

Prepared Statement of Paul J. Ray

How Our Regulatory System Fails Small Business

Before the House Committee on Small Business

October 19, 2023

Chairman Williams, Vice Chairman Luetkemeyer, and distinguished members of the Committee, thank you for inviting me to testify today on the effects of regulation on small business. I am the Director of the Heritage Foundation’s Roe Institute for Economic Policy Studies, where we focus on research and education about economic and regulatory issues. The views I express here are my own rather than the official views of the Heritage Foundation. From June 2018 through January 2021, I served in the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB); for the last year of that period I had the honor to serve as Administrator of the office. In this capacity I oversaw the federal regulatory system. Before that I served as Counselor to the U.S. Labor Secretary and practiced administrative appellate law at Sidley Austin LLP here in Washington.

In many ways, small businesses are the quintessential American enterprise and define the American workplace. The vast majority of American businesses are small.¹ These small businesses create an enormous number of jobs. A little less than half of all Americans work at a small business,² and two of every three new jobs in the United States over the last twenty-five years have been created by small businesses.³ They also generate a vast amount of wealth. Some 44% of U.S. GDP is the fruit of small business activity.⁴ But small businesses offer much more than employment and productivity, as vital as these are. For millions of Americans, opening a small business is a way to achieve agency in their own lives—a way to provide for themselves and their families and serve their customers and communities by dint of their own ingenuity and effort. For this reason we can even say that small business is a school of self-government, offering Americans the chance to develop the practical wisdom they need to carry out their duties as citizens.

The U.S. regulatory system fails small businesses, their owners, and their employees by undermining the rule of law. Rule-of-law values enable small businesses to create jobs, increase production, and make a positive difference in the lives of their customers and communities,⁵ so the administrative system’s failure hinders the ability of small business to achieve all these vital

¹ U.S. Small Business Administration, Office of Advocacy, *Frequently Asked Questions* (March 2023), <chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://advocacy.sba.gov/wp-content/uploads/2023/03/Frequently-Asked-Questions-About-Small-Business-March-2023-508c.pdf>.

² *Id.*

³ See Daniel Wilmoth, *Small Business Facts: Small Business Job Creation* (April 2022), <chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://advocacy.sba.gov/wp-content/uploads/2022/04/Small-Business-Job-Creation-Fact-Sheet-Apr2022.pdf>.

⁴ *Frequently Asked Questions*, *supra* n. 1.

⁵ See, e.g., Lon Fuller, *The Morality of Law* 9 (rev. ed. 1969) (the rule of law enables lives of effective agency).

goals. My focus in these remarks is on the regulatory system as a whole rather than on the substance of any particular regulation, and on how the system affects small business specifically rather than business or the regulated public generally.⁶

I. Rapid Change, Unpredictable Demands

In the *Federalist*, James Madison explained that constant changes to governing law—what he calls “a mutable policy”—“poisons the blessing of liberty itself.”⁷ “It will be of little avail to the people,” he tells us, “that the laws are made by men of their own choice, if ... they be repealed and revised before they are promulgated, or undergo such incessant changes that no man, who knows what the law is to-day, can guess what it will be to-morrow.”⁸ Among the many ills created by a mutable policy is

the unreasonable advantage it gives to the sagacious, the enterprising, and the moneyed few over the industrious and uninformed mass of the people. Every new regulation concerning commerce or revenue, or in any way affecting the value of the different species of property, presents a new harvest to those who watch the change, and can trace its consequences; a harvest, reared not by themselves, but by the toils and cares of the great body of their fellow-citizens.⁹

Madison argued that the proposed Constitution contained safeguards to prevent the mutability which plagued state laws at the time.¹⁰

As Madison’s remarks suggest, stable laws are of immense importance to small business. Small businesses need to be able to predict what the law will permit and prohibit in the future so they can make plans and investments today to prepare for that future. Likewise, they need to know the compliance costs the law will impose on them in the future so they can budget for new hires, equipment, materials, etc. Knowledge of the law’s future requirements sets small

⁶ For this reason I do not discuss issues, such as agency compliance with principles of cost-benefit analysis, which affect small and large businesses in more or less the same ways. For the same reason I do not discuss the recent amendments to Executive Order 12866, *see* E.O. 14094, 88 Fed. Reg. 21879 (Apr. 6, 2023), or the proposed amendments to OMB Circular A-4, *see Request for Comments on Proposed OMB Circular No. A-4, “Regulatory Analysis,”* 88 Fed. Reg. 20915 (Apr. 7, 2023).

