1310 L Street, NW, 7th Floor
Washington, DC 20005
cei.org

202 331 1010 main
202 331 0640 fax

COMPETITIVE ENTERPRISE INSTITUTE
Advancing Liberty from the Economy to Ecology

The Disproportionate Burden of Federal Regulation on Small Businesses

James Broughel, PhD

Submission to the U.S. Senate Committee on Small Business & Entrepreneurship

Hearing on **"**One Size Does Not Fit All: Understanding the Importance of Rightsizing Regulations for Small Businesses"

Iowa Economic Development Authority
1963 Bell Ave
Des Moines, Iowa 50315

August 23, 2023

Chair Cardin, Ranking Member Ernst, and Members of the Senate Committee on Small Business and Entrepreneurship:

My name is James Broughel and I am a senior fellow with the Competitive Enterprise Institute, a non-profit public interest organization committed to advancing the principles of free markets and limited government. My research focuses on regulation, innovation, and economic dynamism. Thank you for the opportunity to submit this written statement on the disproportionate burden that federal regulation places on small businesses.

I have three main points I want to emphasize in this comment:

1. Regulations act as a hidden tax on the public. This tax is also very frequently regressive, meaning its impacts have particular relevance for both small businesses and the poor.
2. Empirical studies suggest the cost of regulation is in the trillions of dollars annually. This burden tends to fall disproportionately on the poor and small businesses, as well as future generations.
3. Regulatory impact analysis should include analysis of the distribution of benefits and costs, but in practice rarely does so. Improved certification procedures for identifying regressive regulations could improve analysis and, more importantly, improve regulatory outcomes for small businesses and society.

The Regressive Nature of Regulatory Costs

Regulation acts much like a tax that takes place off of the government's books. Much like a value added tax, it is a hidden tax on the economy, because the cost of regulation is built into all of the products and services we purchase and sell. Regulatory costs also tend to be regressive, meaning they fall disproportionally on lower income groups of people.[1] Several factors contribute to the regressive nature of regulation.

In the business context, regulation often requires firms to make certain expenditures or investments irrespective of their output or sales level.[2] Such mandatory costs do not vary with the quantity of output and thus become part of the fixed costs of doing business. Thus, a business must contend with them before entering into or continuing to operate in an industry. Smaller firms, with less revenue and lower output, tend to have a harder time absorbing these fixed costs compared to large firms, which can more easily amortize regulatory compliance activities across their more sizable revenue base.

Next, academic evidence suggests regulatory costs are often regressive in their final incidence.[3] Costs imposed on businesses will be passed on to individuals in the form of higher prices, to workers in the form of lower wages, and to shareholders in the form of reduced returns on capital. When these costs represent a larger share of a lower income person's budget than a higher income person, as is often the case, regulatory costs disproportionately burden poorer citizens.

Finally, the benefits of regulation often accrue disproportionately to higher income individuals.[4] The affluent exhibit a greater willingness to pay for regulatory outcomes like safety, environmental quality, carbon reduction, and consumer protections. This higher willingness to pay tends to skew regulatory benefits in their favor, as evaluated in a cost-benefit analysis. Meeting these preferences comes at a cost that is very often imposed regressively for the reasons just discussed. Thus, regulations often have the effect of redistributing from the relatively less well-off to the rich.

The High Burden of Regulatory Costs

The tendency of regulations to force low-income households to bear costs that only high-income households are willing to pay for is like forcing low income households to have champagne taste on a beer budget. This is according to University of Chicago economist Casey Mulligan, in a recent testimony before the House Oversight Committee.[5]

Analysis by Mulligan sheds light on how regulatory costs impact Americans.[6] In a recent report, Mulligan compared the regulatory records of the Biden, Trump, and Obama administrations. He found that, as of the end of 2022, the Biden administration was imposing new regulatory costs at a faster rate than the

---

[1] Diana W. Thomas. "Regressive Effects of Regulation." *Public Choice* 180 (2019): 1–10. https://doi.org/10.1007/s11127-018-00634-8.

[2] Thomas Hopkins. "A Survey of Regulatory Burdens." U.S. Small Business Administration, report number SBA-8029-OA-93 (1995); Thomas Hopkins. "Regulatory Costs in Profile." Center for the Study of American Business, Washington University, Policy Study Number 132 (1996).

[3] James B. Bailey, Diana W. Thomas, and Joseph R. Anderson. "Regressive Effects of Regulation on Wages." *Public Choice* 180, (2019): 91–103. https://doi.org/10.1007/s11127-018-0517-5.

