dispensing facilities in ozone nonattainment areas;
2. USDA Agriculture Marketing Service (AMS) eliminating its requirement for country of origin labeling (COOL) for retail sales of pork and beef;
3. DOT Federal Aviation Administration (FAA) changing paperwork requirements for reciprocal waivers of claims and significantly reducing compliance burden for small businesses;
4. DOT Federal Motor Carrier Safety Administration (FMCSA) narrowing the scope of coverage for its driver-vehicle inspection report; and
5. HHS Centers for Medicare and Medicaid Programs eliminating certain outdated and unnecessary requirements for critical access hospitals.

For each "success story," we summarized the rulemaking outcome; identified the change in costs and benefits; the established reform process, if any, that led to the final rule; and, the benefits to small business. From this exercise as well as other information, we drew the following conclusions:

1. There are opportunities for burden-reducing regulatory reforms at a wide range of federal regulatory agencies;
2. Burden-reducing actions can be accomplished without reducing significant regulatory benefits.
3. Existing reform mechanisms (e.g., EO 13563 on retrospective regulatory review, the Regulatory Flexibility Act, etc.) are making a positive difference.
4. Regulatory reforms that broadly benefit the business community often have specific, meaningful benefits for small businesses.
5. When sensible regulatory reforms are adopted, agencies do not always know how small business will be impacted.
6. Even when regulatory reforms produce only small savings for existing businesses, they may make it easier for nascent firms, such as opportunity entrepreneurs, to enter an industry.

Major Reform Proposals

Consistent with the five case studies, the experts interviewed for this report indicated that established process reforms (e.g., RFA, PRA, OMB centralized review) have made a positive difference in reducing the regulatory burden on small business, but to a lesser degree than what was initially envisioned. When asked to explain why these reforms were successful, respondents identified two primary reasons: (1) small businesses had a "seat at the table" and could engage directly with regulators and/or (2) the small business community had an opportunity to seek enforcement (or the threat of enforcement) via the courts (i.e., judicial review) or a federal advocate (e.g., OMB OIRA or SBA OA) if the agency did not address adequately the concerns of small businesses.

When asked to explain why some established reforms had not worked or were less successful than envisioned, respondents provided a wider range of explanations. Most cited the fact the there is still an inadequate incentive for regulators to address burdens on small businesses, since regulators are rewarded for regulating more and not less. In addition, the policy "tools" available to the small business community to reduce regulatory burden are backed by suboptimal enforcement, whether it be through judicial review or oversight from OMB and/or SBA OA.

During the interview phase, we also posed open-ended questions about promising reforms to the regulatory process that would benefit small businesses. Respondents identified more than twenty such reforms, which we arranged into nine categories, five of which are under the primary control of the legislative branch and four of which are under the primary control of the executive branch. Many of these reforms are not necessarily specific to small business and would also benefit larger businesses. For each category of reform, we identified pros and cons based on the responses from interview subjects, the literature, and our own opinions.

Legislative Reforms

Legislative reforms have the advantage of being relatively permanent, since they are likely to have a staying power from one presidential administration to the next. The biggest drawback is the complicated nature of regulatory reform itself: moving a reform bill through the legislative process is neither easy nor guaranteed; political compromise is needed to secure passage and eventual enactment, and such compromises can weaken the central idea of the reform. In recent years, Congress has become more polarized on partisan lines, yet bipartisan coalitions are required to pass regulatory reform legislation, particularly in the Senate where 60 out of 100 votes are required to limit debate and overcome filibuster threats.

The following are the major categories of legislative reforms:

Modernize the Administrative Procedure Act. This category includes process reforms to the 1946 Administrative Procedure Act (APA), which establishes the way in which federal agencies promulgate regulations. Such process reforms include changes to requirements pertaining to public notice and comment, formal and informal rulemaking, regulatory analysis, retrospective review, judicial review, and presidential review of regulations (i.e., centralized review). An advantage of APA reform is its applicability across federal agencies (all federal agencies are subject to the APA) and

> Moving a reform bill through the legislative process is neither easy nor guaranteed; political compromise is needed to secure passage and eventual enactment, and such compromises can weaken the central idea of the reform.

across different types of rulemakings (e.g., advanced notice of proposed rulemaking, proposed rules, final rules, interim final rules, etc.). Such reforms, however, are not targeted to address concerns unique to small business or entrepreneurs. A current example of this kind of reform is Title I of H.R.5, the Regulatory Accountability Act of 2017, introduced by Bob Goodlatte (R-VA).