⁷ Alexander Hamilton, John Jay, & James Madison, *The Federalist* No. 62, 400 (Modern Library ed. 2000).

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* at 394-401.

businesses up for productivity, and it also enables their owners and employees to exercise agency effectively rather than merely responding to the government’s initiative.¹¹ Further, small businesses often lack access to the high-priced counsel and strategists that enable larger businesses to respond effectively to, and even take advantage of, regulatory changes. Indeed, small businesses often find it difficult even to learn of regulatory changes. Regulatory changes therefore tend to place small businesses at a competitive disadvantage vis-à-vis their larger peers.¹²

These points were brought home to me during my service at OIRA. I recall asking a leader of the small business community which regulatory rescissions had most benefited small business. He responded that, more than any one regulatory change, the knowledge that new regulatory burdens would not be added to small businesses for some years—that the regulatory environment was stable—encouraged small businesses to ramp up hiring and production.

Our regulatory system fails to give small businesses the stability they need to grow and thrive. Regulations in the United States change at a dizzying pace. The Federal Register publishes hundreds of pages of new regulations, amendments to existing regulations, and other administrative materials every business day.¹³ On many issues of key importance to small businesses, such as labor, regulations undergo sweeping changes with every alteration in White House control.¹⁴ The rapidity of regulatory change often bears no relation to changes in the real-world circumstances that businesses face. And while principles of administrative law modestly protect the reliance interests that small businesses, among others, build up around existing regulations,¹⁵ these protections generally operate on a regulation-by-regulation basis rather than with respect to the regulatory ecosystem considered as a whole. But more than the prospect of

¹¹ See Fuller, *supra* n. 5, at 37.

¹² See, e.g., Small Business Administration, Office of Advocacy, *Reforming Regulations and Listening to Small Business* 3, 11 (Apr. 2020), <chrome-extension://efaidnbmnnnibpcajpcgclefindmkaj/https://advocacy.sba.gov/wp-content/uploads/2020/04/2nd-Progress-Report-on-Reg-Reform-Roundtables.pdf> (reporting small business concerns about “[h]igh costs associated with changing regulatory requirements” and noting that small “businesses have “fewer resources for regulatory compliance”).

¹³ See Federal Register, *Federal Register & CFR Statistics* (accessed Oct. 12, 2023), chrome-extension://efaidnbmnnnibpcajpcgclefindmkaj/https://uploads.federalregister.gov/uploads/2023/02/23171002/2022_Aggregated_Charts.pdf (more than 60,000 pages published in the Federal Register every year from 2013 through 2022).

¹⁴ Examples include regulations governing independent contractor and joint employer status as well as the overtime threshold.

¹⁵ See, e.g., *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 156 (2012) (refusing deference to agency interpretation that would have created an “unfair surprise”).

change to any one rule, it appears to be the mutability of the regulatory system as a whole that impedes small business growth.

The reasons for our regulatory instability are many, but two are worth noting here. First, the regulatory process makes it relatively easy to issue, amend, and rescind regulations. The legislative process is famously difficult; this difficulty of course can present its own problems, but it comes with an important benefit: legislation once enacted is difficult to change or repeal, so small businesses can act and plan in reliance on it. But regulations can be changed by the simple expedient of issuing a notice of proposed rulemaking, receiving and evaluating comments from the public, and then issuing a final rule.¹⁶ Sometimes agencies claim that emergency circumstances justify them in laying aside even these modest procedural requirements. Even easier is the process for issuing guidance: agencies can release guidance with no previous notice to the regulated public and need not provide opportunity for public input. (While guidance is often labeled as non-binding, often failure to comply with it comes with a materially increased risk of enforcement, such that regulated parties feel strong incentives to comply.)

Second and relatedly, while new legislation requires consensus by hundreds of legislators pursuing disparate interests,¹⁷ new regulations require the consensus of few officials—indeed, in the last analysis, of only one.¹⁸ Further, the officials with prime responsibility for new regulations are all typically appointed by the same President and hence (unlike in Congress) share large agreement about policy values and measures. When the White House changes control, these officials likewise change. As Madison put it, from “this change of men must proceed a change of opinions; and from a change of opinions, a change of measures.”¹⁹

From the perspective of a critical mass of small business owners and workers, often regulatory stability may be more important than even beneficial regulatory changes at undue frequency. But the regulators—whether career staff or political appointees—do not themselves have to live under the regulations they issue. They lack the “communion of interests and sympathy of sentiments” with the people that Madison and other founders thought so important.²⁰ Their perspective therefore tends—even with all the goodwill in the world—to shortchange the importance of stability and overemphasize the worth of the policy changes they pursue.

