

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Subcommittee on Contracting and the Workforce
From: Committee Staff
Date: June 7, 2012
Re: Hearing: "Caught Up In Red Tape: The Impact of Federal Regulations on Small Businesses and Contractors"

Introduction

At 10:00 AM on June 14, 2012 at the Rock Hill City Council Chambers, 155 Johnston Street, Rock Hill, South Carolina, 29731, the Subcommittee on Contracting and the Workforce will meet for the purpose of receiving testimony on regulatory impediments for small businesses and contractors. The hearing will examine regulatory obstacles to small business job creation, economic growth, and participation in the federal contracting arena. This will be a wide-ranging discussion, examining regulatory actions of various federal agencies.

Background

Small businesses, those with fewer than 500 employees,¹ are generally the creators of the most new jobs, as well as the employers of about half of the nation's private sector workforce. Small businesses also account for about half of the nonfarm, private real gross domestic product. As the recession deepened in 2009, small firms accounted for almost 60 percent of the job losses.

The Bureau of Labor and Statistics releases data on quarterly net job changes by firm size in its Business Employment Dynamics series. The figure below shows net changes in employment for categories of firms with 1 to 19, 20 to 499, and 500 or more employees from the first quarter of 2005 through the third quarter of 2011. It clearly illustrates that small firms shed a significant number of jobs during the recession. In fact, larger small businesses with 20 to 499 employees saw dramatic declines in their net employment at the end of 2008 through the first quarter of 2009. Small businesses as a whole lost more jobs than their larger counterparts in all but one quarter during the recession.² This makes the current recession different from the 2001

¹ There are multiple definitions of small business and this memorandum adopts one such categorization, less than 500 employees.

² Sahin, Kitao, Cororaton, & Laiu, *Why Small Businesses Were Hit Harder by the Recent Recession*, 17 CURRENT ISSUES IN ECONOMICS AND FINANCE, VOL 17.NO. 4, at 3, available at http://www.newyorkfed.org/research/current_issues/ci17-4.pdf.

downturn, in which larger businesses experienced greater net job declines and very small businesses were quicker to recover and have net job increases.³



Hearing Focus

As the chart above indicates, job creation for small businesses has been improving slightly. That said, economic uncertainty, additional federal regulation and tax burdens, plunging consumer confidence and declining small business optimism still pose a significant challenge to small businesses’ future growth.

On October 24, 2011, Gallup released a poll that outlined small business owners’ most pressing concerns. According to this poll, small business owners are most likely to say complying with government regulations (22%) is the most important problem facing them today.

What do you think is the most important problem facing small-business owners like you today? {OPEN-ENDED}

	%
Complying with government regulations	22
Consumer confidence	15
Lack of consumer demand	12
Lack of credit availability	10
Poor leadership/Government/President	9
Cash flow	7
New healthcare policy	5
Competition from big business and overseas	4
Lack of jobs	4

Wells Fargo/Gallup Small Business Index, Oct. 3-6, 2011

GALLUP

³ *Id.*

The Gallup poll is mirrored by numerous trade association surveys, such as one conducted by the United States Chamber of Commerce in March 2012. The Chamber study found that almost half of small-business owners (49 percent) said regulation is a greater threat to their business than taxation (29 percent) or litigation (6 percent).⁴ Similarly, a poll conducted by the National Federation of Independent Business (NFIB) found that 63 percent of respondents believe the rules issued by the federal government have done more to hurt than help small businesses and 74 percent believe the federal government should focus on creating jobs instead of issuing new rules and regulation.⁵

Complying with Government Regulations

Small business owners face unique challenges in navigating federal regulations. According to the study “The Impact of Regulatory Costs on Small Firms” published by the SBA’s Office of Advocacy in September 2010, the annual cost of federal regulation in the United States increased to more than \$1.75 trillion in 2008. Had every U.S. household paid an equal share of the federal regulatory burden, each would have owed \$15,586 in 2008.⁶ By comparison, the federal regulatory burden exceeds by 50 percent private spending on health care, which equaled \$10,500 per household in 2008.