Expand congressional dispensation of new rules. This category includes establishing a procedure for congressional approval of the most impactful rules and/or changes to the Congressional Review Act, which allows for congressional disapproval of rules. An advantage of such a reform is that it puts the onus on Congress, which can and should be responsible for delegating power to administrative agencies in a cost-effective manner. A disadvantage is that specific rulemakings can be quite complex, and Congress lacks the appropriate expertise to analyze and vote on each significant or major rulemaking. Congressional dispensation also has a downside—agencies will have an incentive to politicize the packaging and content of rules in order to "game" the system (e.g., by crafting a rule to secure a positive vote by Congress), and this detracts from the objective application of expertise—the strength of regulatory agencies. An example of this kind of reform is the Regulations from the Executive in Need of Scrutiny (REINS) Act, S.21, introduced by Senator Rand Paul (R-KY).

Create a bipartisan regulatory review commission. A regulatory review commission with politically appointed members jointly chosen by Congress and the President could identify existing rules for elimination or reform (Mandel and Carew 2013). Instead of reviewing every existing rule individually, such a commission could identify a block of existing rules that are no longer beneficial or are outdated, thus reducing regulatory accumulation. One disadvantage, however, is that it does nothing to prevent the issuance of inefficient new regulations. An example of this kind of reform is the Regulatory Improvement Act of 2015, S.708, introduced by Senator Angus King (D-ME) in the 114th Congress.

Reforms primarily under the control of the President provide for greater control due to the absence of congressional approval and concomitant political compromise.

Amend existing burden-reducing statutes. This type of reform is designed to strengthen existing burden-reducing statutes that focus on small business (e.g., RFA) or address a problem facing a subset of small businesses (e.g., the JOBS Act aims to assist small business startups raise money through an initial public offering). Such reforms are the direct complement of APA reform because specific areas of concern to small business are addressed, but generic reform with greater regulatory applicability is sacrificed. For example, the Small Business Paperwork Relief Act of 2015, S.86, introduced by Senator David Vitter (R-LA) in the 114th Congress, called for the suspension of fines for first-time paperwork violations by a small business. Another example is the Small Business Regulatory Flexibility Improvements Act of 2017, H.R.33, introduced by Representative Steve Chabot (R-OH), which would expand the RFA to include more rules and expand the definition of "economic impact" to include indirect effects, which are not always considered by regulators (Wiener and Graham, 1995).

Executive Branch Reforms

Reforms primarily under the control of the President provide for greater control due to the absence of congressional approval and concomitant political compromise. However, this positive aspect comes at a price—limited judicial review (i.e., enforcement "teeth") and lack of permanence in the face of changing presidential administrations.

The following are the four major categories of executive branch reforms:

Strengthen prospective review of new rules. This category includes strengthening OMB/OIRA by increasing staff and expanding its review of new rules to include significant rules from "non-covered" agencies (i.e., independent regulatory commissions such as the FCC and SEC), including expanded requirements for cost-benefit analysis (Graham 2008, 2014), and planning for future evaluation of the effectiveness of new rules after they are enacted. Its great advantage is its focus on prevention to reduce the amount of unnecessary or overly burdensome regulation in the future. The downside is that such reforms do nothing to identify existing rules in need of elimination or change.

Strengthen retrospective review of existing rules. This category includes strengthening OMB/OIRA by increasing its scrutiny of existing regulations through retrospective review planning, building on the experience under EO 13563. Existing regulations of concern can be identified and remedied in accordance with the APA, which allows for public notice and comment. The drawback to such retrospective review is that control is left primarily in the hands of the agencies. In some cases, have used retrospective review to increase net regulatory burden rather than reduced net burden, although some examples of de-regulatory efforts can be found, as documented in this report.

Enhance transparency of new regulatory actions. This category includes reforms to require earlier and greater disclosure of future regulatory actions (including the evidence related to costs and benefits) and otherwise providing opportunities for early engagement between small businesses and regulators. Such reforms provide earlier and clearer signals to the regulated community with benefits in terms of planning for investment and compliance. Such reform, however, does not directly reduce small business burden. Examples include EPA's notice of initiation, which is a monthly, on-line listing of new rules on which the Agency has started working, along with an identifiable point of contact for further information. An alternative approach is to require all highly costly rules to undergo an advanced notice of proposed rulemaking, where technical issues are resolved, before a new regulation is proposed and finalized.