¹⁶ See 5 U.S.C. 553.

¹⁷ See, e.g., *The Federalist* No. 10, *supra* n. 7, at 60.

¹⁸ This number is slightly higher (two or three) for independent, multi-member commissions.

¹⁹ See, e.g., *The Federalist* No. 62, *supra* n. 7, at 399.

²⁰ *Id.* No. 57, 367.

II. Obscurity

A second major way the regulatory system fails small businesses is by issuing numerous, complex, and sometimes inaccessible regulations that, on account of these features, are at times practically impossible for anyone but the most sophisticated parties to understand. This regulatory obscurity makes it difficult for small businesses to plan and operate effectively, depressing job creation and productivity and restricting small business owners' ability to put their ingenuity and initiative to work.²¹

The problem of legal obscurity is not a new one. In his first annual message to Congress, President Lincoln, after touching on matters affecting the war, urged Congress to simplify the federal laws, which at the time “fill[ed] more than six thousand closely printed pages.”²² He worried that so extensive a body of laws contained provisions “often obscure in themselves, or in conflict with each other, or at least so doubtful as to render it very difficult for even the best informed persons to ascertain precisely what the statute law really is.”²³

Today's federal statutes exceed by an order of magnitude those in effect in Lincoln's day.²⁴ But regulations are more abundant still: the Code of Federal Regulations, which houses the collection of permanent federal regulations, totals some 185,000 pages²⁵; that is about three regulatory pages for every statutory page. And this figure does not count the many, many pages of regulatory preambles, precedential adjudications, and guidance documents, none of which appear in the Code of Federal Regulations. The magnitude of this body of secondary regulatory documents is difficult to exaggerate; for instance, a single agency, the Department of Labor, offers some 9,600 guidance documents on its online guidance portal, and this figure does not include precedential adjudications or regulatory preambles.²⁶ Unlike the provisions in the Code

²¹ See Fuller, *supra* n. 5, at 36 (obscurity undermines the rule of law).

²² Abraham Lincoln, Annual Message to Congress 279, 286 (Dec. 3, 1861) in *Abraham Lincoln: Speeches and Writings, 1859-1865* (1989).

²³ *Id.*

²⁴ See, e.g., GovInfo, GPO Produces U.S. Code with New Digital Technology (Sept. 23, 2019), <https://www.govinfo.gov/features/uscode-2018#:~:text=The%20U.S.%20Code%20is%20a,of%20the%20Law%20Revision%20Counsel> (noting that the U.S. Code is approximately 60,000 pages long).

²⁵ See Federal Register, *supra* n. 13 (188,343 Code of Federal Regulations pages in 2021).

²⁶ See Guidance Search, available at <https://www.dol.gov/guidance> (accessed Oct. 12, 2023).

of Federal Regulations, secondary regulatory documents can be found all over agency websites and, in some cases, can be inspected only for a fee or in person.²⁷

To be sure, most regulations do not apply to most businesses; no small business owner needs to know the vast majority of regulations. Nevertheless, the magnitude and dispersal of federal regulations can make it hard for small business owners, who often cannot afford to retain counsel with deep regulatory expertise, to know where to begin to learn the standards that apply to them.²⁸ Further, some of the bodies of regulations covering specific topics relevant to small businesses are quite large. For instance, the regulations governing just overtime payments, which affect a vast number of small businesses, run some seventy-two pages even excluding guidance and other interpretive documents.²⁹ And small businesses often find themselves subject to equal employment opportunity statutes, with their many pages of Equal Employment Opportunity Commission guidance.

While agencies promulgate and amend regulations with vigor, the same cannot be said for updating or rescinding regulations that have been overtaken by events. Neglected regulations accumulate over time, forming an obscure hodge-podge that the regulators themselves would not have chosen. When this happens, small businesses facing long-abandoned regulations must choose whether to tie up time and other resources in likely-meaningless compliance or risk non-compliance.

Some of the causes for regulatory obscurity are the same as those covered in the preceding Part. Another cause is the union in the same agencies of policy-setting and enforcement powers. The conjunction of these two powers gives policy-setting officials the opportunity to issue guidance, preambles, and other secondary regulatory material that claim to lack legal effect but to which the enforcement offices can nevertheless be expected to give considerable weight. This dynamic seems to have fostered the proliferation of secondary regulatory material in a wide variety of locations outside the Code of Federal Regulations.