While all citizens and businesses pay some portion of these costs, the distribution of the burden of regulations is quite uneven. The portion of regulatory costs that falls initially on all businesses was \$8,086 per employee in 2008. The smallest of the small businesses (those defined as 19 employees or less) bear the largest burden of federal regulations. As of 2008, small business face an annual regulatory cost of \$10,585 per employee, which is 36 percent higher than the per-employee regulatory cost facing large firms (defined as firms with 500 or more employees).

The underlying force driving this differential cost burden is easy to understand. Many of the costs associated with regulatory compliance are “fixed costs” that will not vary with the size of the firm. As a result, large firms can spread these costs over more employees thereby gaining a cost advantage in comparison to smaller firms. An example may help elucidate this proposition. Assume that the Federal Deposit Insurance Corporation imposes a reporting requirement that banks must make and that the report costs \$100,000. A bank with only 100 employees will face an additional cost of \$1,000 per employee. A bank with 100,000 employees will face a cost of only \$1 per employee. The reporting requirement, although nominally identical has a disparate impact on smaller banks. The smaller bank, in order to recover the cost, may have to charge higher fees than its larger competitor, thereby harming the ability of small businesses to grow. Although economies of scale are generally perceived in the production of a good, these economies also exist in compliance with regulations.⁷ The raft of

⁴ This survey can be found here: <http://www.uschamberssmallbusinessnation.com/community/quarterly-survey-2>

⁵ This survey can be found here: <http://www.sensibleregulations.org/wp-content/uploads/2012/02/Final-Final-Final-SBSR-Poll-Press-release-0221.pdf>

⁶ NICOLE V. CRAIN AND W. MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS, OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION, at iv (Sept. 2010), available at <http://www.sba.gov/sites/default/files/rs371tot.pdf>.

⁷ *Id.*

new regulations with respect to health care, the environment, and taxes, will exacerbate the competitive disadvantages facing small businesses. The comparative disadvantage may dampen small businesses' willingness to expand, thereby hindering job and economic growth.

While it should be noted that not all federal regulatory actions negatively impact small businesses, the number of federal regulations continues to rise. The sheer number of regulations continues to put downward pressure on the business sector, primarily the small business sector. According to the fall 2011 Regulatory Plan and the Unified Agenda of Federal Regulatory and Deregulatory Actions in the Federal Register, which lists federal regulatory actions at various stages of implementation, 60 federal departments, agencies, and commissions have 4,128 regulations at various stages of implementation.⁸ Additionally, of the 4,128 regulations now in the pipeline, 212 are "economically significant" rules yielding at least \$100 million in economic impact. That number represents a 32.5-percent jump over the 160 rules in 2006, and a higher level than any year of the past decade except for the 224 rules in 2010.⁹

Most Often Cited Regulatory Burdens Facing Small Business

While various regulatory actions influence different industries and different segments of the economy, there are several far-reaching proposed and final regulations that have a significant effect on the entire small business community. While a complete account of all the regulations impacting small businesses is beyond the scope of this memo, what follows is a brief examination of the most often cited regulatory actions that have or could have a negative impact on the small business community.

Patient Protection and Affordable Care Act (PPACA)

The Patient Protection and Affordable Care Act¹⁰ (PPACA) was signed into law on March 23, 2010, and the reconciliation legislation containing amendments to the Act¹¹ was signed into law on March 30, 2010. PPACA requires individuals to purchase and maintain at least minimum essential health insurance coverage or, with certain exceptions, pay a penalty for not doing so, and establishes health insurance exchanges where individuals will be able to purchase health insurance. Certain individuals may be eligible for subsidies to help defray the cost of insurance.

The health care law will become effective in stages over time. Since 2010, 46 different provisions of the law have been implemented. Between now and 2018 when it is complete, 46 more provisions will be implemented. Small businesses are having great difficulty understanding what they need to do in order to track and comply with all these changes.

