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The Impact of Regulatory Costs on Small Firms

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Purpose

This research updates and further delineates the disproportionality of the burden imposed by federal regulations on small business. Previous research by the Office of Advocacy, Hopkins (1995) and Crain and Hopkins (2001), has established that regulatory and paperwork costs were found to be more onerous on small firms than on larger firms.

Overall Findings

In the face of 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) and Crain and Hopkins (2001).

The research finds that the cost of federal regulations totals \$1.1 trillion; the cost per employee for firms with fewer than 20 employees is \$7,647.

Highlights

- 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 compliance cost per employee for small manufacturers is at least double the compliance cost for medium-sized and large firms. In the service sector, regulatory costs differ little from small to larger 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 \$2,400, or 45 percent, more for small firms to comply than their larger counterparts. The 2001 study, using a slightly different methodology, concluded that the disproportionality rate was higher—nearly 60 percent.

- Environmental and tax compliance 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 67 percent higher in small firms than the cost in large firms. In the aggregate estimates for all sectors, the cost per employee of economic regulations falls most heavily on large firms. The cost per employee of workplace regulations falls most heavily on medium-sized firms.

Type of Regulation	All Firms	Cost per employee for firms with:		
		<20 employees	20-499 employees	500+ employees
All Federal Regulations	\$ 5,633	\$ 7,647	\$ 5,411	\$ 5,282
Economic	\$ 2,567	\$ 2,127	\$ 2,372	\$ 2,952
Workplace	\$ 922	\$ 920	\$ 1,051	\$ 841
Environmental	\$ 1,249	\$ 3,296	\$ 1,040	\$ 710
Tax Compliance	\$ 894	\$ 1,304	\$ 948	\$ 780

Scope and Methodology

The report divides federal regulations into four categories: economic, workplace, environmental, and tax compliance. The two main components of economic regulation are estimated separately; the estimated costs of economic regulations affecting international trade are mainly derived from the report issued by the U.S. International Trade Commission in 2004. The costs of domestic economic regulations, in a significant shift from previous estimates, are first estimated by running a cross-country regression analysis based on data from the Organization for Economic Cooperation and Development. Secondly, 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 (Office of Advocacy, 2005). Environmental regulations estimates are mainly based on OMB reports. Tax compliance costs, finally, are based on the 2002 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.

In accordance with the OMB's and SBA's peer review guidelines, the report has been peer reviewed by three academics in this field of study. 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

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at www.sba.gov/advo/research.

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