Establish an incremental regulatory budget. This category includes establishing a process whereby new regulations or new regulatory burdens are permissible only if accompanied by an equal or greater reduction of existing regulations or regulatory burden (Graham 2015b). The "linkage" would create an incentive for regulatory agencies to both minimize burden in new rules and reduce unnecessary burden in existing rules. A disadvantage relates to the accounting of rules and/or burden, which can be complicated and poses implementation challenges. An example is the executive order on reducing regulation and controlling regulatory costs issued by President Trump on January 30, 2017.

Policy makers would do well to consider the pros and cons of each type of reform as they grapple with the best approach to smart regulation. It may be that more than one reform is chosen, in which case reforms should, ideally, complement each other: some reforms address existing rules while others address new rules, or some address all rules while others focus on rules impacting small businesses. It should not be assumed that reforms that focus on small business would do more good for small business than reforms that benefit all businesses. For example, the creation of OIRA, and its review process for new regulations, has provided significant efficiencies for all businesses and the US economy, including small businesses (Graham, 2008).

Criteria for Evaluation

To enable policy makers to evaluate or tailor regulatory reform proposals for small businesses, we recommend using the following criteria: (1) consideration of costs and benefits, (2) leveraging established processes and institutions, and (3) leveraging the expertise of small business to identify problems/solutions. Each criterion is important. Whereas the first criterion is central to our definition of smarter regulation (Graham 2015a), the second minimizes implementation issues and the third ensures that the concerns of small businesses are addressed.

We offer the following two examples of smarter regulation—one of a legislative proposal, and one of an executive branch proposal.

Consider a legislative proposal that allows small businesses more time for planning and compliance via earlier public notification. Under criterion 1, the notification could indicate both the estimated benefits and costs of the future regulatory action. Under criterion 2, public notification could be achieved earlier using existing disclosure mechanisms (e.g., the Unified Agenda, regulations.gov, the agency's website, an Advance Notice of Proposed Rulemaking, etc.). Under criterion 3, the proposal could focus on disclosure of the most important regulatory actions as identified by the small business community.

Consider an executive branch proposal to eliminate or reform one or more regulations for every new regulation. Under criterion 1, the proposal could establish criteria for ensuring that eliminated regulations include only those that impose a net burden on society (e.g., outdated regulations or regulations that fail a cost-benefit test). Under criterion 2, the proposal could be implemented through the established OMB/OIRA review process such that when OIRA concludes review of a new rule, it also concludes review of the existing rule(s) to be eliminated or reformed. The established process that agencies use to develop plans for retrospective review could be leveraged to include existing rules targeted for elimination or reform. Under criterion 3, the public could nominate existing rules for elimination through an open public solicitation where the focus is on small business burden reduction.

Every category of reform can be tailored along these lines to advance smart regulation. In other words, it may not be necessary to establish any new organizations or new processes in order to enact and implement a smarter regulatory system.

Particularly valuable would be reforms targeted to eliminate barriers to entry for nascent firms and increase the rate of new firm formation. Such a targeted policy is likely to benefit opportunity entrepreneurs and yield economic gains that have a positive effect on the broader economy and enhance US competitiveness. For example, a bipartisan commission could be organized through the National Research Council to identify the elimination or reform of regulations that serve as barriers to entry for entrepreneurs.

Conclusion

Small businesses and entrepreneurs have a significant, positive impact on the economy, but this positive impact is adversely impacted by the cumulative burden of regulation, which is growing. Regulation has a particularly negative impact on entrepreneurship, which plays a crucial role in job creation, innovation, productivity, and economic growth.

In recent decades, several reforms designed to lessen or minimize regulatory burden on small business have been adopted. Academic studies have concluded that regulations and policies designed specifically to help small businesses do not always have the intended effect—either because the policies end up benefiting larger competitors as much as (or even more) than they do small businesses or because they fail to meet their objectives entirely. Only rarely do the reforms focus specifically on the fate of entrepreneurs.

More recently, policy makers have proposed a wide range of reforms to the regulatory process. We recommend that policy makers work in a bipartisan manner to evaluate or tailor regulatory reform proposals for small businesses using the following criteria: (1) consideration of benefits as well as costs (or a focus on cost-effectiveness), (2) leveraging established processes and institutions, and (3) leveraging the expertise of small business to identify problems/solutions. Particularly valuable are reforms that aim to eliminate barriers to entry for nascent firms. Such a targeted policy is likely to benefit "opportunity" entrepreneurs to yield economic gains that have a positive effect on the broader economy and enhance US competitiveness.

