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RESEARCH SUMMARY

Counting the Cost of Regulation: The Effect on Firms' Operating Costs

In principle, regulations increase the operating costs of businesses, but there is no hard evidence of the magnitude of these costs. A major roadblock to regulatory reform is a vague, pervasive belief that the adverse effects of regulation on business are not truly that large. In "The Impact of Regulatory Growth on Operating Costs," Richard Fullenbaum and Tyler Richards provide evidence that (a) the costs of overall regulatory growth are quite large and, consequently, (b) the benefits of regulatory reform would be substantial.

Regulations that increase operating costs are often those that alter the day-to-day operations of a firm in some way. This could be through changes in the allowed or mandated behavior of employees. Or it could be through changes in the technology that firms can or must use during operations. This study examines the effect of the growth of such regulations on operating costs per unit of output across an array of US industries.

THE *ACTUAL* IMPACT OF REGULATORY GROWTH ON OPERATING COSTS

- The average rate of regulatory growth drives up operating costs per unit of output by about 3.3 percentage points per year.
- The total effect of this annual percentage increase compounds over time.
- Regulations created four to five years earlier have an even larger effect than those in the current year.
- If no factors other than regulation had affected operating costs over the past 20 years, the increase in regulations alone would have driven up operating costs per unit of output by 92 percent.

THE *HYPOTHETICAL* IMPACT OF REGULATORY REDUCTIONS ON OPERATING COSTS

- If we hold everything (general technology, inflation, etc.) except regulations constant, then reducing the total volume of regulations to their 1998 levels would cut operating costs nearly in half.
- In this way, reducing the volume of regulations works much like technological innovation. It drives down operating costs and increases economic growth—even if technology remains constant.

KEY TAKEAWAY

This study indicates that as a result of new regulations, businesses incur substantial negative effects. It also demonstrates that unit operating costs could, hypothetically, be halved if the total volume of regulations were reduced to 1998 levels.