Further, agencies lack incentives to rescind regulations that no longer respond effectively to present-day conditions. Agencies have limited resources; absent strong external constraints, they tend to spend these resources responding to the day's most salient problems (as identified either by themselves or by political direction from the White House) rather than on revisiting regulations issued in response to yesterday's problems. While Congress has attempted to supply

²⁷ See Emily S. Bremer, "Incorporation by Reference in an Open-Government Age," 36 *Harvard Journal of Law & Public Policy* 131, 181-82 (2013) (discussing costs for acquiring standards incorporated by reference).

²⁸ See Small Business Administration, Office of Advocacy, *supra* n. 12, at 9 (reporting small business concerns about regulations "that run to hundreds of pages, and which require advanced legal and technical background to understand).

²⁹ See 29 CFR pt. 778.

such an external constraint, in the form of the Regulatory Flexibility Act's requirement of retrospective review,³⁰ that requirement has proven largely ineffective.

III. Regulatory Enforcement

No discussion of the regulatory system's impact on small business can be complete without coverage of regulatory enforcement. Enforcement issues bear powerfully on rule-of-law values for many reasons. Among them is that, because administrative investigations precede an agency's determination that a violation has occurred, even perfectly compliant small businesses may find themselves under investigation. The same is true with respect to administrative adjudications, which are sometimes commenced against parties ultimately found to be in compliance. This matters because investigative and adjudicatory proceedings themselves can be immensely costly. This is true especially for small businesses. Unlike their larger peers, small businesses often do not have the flexibilities to devote significant staff time to correspondence with agency officials and appearances before administrative tribunals, and they may not have access to high-caliber counsel to help them through investigations and represent them in adjudications. The upshot is that small businesses may not be able to bear the costs of investigations and adjudications as efficiently as their larger peers.³¹ For small businesses in particular, then, it is important that investigations and adjudications limit their imposition of costs in time, effort, and expense.

Agencies have extremely broad discretion when conducting investigations and prosecuting violations. The Administrative Procedure Act has little to say on point,³² and other sources of law likewise leave agencies with very large discretion. The result is sometimes agency investigations that impose heavier burdens on their targets than an adverse adjudication would have done. For instance, consider the Boucher family, Indiana farmers who cut down nine trees on a portion of their own land which the U.S. Department of Agriculture suspected might be a wetland.³³ USDA initiated its investigation some eight years after the first trees were cut down, and its investigation took more than ten years to complete.³⁴ The ability of such untimely and protracted investigations to upset reasonably formed expectations is immense. The prospect of unduly costly investigations and adjudications, even of compliant parties, further

³⁰ 5 U.S.C. 610. I discuss the retrospective review requirement further below.

³¹ See Small Business Administration, Office of Advocacy, *supra* n. 12, at 3 (for small businesses, the "cost of regulations is higher relative to available resources").

³² See 5 U.S.C. ch. 5, subch. II.

³³ See *Boucher v. U.S. Dep't of Agriculture*, 934 F.3d 530 (7th Cir. 2019).

³⁴ *Id.*

undermines the rule-of-law values necessary for small businesses to thrive and support their workers and communities.

IV. Promising Reforms

A. Addressing Mutability

The regulatory system was created partly to obtain flexibility to respond rapidly to changing circumstances.³⁵ Much of the potential for mutability, then, is baked into the system, and opportunities to remedy it are limited. Nevertheless, opportunities do exist.

Regulations are so mutable due chiefly to the expedition of the procedures by which they may be issued. Congress could counteract regulatory mutability by demanding more rigorous procedures for issuing regulations. One way it could do so would be to enact legislation like the Regulations from the Executive in Need of Scrutiny (REINS) Act.³⁶ The REINS Act would require affirmative congressional approval for the most important regulations, thus layering the robust deliberative procedures specified in Article I of the Constitution atop the much less stringent procedures employed by agencies. Passing the REINS Act would bring greater stability and accountability to the regulatory environment.

There are also more modest steps Congress could take to enhance regulatory stability. For instance, Congress could require advance notices of proposed rulemaking and advance consultation with potentially affected parties for important regulations, much as the Regulatory Accountability Act would have done.³⁷ The notice provided by publication of an ANPRM and consultations with affected parties would allow regulated parties longer lead time within which to alter their conduct to respond to the possibility of regulatory change. This longer time horizon is no substitute for regulatory durability, especially for small businesses which may not monitor the coverage generated by ANPRMs or participate in advance consultations, but nevertheless would represent a meaningful contribution toward addressing the problem of mutability.

