

SMALL BUSINESS RESEARCH SUMMARY

The Impact of Regulatory Costs on Small Firms

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Purpose

In November 1995, Thomas Hopkins completed *Profiles of Regulatory Costs*, the first study for the Office of Advocacy calculating regulatory costs by firm size. At that time, regulatory and paperwork costs were found to be much more onerous on small firms than larger firms. The purpose of the new research was to update the study to see what, if any, changes had occurred, given legal and economic changes since publication of the first study.

Overall Findings

Small businesses bear a disproportionate share of the federal regulatory burden. This result is broadly consistent with the 1995 Hopkins report, as well as with other studies completed during the past two decades pursuant to the Regulatory Flexibility Act.

Total costs of federal regulations are estimated to be \$843 billion in 2000, of which \$497 billion fell on business and \$346 billion fell on consumers or other governments. For firms employing fewer than 20 employees, the annual regulatory burden is \$6,975 per employee—nearly 60 percent more than that of firms with more than 500 employees, at \$4,463 (see table.)

Regulatory developments and new data since the earlier study clarify and in some cases, amplify the basic 1995 findings: regulatory costs continue to increase and to disadvantage small businesses.

The Incidence of Federal Regulations by Firm Size, All Business Sectors (Dollars)

| Type of Regulation | Cost per Employee for Firms with: | |
|------------------------|-----------------------------------|----------------|
| | <20 Employees | 500+ Employees |
| All Federal Regulation | 6,975 | 4,463 |
| Environmental | 3,328 | 717 |
| Economic | 1,616 | 2,485 |
| Workplace | 829 | 698 |
| Tax Compliance | 1,202 | 562 |

Highlights

- Environmental regulations and tax compliance paperwork are particularly disproportionate in their effects on small businesses. Such regulations impose about 40 percent of the total business regulatory burden. Other regulatory burdens—workplace rules and constraints on pricing and the products firms can sell or buy (“economic” regulation)—are distributed more evenly.

- The report details the distribution of regulatory costs for four major business sectors: manufacturing, trade (wholesale and retail), services, and other (a residual comprising all other enterprises). The findings reveal that the disproportionate cost burden on small firms is particularly stark for the manufacturing sector. In that sector the cost per employee for small firms is more than double the cost for large

firms. In the trade sector (wholesale and retail businesses) the regulatory cost differential between small businesses and larger firms is not nearly so large—in the range of 11 to 18 percent. The disproportionate regulatory burden on small firms in the other major sectors falls between these two levels. No attempt is made to measure benefits in this study since they tend to be distributed over the entire population, whereas the costs fall disproportionately on small firms.

- The cost of economic regulations falls most heavily on large firms in two major sectors (manufacturing and other). The cost of workplace regulations falls most heavily on medium-sized firms, which most likely reflects the fact that many workplace regulations explicitly exempt small firms.

Scope and Methodology

Crain-Hopkins focused on direct effects from regulation and paperwork burdens falling on businesses (regulatory benefits are not evaluated).

Figures for the effect of environmental regulations were based on OMB estimates for the entire economy. For economic regulations, the researchers used figures from OECD and OMB as a basis. For tax compliance, they employed a 2000 report from the Tax Foundation.

Business regulatory costs were allocated into four industrial sectors: manufacturing, trade (wholesale and retail), services, and other (a residual comprising all other enterprises).

The next task involved allocating the costs of regulations into three size categories: firms with fewer than 20 employees (small), those with 20 to 499 employees (medium-sized), and firms with 500 or more employees (large). The specific allocation procedure differed for each type of regulation. The general methodology used regression analysis to estimate the relationship between costs per employee and firm size.

Comments from Advocacy

“Clearly, conditions have not improved for small businesses with the regulatory changes since the first Hopkins study,” said Acting Chief Counsel for Advocacy Susan Walthall. “The regulatory playing field is still tilted toward large and medium-sized businesses, particularly with environmental regulations and in the manufacturing sector. New ways of regulating need to be developed so that the burdens are more equally distributed. Otherwise, the entry of small business into regulated areas will be discouraged, competition will be reduced, and the innovative benefits of small firm entry will be lost.”

Ordering Information

For researchers in this area, the bibliography is outstanding. The complete report is available online at <http://www.sba.gov/advo/research> or from:

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