Small businesses are key to getting our economy back on track, but they bear the brunt of the increasing cost of regulation. Legislators seem to recognize as much and have introduced several bills requiring a better understanding of the effects of regulation on small businesses. Just last week the House of Representatives held a mark-up session for H.R. 527, the Regulatory Flexibility Improvements Act of 2011, designed to ensure more complete analysis of the impact of proposed regulations on small entities. With regulatory activity on the rise, the bill represents a valuable effort to minimize the extent to which the growth in the administrative state impedes economic recovery.

Under the Regulatory Flexibility Act of 1980 (RFA), federal agencies must assess the impact of pending regulations on small businesses and attempt to minimize their net costs. While the RFA was a significant regulatory reform when it was enacted 30 years ago, it has been plagued by a number of shortcomings, most notably the fact that its analytical requirements can be sidestepped if the head of a regulatory agency certifies that a proposed regulation would not have a “significant economic impact on a substantial number of small entities.” Moreover, recent judicial interpretations of the RFA have held that agencies need not take the “indirect effects” of regulation into account in determining what constitutes a “significant economic impact.” Combined, these loopholes are very significant, as it is often the indirect effects of regulation (e.g., increased energy prices, impediments to innovation, or inefficiencies imposed on larger industries on which small businesses depend) that impose the greatest burdens on small entities.

H.R. 527 attempts to remedy the deficiencies of the RFA, defining “economic impact” to include both direct economic effects and any “reasonably foreseeable” indirect effects, in addition to strengthening the act’s procedural requirements.

Perhaps the most compelling reason for expanding the RFA’s requirements lies in the distributive effects of federal regulation. The fixed-cost nature of regulation results in small entities shouldering a disproportionate share of regulatory burdens. The Small Business Administration estimates that the cost per employee of federal regulation for firms employing fewer than 20 people is 36% higher than that for larger firms. Expanding the range of economic effects federal agencies must consider in promulgating regulations that affect small businesses is an important step in adjusting regulatory policy to the reality that small firms lack the financial, legal, and political resources of big business.
Even if one is unmoved by considerations of fairness, the centrality of small businesses to the strength of the overall economy warrants significant attention and makes the need for reform urgent. “…[S]mall businesses produce most of the new jobs in this country,” President Obama noted last September. “They are the anchors of our Main Streets.” Regulations do not affect targeted industries in a vacuum. Rather, they increase the overall cost of economic activity, operating as a “hidden tax” with effects that reverberate throughout the economy as a whole. That some effects of regulation are “indirect” is irrelevant to their degree of magnitude. Forcing regulators to take stock of indirect effects and consider alternative means of accomplishing their goals will help minimize regulatory burdens on small business that might otherwise stand in the way of economic recovery.

Finally, irrespective of the economic importance of small businesses, the notion that regulators should consider the full range of relevant information when possible is reasonable regardless of one’s general feelings about regulation. Hiding or ignoring the indirect costs of regulation does not make for good public policy.

Federal regulation plays an important role in maintaining our quality of life. But demands for health, safety, and a clean environment must inevitably be weighed against other goals, the most timely being the need for economic growth. It is encouraging that Congress is focusing on finding a more appropriate balance between these competing priorities.

*****

Jay Sykes, an intern at the George Washington University Regulatory Studies Center, is a recent graduate of Georgetown University and will enter Yale Law School this fall. The above commentary was also published in The Daily Caller on July 12, 2011.