B. Addressing Obscurity

Insofar as regulatory obscurity is the product of the very large number of federal regulations, the same ease of regulating which leads to the mutability problem also promotes

³⁵ See James Landis, *The Administrative Process* 69 (1938) (“The chief virtue of th[e] modern tendency toward delegation [to administrative agencies] is that it is conducive to flexibility—a prime quality of good administration. The administrative is always in session. Its processes operate with comparative rapidity.”)

³⁶ See, e.g., H.R. 277 (2023).

³⁷ H.R. 5 (2017). See in particular section 103(c) of the bill.

obscurity, and some of the remedies for the former would also address the latter. In this section I focus on remedies specific to the obscurity problem.

One major reason small businesses may struggle to learn the regulatory standards that apply to them is, as I have said, the fact that those standards cannot all be found in the Code of Federal Regulations, but rather are dispersed across many locations. Executive Order 13891,³⁸ issued in 2019, sought to address this problem by requiring each agency (or agency component) to place all its guidance on a single, searchable website.³⁹ By bringing each agency's guidance together in a single place, E.O. 13891 made it significantly easier for small businesses to access these documents, helping to level the playing field between small businesses and their larger competitors. The Guidance Out of Darkness (GOOD) Act⁴⁰ would impose a similar requirement to similar effect.

E.O. 13891 also required each guidance document to contain a disclaimer informing the public of its non-binding character.⁴¹ Executive Order 13892 reinforced this requirement by forbidding agencies from relying on guidance to prove a violation.⁴² The Guidance Clarity Act⁴³ would likewise mandate a disclaimer that guidance does not bind at law. This approach would alleviate the obscurity problem, because it would inform small businesses (and other relatively unsophisticated parties) which standards are mandatory and which are not, helping small business owners and workers to understand precisely where they stand.

Yet another step Congress could take to bring much-needed regulatory clarity to small businesses is to require that (some or all) federal regulations expire after a specified period of time, subject to such exceptions as necessary to make the legislation workable and to provide for emergencies, unless the author agency finds through a new rulemaking process that the regulation remains necessary. As I have mentioned, Congress has already enacted a retrospective review requirement,⁴⁴ but this requirement has proven generally ineffective on account of its lack of enforceability against agencies, which hesitate to commit significant resources to retrospective review. A sunset provision would give the agencies the necessary

³⁸ 84 Fed. Reg. 55235 (Oct. 9, 2019).

³⁹ *Id.* at 55236, sec. 3.

⁴⁰ H.R. 890 (2023).

⁴¹ 84 Fed. Reg. at 55237, sec. 4.

⁴² 84 Fed. Reg. 55239, 55240, sec. 3 (Oct. 9, 2019).

⁴³ H.R. 4428 (2023).

⁴⁴ *See supra* at 8.

incentives to review their existing regulations and rescind or amend those that are no longer necessary or effective, clearing the field for small businesses' initiative and ingenuity.

C. Making Enforcement Fair and Predictable

Executive Order 13924 recognized the tight connection between fair administrative enforcement and small business growth.⁴⁵ Pursuant to that insight, the order set out a list of standards for fairness in enforcement and directed agencies to revise their procedures accordingly.⁴⁶ Congress could take a similar approach, either devising standards for agency enforcement itself or directing agencies to promulgate standards and then operate by them. Doing so would increase the ability of small businesses to rely on their compliance with existing law and regulations as protection against unreasonable costs in response to agency enforcement actions.

Conclusion

Our modern regulatory system's failure to uphold rule-of-law values impedes the ability of small business owners and workers to create jobs, increase productivity, and make a difference in the lives of their families and communities. Congress can take action to promote the rule of law for small business.

⁴⁵ 85 Fed. Reg. 31353, 31353-54, sec. 1 (May 19, 2020) (agencies "should give businesses, especially small businesses, the confidence they need to re-open by ... committing to fairness in administrative enforcement and adjudication").

⁴⁶ *Id.* at 31355, sec. 6.

APPENDIX

The Heritage Foundation is a public policy, research, and educational organization recognized as exempt under section 501(c)(3) of the Internal Revenue Code. It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work.

On information and belief, the Heritage Foundation is the most broadly supported think tank in the United States. During 2022, it had hundreds of thousands of individual, foundation, and corporate supporters representing every state in the U.S. Its 2022 operating income came from the following sources:

- Individuals 78%
- Foundations 17%
- Corporations 2%
- Program revenue and other income 3%

The top five corporate givers provided The Heritage Foundation with 1% of its 2022 income. The Heritage Foundation's books are audited annually by the national accounting firm of RSM US, LLP.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own and do not reflect an institutional position of The Heritage Foundation or its board of trustees.