About the Authors

Anna Williams is a dual master's degree student at Indiana University, graduating in May 2017 with a Master of Public Affairs from the School of Public and Environmental Affairs and a Master of European Affairs from the School of International Studies. Ms. Williams sits on the Indiana University Board of Trustees where she acts as legal owner for the university's financial, physical, and human assets. She will join Eli Lilly and Company's Market Access and Strategy department following graduation.

Keith Belton is Founder and Principal of Pareto Policy Solutions, LLC, a policy analysis and advocacy firm based in Washington, DC. He holds a B.S. degree (chemistry) from the University of Maryland, and M.S. (environmental science), and Ph.D. (public policy) degrees from the George Washington University.

John Graham is Dean of the Indiana University School of Public and Environmental Affairs (SPEA), from 2001 to 2006 Dr. Graham served as the Senate-confirmed administrator of the Office of Information and Regulatory Affairs in the U.S. Office of Management and Budget. In this capacity, he was responsible for federal regulatory, information and statistical policies. He holds a BA degree (politics and economics) from Wake Forest University, an MA degree (public affairs) from Duke University and a Ph.D. degree (public affairs) from Carnegie-Mellon University.

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Appendix: Reforms of Specific Regulations

This Appendix presents a list and summary of the most significant regulatory reform efforts of the last decade, many of which affect small businesses. From this list, we chose five final regulations to serve as case studies.

The regulation search included (1) identification of the largest quantified burden- reducing final regulations in the most recent ten-year period, (2) identification of the most successful SBA OA efforts to reduce burden on small business in the most recent ten-year period, and (3) identification of successful retrospective review efforts from agency annual plans on retrospective review under the Obama Administration.

Largest Quantified Burden-Reducing Final Rules

These final rules were identified using the American Action Forum web tool, Reg Rodeo. AAF (a Republican think tank) compiles its Reg Rodeo entries from a daily reading of the *Federal Register*. Only final rules and approved ICRs are included in Reg Rodeo, along with the agency-quantified cost or paperwork burden hours (positive or negative). Reg Rodeo only focuses on regulatory costs or burden that are quantified; it does not look at benefits.

For each year, we selected the top-two burden-reducing final rules. These final agency actions may be due to Congressional mandate, a court decision, or administrative discretion. The specific final rule may or may not have a significant impact on small business or state and local government.

USDA AMS. Removal of Mandatory Country of Origin Labeling for Beef and Pork Muscle Cuts, Ground Beef, and Ground Pork, 81 FR 10755. March 2, 2016. (Congress repealed this program; hence, this action.)

USDA FNS. Meal Pattern Revisions Related to the Healthy, Hunger-Free Kids Act of 2010. 81 FR 24348. April 25, 2016.

DOT PHMA. Hazardous Materials: Requests for the Safe Transport of Bulk Explosives (RRR), 80 FR 79424. December 21, 2015.

DOT FMCSA. Electronic Logging Devices and Hours of Service Supporting Documents. 80 FR 78292. December 16, 2015.

HHS CMMS. Medicare and Medicaid Programs; Regulatory Provisions to Promote Program Efficiency, Transparency, and Burden Reduction, Part II. 79 FR 27106. May 12, 2014.

DOT FMCSA. Inspection, Repair, and Maintenance: Driver-Vehicle Inspection Report (DVIR). 79 FR 75437. December 18, 2014.

Department of Education. Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 78 FR 65768. November 1, 2013.

EPA. National Emission Standards for Hazardous Air Pollution for the Portland Cement Manufacturing Industry and Standards of Performance for Portland Cement Plants, 78 FR 10006. February 12, 2013.

HHS CMMS. Medicare and Medicaid Payment Programs; Reform of Hospital and Critical Access Hospital Conditions of Participation, 77 FR 29034. May 16, 2012.

HHS CMMS. Medicare and Medicaid Programs; Regulatory Provisions to Promote Program Efficiency, Transparency, and Burden Reduction, Part I. 77 FR 29002. 2012.

EPA. Oil Pollution Prevention; Spill Prevention, Control, and Countermeasures (SPCC) Rule – Amendments for Milk and Milk Product Containers. 76 FR 21652. 2011.