⁸ Clyde Wayne Crews, Jr., *Ten Thousand Commandments 2011: An Annual Snapshot of the Federal Regulatory State* Competitive Enterprise Institute (2011) available at <http://cei.org/sites/default/files/Wayne%20Crews%20-%202010.000%20Commandments%202011.pdf>.

⁹ *Id.*

¹⁰ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

¹¹ The Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

Chief among the complaints regarding implementing the PPACA is the employer mandate. Beginning in 2014, PPACA requires any employer with more than 50 full-time equivalent employees¹² during the preceding calendar year to provide health insurance to their employees. If the employer fails to do so, and at least one full-time employee receives a premium subsidy to purchase health insurance through the new health insurance exchanges, a penalty of \$2,000 per employee will be assessed. Employers with more than 50 employees who offer coverage but have at least one full-time employee receiving a premium tax credit will pay the lesser of \$3,000 for each employee receiving a premium credit or \$2,000 per full-time employee.

Small businesses have also expressed concern regarding the potential for higher health insurance premiums as a result of the health care law. According to a study by former Congressional Budget Office Director Douglas Holtz-Eakin, the PPACA tax on health insurance companies alone will increase small business health care costs by up to three percent or nearly \$5,000 per family over the next decade.¹³

Environmental Protection Agency

The EPA has consistently drawn the ire of the small business community. The proposed rule to regulate greenhouse gasses (GHG);¹⁴ the EPA's proposed Utility Maximum Achievable Control Technology rule,¹⁵ and the potential regulation of coal ash¹⁶ all have the capacity to increase costs disproportionately on small businesses. Each of these rules, on their own and in combination, could directly and indirectly lead to substantially higher energy costs and reductions in employment. On average, small businesses face a 30 percent price differential for electricity and a 20 percent price difference for natural gas compared to larger businesses.¹⁷ Some estimate the EPA GHG regulation alone could increase the cost of gasoline by 50 percent, electricity by 50 percent and natural gas by 75 percent over the next twenty years.¹⁸ In addition, the rules could result in a number of small businesses becoming subject to emissions

¹² In determining whether a company is a large employer, both full-time and part-time employees are included in the calculation. Full-time employees are those working 30 or more hours per week. The hours worked by part-time workers are included on a monthly basis by determining their number of hours worked and dividing by 120. Seasonal workers are excluded if they work less than 120 days per year.

¹³ <http://americanactionforum.org/sites/default/files/Case%20of%20the%20Premium%20Tax.pdf>.

¹⁴ Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, 75 Fed. Reg. 31,514 (June 3, 2010) (to be codified at 40 C.F.R. 51, 52, 70 and 71), available at <http://www.gpo.gov/fdsys/pkg/FR-2010-06-03/pdf/2010-11974.pdf>.

¹⁵ Proposed National Emission Standards for Hazardous Air Pollutants from Coal and Oil-Fired Electric Utility Steam Generating Units and Standards of Performance for Fossil Fuel-Fired Electric Utility, Industrial-Commercial-Institutional, and Small Industrial-Commercial-Institutional Steam Generating Units, 76, Fed Reg. 24,975 (May 3, 2011) (to be codified at 40 C.F.R. Parts 60, 63).

¹⁶ Hazardous and Solid Waste Management System, Identification and Listing of Special Wastes, Disposal of Coal Combustion Residues from Electric Utilities, 75 Fed. Reg. 35,128 (June 21, 2010) (to be codified at 40 C.F.R. Parts 257, 261, 264, 268, 271, 302).

¹⁷ UNITED STATES SMALL BUSINESS ADMINISTRATION OFFICE OF ADVOCACY, CHARACTERIZATION AND ANALYSIS OF SMALL BUSINESS ENERGY COSTS at 3, (April 2008), available at <http://archive.sba.gov/advo/research/rs322tot.pdf>.