[4] Ibid.

[5] Testimony of Casey B. Mulligan. Hearing on "Death by a Thousand Regulations: The Biden Administration's Campaign to Bury America in Red Tape." Committee on Oversight and Accountability, U.S. House of Representatives (June 14, 2023). https://oversight.house.gov/hearing/death-by-a-thousand-regulations-the-biden-administrations-campaign-to-bury-america-in-red-tape/.

[6] Casey B. Mulligan. "Burden is Back: Comparing Regulatory Costs between Biden, Trump, and Obama." *Committee to Unleash Prosperity* (June, 2023). https://committeetounleashprosperity.com/wp-content/uploads/2023/06/CTUP_BurdenisBack_ComparingRegulatoryCosts.pdf.

Obama administration did in a comparable period. Biden's regulations are estimated to impose costs on Americans of almost $10,000 per household.[7]

Meanwhile, Mulligan's report argues that federal agencies significantly understate regulatory costs by overlooking opportunity and resource costs. Compounding matters, the Biden White House is currently attempting to phase out consideration of the opportunity costs of investment from federal regulatory impact analysis.[8] Even assuming agency cost estimates are correct, the report concludes that the Biden administration is adding regulatory costs at a rate of over $600 billion per year.

If this pace continues over eight years at the rate seen under Obama, it would amount to almost $60,000 per household in added costs. To many, that will be a crushing burden. The Trump administration's deregulation efforts worked in the opposite direction, reducing regulatory costs by about $11,000 per household over 4 years.

The Growing Burden of Regulatory Costs: Regulations Slow Economic Growth

A review of recent academic literature indicates that regulations substantially reduce economic growth, though estimates vary by how much. According to a 2021 survey of cross-country research conducted by Robert Hahn and me,[9] the academic consensus among studies is that economic regulations like price controls and barriers to entry hamper growth, while the effects of social regulations are more ambiguous largely because they haven't been studied to the same extent.

A 2020 study estimates that the accumulation of federal regulations since 1980 lowered U.S. GDP growth by around 0.8 percentage points per year, reducing 2012 GDP by $4 trillion or 25% below what it would otherwise have been.[10] A study by my CEI colleague Wayne Crews estimates the annual cost of federal regulations at around $1.9 trillion.[11] Another published paper by John Dawson and John Seater estimates that the total accumulation of federal regulations from 1949 to 2005 reduced U.S. output growth by 2 percentage points annually, lowering GDP to just 28% of what it could have been by 2005–a $38.8 trillion loss.[12]

Meanwhile, one 2023 study by Shikhar Singla estimated that annual regulatory costs faced by US firms increased by $1 trillion from 1970 to 2018.[13] The paper finds that regulatory costs have disproportionately impacted small firms, with an average cost per employee of $9,093 compared to $5,246 for large firms. These figures are broadly consistent with other studies that have also found the

---

[7] Note that these costs will tend to be spread across time.
[8] James Broughel. "Biden Knocks Opportunity Cost." *Wall Street Journal* (August 11, 2023).
[9] James Broughel and Robert W. Hahn. "The Impact of Economic Regulation on Growth: Survey and Synthesis." *Regulation & Governance* 16, no. 2 (2021): 448–69. https://doi.org/10.1111/rego.12376.
[10] Bentley Coffey, Patrick A. McLaughlin and Pietro Peretto. "The Cumulative Cost of Regulations." *Review of Economic Dynamics* 38 (2020): 1–21. https://doi.org/10.1016/j.red.2020.03.004.
[11] Wayne Crews. "Ten Thousand Commandments 2022." *Competitive Enterprise Institute* (2022). https://cei.org/studies/ten-thousand-commandments-2022/.
[12] John W. Dawson and John J. Seater. "Federal Regulation and Aggregate Economic Growth." *Journal of Economic Growth* 18 (2013): 137–77. https://doi.org/10.1007/s10887-013-9088-y.
[13] Shikhar Singla. "Regulatory Costs and Market Power." *DFG Center for Advanced Studies on the Foundations of Law and Finance*, LawFin Working Paper No. 47 (2023). https://shikharsingla.com/files/reg.pdf.

cost of regulation per employee to be higher for smaller firms than larger ones.[14] Not surprisingly, over regulation was the top concern among CEOs in a 2018 Price Waterhouse Coopers survey.[15]

The 2023 Singla paper shows that increases in regulatory costs can have harmful effects on competition, leading to small firms becoming smaller and large firms becoming larger.[16] For example, a 100% increase in regulatory costs leads to a 1.2-1.9% increase in establishments, employees and wages for large firms, while decreasing those metrics by 1.4-1.6% for small firms. The smaller the firm, the more competitively disadvantaged it becomes. The highest regulatory costs are found to be from environmental and transportation regulations. Overall, the disproportionate impact of regulations on small firms explains 31-37% of the rise in industry concentration and markups during the study period.