HHS CMMS. Medicare and Medicaid Programs; Changes to the Ambulatory Surgical Center Patient Rights Conditions for Coverage; etc. 76 FR 65886. October 24, 2011.

SEC. Indexed Annuities, 75 FR 64642. October 20, 2010. (The courts vacated this rule; hence this action removing the regulation from the CFR.)

DOT PHMSA. Hazardous Materials: Risk-Based Adjustment of Transportation Security Plan Requests, 75 FR 10974. March 9, 2010.

EPA. Operating Permit Programs: Flexible Air Permitting Rule, 74 FR 51418. October 6, 2009.

EPA. Oil Pollution Prevention; Spill Prevention, Control, and Countermeasures (SPCC) Rule – Amendments, 74 FR 58784. November 13, 2009.

USDA Forest Service. National Forest System Land Management Planning, 73 FR 21468. April 21, 2008. (The courts directly influenced this final rule.)

EPA. Oil Pollution Prevention; Spill Prevention, Control, and Countermeasures (SPCC) Rule Requirements – Amendments, 73 FR 74236. December 5, 2008.

NRC. Occupational Dose Records, Labeling Containers, and the Total Effective Dose Equivalent, 72 FR 68043. December 4, 2007.

FDA. Petition to Request an Exemption from 100 Percent Identity Testing of Dietary Ingredients, etc. 72 FR 34959. June 25, 2007. (interim final rule).

DOT PHMSA. Hazardous Materials: Harmonization with the UN Recommendations, International Maritime Dangerous Goods Code, and International Civil Aviation Organization's Technical Instructions, 71 FR 78596. December 29, 2006.

SEC. Mutual Fund Redemption Fees, 71 FR 58257. October 3, 2006.

SBA Office of Advocacy – Annual Success Stories

These final actions were identified from a review of SBA Office of Advocacy's (SBA OA) annual reports. For each annual report, two of the largest quantified burden-reducing final actions were chosen. Note that the quantification used by SBA OA (1) could come from the agency or come from a third-party, (2) reflect only reductions in small business burden, and (3) typically focus on changes made between proposed and final action or even prior to the proposal. In many cases, the final action increases burden on small business, but less so than the chosen baseline.

EPA. Underground Storage Tank Regulations—Revisions to Existing Requirements and New Requirements for Secondary Containment and Operator Training, 80 FR 41566. July 15, 2015.

EPA. Definition of Solid Waste. 80 FR 1694. January 13, 2015.

EPA. Effluent Limitations Guidelines and Standards for the Construction and Development of Point Source Category. 79 FR 12661. March 6, 2014.

HHS CMMS. Medicare and Medicaid Programs; Home Health Prospective Payment System Rate Update for CY2014, Home Health Quality Reporting Requirements, and Cost Allocation of Home Health Survey Expenses, 78 FR 72256. December 2, 2013.

EPA. Commercial and Industrial Solid Waste Incineration Units: Reconsideration and Final Amendments; Nonhazardous Secondary Materials that are Solid Wastes, 78 FR 9112. February 7, 2013.

EPA. NESHAP for Reciprocating Internal Combustion Engines; NSPS for Stationary Internal Combustion Engines, 78 FR 6674. January 30, 2013.

DOT FMCSA. Hours of Service of Drivers. 76 FR 248. December 27, 2011.

EPA. Final NPDES General Permit for Stormwater Discharge from Construction Activities. February 29, 2012. (This is a notice of final permit issuance; it is not a final rule.)

DOJ. Nondiscrimination on the basis of Disability by Public Accommodations and in Commercial Facilities. 75 FR 56236. September 15, 2010.

EPA. Lead; Clearance and Clearance Testing Requirements for the Renovation, Repair, and Painting Program, 76 FR 47918. August 5, 2011.

EPA. Effluent Limitations Guidelines and Standards for the Construction and Development Point Source Category. 74 FR 62996. December 1, 2009.

FAA. Production and Airworthiness Approvals, Part Marking, and Miscellaneous Amendments. 74 FR 53368. October 16, 2009.

HUD. Real Estate Settlement Procedures Act (RESPA): Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs; Withdrawal of Revised Definition of "Required User", 74 FR 22822. May 15, 2009.