¹⁸ AFFORDABLE POWER ALLIANCE, POTENTIAL IMPACT OF THE EPA ENDANGERMENT FINDING ON LOW INCOME GROUPS AND MINORITIES, at 1 (March 2010), available at <http://www.affordablepoweralliance.org/LinkClick.aspx?fileticket=GBqH57mHH5w%3D&tabid=40>.

regulations,¹⁹ which may subject them to significant costs associated with permitting and compliance.

Dodd-Frank

While not necessarily directly impacting small business, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),²⁰ could be playing a role in reduced lending by banks to small businesses. This could be, in part, due to the stricter regulatory environment created by Dodd-Frank, and the new Consumer Financial Protection Bureau (CFPB), combined with the uncertainty brought by many of the law's vague provisions.

According to the United States Chamber of Commerce, Dodd-Frank calls for over 500 regulatory rulemakings, 60 studies, and 93 reports. The sheer weight of these new regulations, coupled with uncertainty by the banking industry about the cost of implementation, could lead to decreased access to capital for small businesses. At a recent hearing before the Committee on Small Business' Subcommittee on Economic Growth, Tax, and Capital Access, Thomas Boyle, testifying on behalf of the American Bankers Association, stated: "Each new regulation, or change in an existing one, adds another layer of complexity and cost of doing business. The Dodd-Frank Act will add an additional, enormous burden, has stimulated an environment of uncertainty, and has added new risks that will inevitably translate into fewer loans to small businesses."²¹

Regulatory Flexibility Act (RFA)

The basic premise of the RFA is that a one-size-fits-all regulation may impose disproportionate cost burdens on small entities. Under the RFA, each agency must review its regulations to ensure that, while accomplishing its statutory mandate, the ability of small entities (the RFA applies to small businesses, small not-for-profit institutions, and small governmental jurisdictions) to invent, produce, and compete is not inhibited. The RFA forces agencies to identify and account for the often excessive small entity cost consequences of federal rulemaking actions. Agencies must balance the burdens imposed by regulations against their benefits and propose alternatives to regulations which create economic disparities among different-sized entities.²²

¹⁹ Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, 74 Fed. Reg. 55,292 (October 27, 2009) (to be codified at 40 C.F.R. Parts 51, 52, 70).

²⁰ Pub. L. No. 111-203, 124 Stat. 1376.

²¹ *The Dodd-Frank Act: Impact on Small Business Lending: Hearing Before the Subcommittee on Economic Growth, Capital Access Tax of the House Committee on Small Business*, 112th Cong. (2011) (statement of Thomas Boyle, Vice Chairman, State Bank of Countryside), available at http://smbiz.house.gov/UploadedFiles/Boyle_Testimony.pdf.

²² In the interest of space, this is a cursory description of the RFA. For a more detailed and thorough examination of the RFA, its history, and agency compliance, please see two memoranda prepared by the House Small Business Committee Staff here http://smbiz.house.gov/UploadedFiles/RFA_Hearing_Memo.pdf and here http://smbiz.house.gov/UploadedFiles/6-15_Memo.pdf.

Unfortunately, due to limited enforcement mechanisms and the lack of judicial review, agencies have only sporadically complied with the law. Both Presidents Bush²³ and Obama²⁴ have issued executive orders requiring agencies to adopt standards for complying with the RFA. The Executive Orders also mandate that agencies make those standards known to the public, and give the Small Business Administration's Office of Advocacy the opportunity to comment on proposed rules that will have a significant economic on a substantial number of small entities prior to publication in the Federal Register, and required agencies to prepare plans for periodic review of regulations. Additionally, several Committee on Small Business oversight hearings from the 106th through the 112th Congresses have exposed deficiencies in agency compliance with the RFA.

Conclusion

One of the most important things Congress and the Administration can provide small business owners is a sense of regulatory certainty. It remains difficult for entrepreneurs to plan more than a short time into the future due to continuing uncertainty in the U.S. economy. This hearing represents an opportunity to examine the largest regulatory impediments to small business job growth and participation in the federal marketplace.

²³ Exec. Order No. 13,272, 67 Fed. Reg. 53,462 (Aug. 16, 2002).

²⁴ Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2010).