

The Impact of Regulatory Costs on Small Firms

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Regulations are needed to provide the rules and structure for societies to properly function. This research, while mindful of this important fact, focuses on the costs imposed by federal regulations; it thus updates and verifies the finding of disproportionality in the burden imposed by federal regulations on small business. Previous research by the Office of Advocacy has established that regulatory and paperwork costs were found to be more onerous for small firms than larger firms.

Overall Findings

In the face of yet higher costs of federal regulations, the research shows that small businesses continue to bear a disproportionate share of the federal regulatory burden. The findings are consistent with those in Hopkins (1995), Crain and Hopkins (2001), and Crain (2005).

The research finds that the total costs of federal regulations have further increased from the level established in the 2005 study, as have the costs per employee. More specifically, the total cost of federal regulations has increased to \$1.75 trillion, while the updated cost per employee for firms with fewer than

20 employees is now \$10,585 (a 36 percent difference between the costs incurred by small firms when compared with their larger counterparts).

A caveat is necessary at this point. This current iteration of the study uses an index for the calculation of the economic regulations estimate that is wider and more encompassing than that previously used. While different from the previous index, it provides the study with a fuller estimate, thus partially remedying previous underestimates. More specifically, the Regulatory Quality Index from the World Bank used in this study has more observations and also has continuous data from 1998 to 2008. The OECD index used in the previous study (2005) was more limited in scope and had observations every five years. A significant increase in the new estimate is due to the new, more encompassing methodology. To obtain an idea of how much of the increase in the estimate of economic regulations was due to the new methodology, the authors ran the new index on the 2005 data, in effect re-estimating the 2005 model using the new index. The economic regulations increased from \$727 billion to \$1.172 trillion, a \$445 billion increase.

Annual Cost of Federal Regulations by Firm Size

Type of Regulation	Cost per Employee for All Firms	Cost per Employee for Firms with:		
		Fewer than 20 Employees	20–499 Employees	500 or More Employees
All Federal Regulation	\$8,086	\$10,585	\$7,454	\$7,755
Economic	5,153	4,120	4,750	5,835
Environmental	1,523	4,101	1,294	883
Tax Compliance	800	1,584	760	517
Occupational Safety and Health and Homeland Security	610	781	650	520

Source: *The Impact of Regulatory Costs on Small Firms*, by Nicole Crain and Mark Crain, 2010. U.S. Small Business Administration, Office of Advocacy (www.sba.gov/advo/research/rs371tot.pdf).

While the true costs of federal regulation have yet to be calculated, Advocacy research has repeatedly and consistently attempted to uncover an estimate of the burden in general, and the impact it has on small businesses, in particular. This current iteration of the research advances the scope, and attempts to make a dent in previous underestimates.

Highlights

- Environmental regulations appear to be the main cost drivers in determining the severity of the disproportionate impact on small firms. Compliance with environmental regulations costs 364 percent more in small firms than in large firms. The cost of tax compliance is 206 percent higher in small firms than the cost in large firms.
- The disproportionality of the burden borne by small firms, identified in previous Advocacy studies, is further validated in this instance. On a per-employee basis, it costs about \$2,830 more for small firms to comply than their larger counterparts. This straight difference translates into 36 percent. When compared with the 2005 study reflecting the new methodology, the disproportionality rate is lower. The current study basically finds that while there still is disproportionality borne by small business, there is slightly less disproportionality in the underlying distribution.
- This report details the distribution of regulatory costs for five major sectors of the U.S. economy: manufacturing, trade (wholesale and retail), services, health care, and other (a residual category containing all enterprises not included in the other four). The sector-specific findings reveal that the disproportionate cost burden on small firms is particularly stark for the manufacturing sector. The “other” category also deserves mention here as the disproportionality between small and large is stark. The compliance

Hopkins, Thomas D., 1995. *Profiles of Regulatory Costs*. U.S. Small Business Administration, Office of Advocacy. www.sba.gov/advo/research/rs1995hoptot.pdf.

Crain, W. Mark, and Thomas D. Hopkins, 2001. *The Impact of Regulatory Costs on Small Firms*. U.S. Small Business Administration, Office of Advocacy, www.sba.gov/advo/research/rs207_tot.pdf.

W. Mark Crain, 2005. *The Impact of Regulatory Costs on Small Firms*. U.S. Small Business Administration, Office of Advocacy, www.sba.gov/advo/research/rs264tot.pdf.

Johnson, Joseph M., 2005. “A Review and Synthesis of the Cost of Workplace Regulations,” in *Cross-Border Human Resources, Labor and Employment Issues*.

cost per employee for small manufacturers is more than double the compliance cost for medium-sized and large firms (110 percent and 125 percent, respectively). In the service sector, regulatory costs differ little between small businesses and larger firms. The distribution of the regulatory burden across firm sizes in the other major business sectors falls somewhere between these two cases.

Scope and Methodology

The report divides federal regulations into four categories: economic, environmental, tax compliance, OSHHS (occupational safety and health, and homeland security). The estimate of economic regulations is obtained by regressing the Regulatory Quality Index on gross domestic product per capita, and includes labor market economic regulations that were included in the workplace regulation column in previous reports. Second, gaps in the baseline are filled with Office of Management and Budget (OMB) estimates. The costs of workplace regulations are based on the updated estimates from the study by Joseph Johnson (2005). Homeland security cost estimates are based on OMB reports, as are environmental regulations estimates. Tax compliance costs, finally, are based on the 2005 report from the Tax Foundation. The allocation of costs across employment classes was made possible by use of Census data published by the Office of Advocacy.

This report was peer reviewed consistent with the Office of Advocacy’s data quality guidelines. More information on this process can be obtained by contacting the director of economic research at advocacy@sba.gov or (202) 205-6533.

Ordering Information

Research from the Office of Advocacy is online at www.sba.gov/advo/research. The url of the report is www.sba.gov/advo/research/rs371tot.pdf. Copies are available for purchase from:

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