The empirical literature indicates regulations can impose a significant drag on measurable economic growth, compounding to trillions of dollars over time. Moreover, these costs fall disproportionately on small businesses. More careful analysis of new regulations for their impacts on investment, innovation, competition, and total factor productivity, combined with reforms to streamline inefficient rules, could yield sizable economic gains, especially for small businesses. Unfortunately, the current state of regulatory economic analysis leaves much to be desired.

Distributional Analysis Can Help Identify Impacts on Small Businesses

The Biden administration is now in the process of updating the federal government's guidance to executive agencies on the production of regulatory impact analysis.[17] There is much to dislike about the update, as it creates too much analytical discretion that will make the economic analysis of regulatory actions all but meaningless.[18] I am on record as being a critic of the administration's updates.[19] As I noted in a recent comment to OMB, "It is the equivalent of basing analysis on Scientology or some related pseudoscience."[20]

Criticisms aside, however, there are actually some things to like in the Biden administration's update, and one such area is an increased focus on the distribution of benefits and costs. More disaggregation of benefits and costs to focus on the parties actually impacted by regulation—if it were done objectively—would be a welcome development. It is very likely that small businesses should be singled out for distributional analysis purposes and that such analyses would often uncover that small businesses are disproportionately impacted by regulations.

---

[14] See Wayne Crews. "Ten Thousand Commandments 2022," at 33, as well as the referenced studies on p. 31.
[15] Price Waterhouse Coopers. "2018 Global Investor Survey." (2018). https://www.pwc.com/gx/en/news-room/docs/report-pwc-global-investor-survey-2018.pdf.
[16] Shikhar Singla. "Regulatory Costs and Market Power."
[17] Office of Management and Budget. "Circular A-4: Regulatory Analysis, Draft for Public Review." Washington, DC: Office of Management and Budget (April 6, 2023).
[18] James Broughel. "Comments to the Office of Management and Budget on the proposed draft update to Circular A-4: Regulatory Analysis." Competitive Enterprise Institute (June, 2023). https://cei.org/regulatory_comments/comments-to-the-office-of-management-and-budget-on-the-proposed-draft-update-to-circular-a-4-regulatory-analysis/.
[19] James Broughel. "Biden's 'Evil' Modernizing Regulation Update." *Forbes* (June 6, 2023).
[20] James Broughel. "Comments to the Office of Management and Budget on the proposed draft update to Circular A-4: Regulatory Analysis."

The history of federal regulatory agencies conducting distributional analysis is not encouraging, however. Studies that have looked into the issue find that it is rarely done,[21] especially in the context of evaluating the distribution of regulatory costs.[22] This is despite numerous existing executive orders already requiring consideration of distributional impacts.[23] The proposed Prove It Act represents a step forward that could help in this area.[24] The Regulatory Flexibility Act of 1980 requires agency heads to certify that particular regulations do not have "a significant economic impact on a substantial number of small entities."[25] Otherwise, a regulatory flexibility analysis (RFA) is required. Such certifications are well-known to be unreliable,[26] demonstrating the need for third party review of certifications. It is unlikely that further executive orders or guidance to federal agencies will lead to more or better distributional analysis, given this poor track record. What is likely needed is fresh input from Congress.

Wayne Crews in his annual *10,000 Commandments* report documents the number of regulations identified as impacting small businesses.[27] These numbers are reported in figure 1 below from 2008 onward. In recent years, more than 900 regulations per year were identified as affecting small businesses. This could be an underestimate given the inconsistent certification of regulations. Nevertheless, it still constitutes about 20 to 30 percent of regulations issued each year,[28] a not insignificant number.

There is also some confusion about what constitutes a regulation affecting small business. For example, the Unified Agenda of Regulatory and Deregulatory Actions identifies rules that require an RFA, but also denotes rules that affect small entities.[29] This is problematic given that regulations with a significant impact on a substantial number of small entities are supposed to be required to have an RFA. This confusion further demonstrates the need for improving the certification process. This Senate committee could help clarify the impact of regulations on small businesses by strengthening the certification process and requiring via statute careful consideration of the distributional impacts of regulations.