EPA. Oil Pollution Prevention;; Spill Prevention, Control, and Countermeasures Rule – Amendments, 73 FR 74236. December 5, 2008. (SBA OA refers to this final rule as SPCC II.)

EPA. Oil Pollution Prevention;; Spill Prevention, Control, and Countermeasures Rule – Amendments, 71 FR 77266. December 26, 2006. (SBA OA refers to this final rule as SPCC I.)

FCC. Informal Compliant No. 08-S001991. Denying QWEST Petition for Forbearance. July 25, 2008. (This is an FCC order; not a final rule.)

DoD, GSA, and NASA. Federal Acquisition Regulation; FAR Case 2006-007, Contractor Code of Business Ethics and Conduct. 72 FR 65873. November 23, 2007.

HHS CMMS. Medicare and Medicaid Programs; Reporting Outcome and Assessment Information Set Data as part of the Conditions of Participation for Home Health Agencies, 70 FR 76199. December 23, 2005.

EPA. RCRA Burden Reduction Initiative. 71 FR 16862. April 4, 2006.

Selected Completed Reforms Listed in Agency Retrospective Review Plans

We reviewed the latest (July 2016) retrospective review plans from all cabinet agencies plus EPA, GSA, SBA, and SSA. We selected "completed" final rules that were not related to federal benefit programs and/or were not aimed at reducing burden only for federal agencies. The list below represents burden-reducing final rules as a result of President Obama's retrospective review efforts. For the most part, these are relatively small burden reductions. It is possible that some of these may increase net burden as we only reviewed the description in the agency plans; we did not review the accompanying RIA or ICR.

USDA FSIS. Electronic Import Inspection Application and Certification of Imported Products and Foreign Establishments; Amendments to Facilitate the Public Health Inspection System and Other Changes to Import Inspection Regulations. 79 FR 56220. September 19, 2014.

DoD. Defense Federal Acquisition Regulation Supplement; Defense Trade Cooperative Treaties with Australia and the United Kingdom. 78 FR 36108. June 17, 2013.

DOE. Energy Conservation Programs; Test Procedures for Residential Clothes Washers. 77 FR 13888. March 7, 2012.

HHS FDA. Implementation of Device Registration and Listing Requirements Enacted in the Public Health Security and Bioterrorism Preparedness and Response Act of 2002, etc. 77 FR 45927. August 2, 2012.

HHS FDA. Amendments to Sterility Test Requirements for Biological Products. 77 FR 26162. May 3, 2012.

HHS FDA. Revocation of General Safety Testing Requirements that are Duplicative of Requirements in Biologics License Applications. 80 FR 37971. July 2, 2015.

HHS FDA. Removal of Review and Reclassification Procedures for Biological Products Licensed Prior to July 1, 1972, Technical Amendment. 81 FR 45409. July 14, 2016.

HHS. Removing Outmoded Regulations Regarding the Smallpox Vaccine Injury Compensation Program. 81 FR 62817. September 13, 2016.

DOT FAA. Acceptance Criteria for Portable Oxygen Concentrators Used Onboard Aircraft. 81 FR 33498. May 24, 2016.

DOT FAA. Reciprocal Waivers of Claims for Licensed or Permitted Launch and Reentry Activities. 81 FR 55115. August 18, 2016.

DOT FAA. Changes to the Application Requirements for Authorization to Operate in Reduced Vertical Separation Minimum Airspace. 81 FR 47009. July 20, 2016.

DOT FRA. Safety Glazing Standards. 81 FR 6775. February 9, 2016.

EPA. Electronic Reporting under the Toxic Substances Control Act. 78 FR 72818. December 4, 2013.

EPA. Air Quality: Widespread Use for Onboard Refueling Vapor Recovery and Stage II Waiver. 77 FR 28772. May 16, 2012.

EPA. Hazardous Waste Management System; Modification of the Hazardous Waste Manifest System; Electronic Manifests. 79 FR 7518. February 7, 2014.

EPA. Emergency Planning and Notification; Emergency Planning and List of Extremely Hazardous Substances and Threshold Planning Quantities. 77 FR 16679. March 22, 2012.

EPA. Lead-Based Paint Programs; Amendment to Jurisdiction-Specific Certification and Accreditation Requirements and Renovator Refresher Training Requirements. 81 FR 7987.

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Policy Research

1001 Connecticut Ave. NW, Suite 620 | Washington, DC 20036-5590
t. 202.293.5811 | info@accf.org | www.accf.org