---

[21] Lisa A. Robinson, James K. Hammitt, and Richard J. Zeckhauser. "Attention to Distribution in U.S. Regulatory Analyses." *Review of Environmental Economics and Policy* 10, no. 2 (2016): 308–28. https://doi.org/10.1093/reep/rew011; Caroline Cecot and Robert Hahn, "Incorporating equity and justice concerns in regulation," *Regulation & Governance,* Online version of record before inclusion in an issue. https://onlinelibrary.wiley.com/doi/full/10.1111/rego.12508

[22] Caroline Cecot. "An Equity Blindspot: The Incidence of Regulatory Costs." *Journal of Benefit-Cost Analysis* 14, no. 1 (2023): 35–43. https://doi:10.1017/bca.2023.3.

[23] Executive Order no. 12866, Federal Register 58, no. 190 (October 4, 1993): 51,736; Executive Order No. 12898, Federal Register 59, no. 32 (February 16, 1994): 7629; Executive Order no. 13563, Federal Register 76, no. 11 (January 21, 2011): 3,821.

[24] S.1411 - Prove It Act of 2023. 118th Congress (2023-2024).

[25] The Regulatory Flexibility Act of 1980 (P.L. 96-354), § 605.

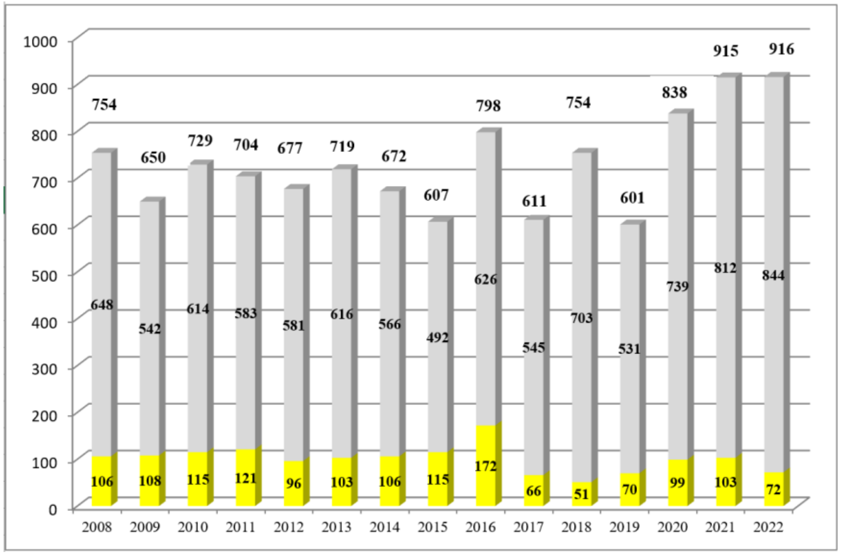
[26] Keith W. Holman. "The Regulatory Flexibility Act at 25: Is the Law Achieving Its Goal?" *Fordham Urban Law Journal* 33, No. 4 (2006): 101-118.

[27] Wayne Crews. "Ten Thousand Commandments 2022."

[28] Federal Register Statistics, "Federal Register & CFR Publication Statistics – Aggregated Charts," Accessed August 11, 2023. Available at: https://www.federalregister.gov/reader-aids/federal-register-statistics.

[29] Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions, available at: https://www.reginfo.gov/public/do/eAgendaMain.

Figure 1: Number of Final Rules in the Federal Register Affecting Small Business



Note: "Significant" subset of rules depicted in yellow.
Source: Compiled from the Federal Register by CWC Jr. in 10,000 Commandments Report.

Conclusion

The regulatory system we have today represents what may be the worst of all possible worlds. Within the current generation, regulations tend to redistribute from the poor to the rich, as low-income households and small businesses are forced to subsidize the policy preferences of the well-off. Across time, regulations slow economic growth, leaving future generations with lower living standards than would otherwise be the case.

Thus, we are consuming resources through regulation today to serve the interests of the rich and large corporations. Those that pay the consequences are low income citizens, small businesses and future generations.

Federal agencies are able to avoid accountability for their actions in part because their analysis of regulatory impacts is so sparse and unreliable. A major step toward addressing these problems is to better account for the distributional impacts of regulations, including distributional impacts on small businesses. The academic evidence consistently tells the same story, which is that small businesses are disproportionately impacted by the burdens of federal regulations.

Fortunately, there are proactive steps Congress can take to alleviate these burdens, some of which, like the Prove It Act, are already activity being considered by this committee.

Thank you once again for the opportunity to submit this statement. Please feel free to reach out to me with questions.

James Broughel, PhD