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SBA Study Claiming \$1.75 Trillion Cost of Regulations Was Based on Series of Significantly Flawed Calculations, Says CPR Report

SBA's Figure for Annual Costs Largely Based on Public Polling Data

(Washington) -- A widely cited U.S. Small Business Administration Office of Advocacy study claiming that regulations cost the U.S. economy \$1.75 trillion in 2008 was based on a number of flawed methodologies, and should be withdrawn, says a new report issued by the Center for Progressive Reform today. The \$1.75 trillion number has been cited repeatedly by members of Congress and conservative think tanks interested in rolling back regulatory protections.

"This \$1.75 trillion dollar number has been thrown around a lot, but when we actually looked into it, we found that it's based on questionable assumptions and fuzzy math," said Sidney Shapiro, co-author of the CPR report. "The SBA report makes no effort to account for the benefits of regulation, even though benefits typically exceed the costs. In addition, more than 70 percent of the SBA figure is based on public opinion polling about the regulatory climate in different countries, numbers that were never meant to be spun off into an absurd guess about the total effect on the U.S. economy."

Shapiro, a CPR Member Scholar and Wake Forest University law professor, sent a letter today to Karen Mills, the SBA Administrator, and Dr. Winslow Sargeant, Chief Counsel of the SBA's Office of Advocacy, calling on the SBA to withdraw the study and disavow its findings.

The "\$1.75 trillion" study was commissioned by the SBA's Office of Advocacy, and completed by economists Nicole Crain and Mark Crain in 2010. Crain and Crain did not show the full calculations they used to arrive at their cost estimates, and declined to furnish their raw data to CPR despite several requests. Remarkably, an SBA representative told CPR his office did not have access to the underlying data, since SBA had only contracted to receive the final report. Thus, SBA entered into an agreement to spend taxpayer money on a report whose findings it could not then have verified in any significant way—not even checking the arithmetic.

The Crain and Crain study is at odds with estimates of the White House Office of Management and Budget. A 2009 OMB report, based on data from federal agencies under the Bush and Clinton Administrations, found that in 2008, total regulatory costs ranged from \$62 billion to \$73 billion, with total benefits of \$153 billion to \$806 billion (adjusted from 2001 to 2009 dollars). (CPR has in the past demonstrated that OMB reports underestimate benefits and overestimate costs.)

The SBA report says it found a much higher number for costs because it considers far more rules than do the annual OMB reports, including non-major rules, rules that are more than 10 years old, and rules issued by independent regulatory agencies. There are reasons to doubt this assertion, however. Crain and Crain's calculations for the regulations not covered by OMB's report appear to

be based largely on a decidedly unusual data source for economists – public opinion polling, the results of which Crain and Crain massage into a massive, but unsupported estimate of the costs of “economic” regulations. Because Crain and Crain have refused to make their underlying data or calculations public it is difficult to know precisely how they arrived at the result that economic regulation has a cost of \$1.2 trillion dollars, comprising 70 percent of the total costs in their report. Nevertheless, there are good reasons to be skeptical about their calculations. For one thing, as noted, it is based on the results of public opinion polling concerning the business climate of countries that has been collected in a World Bank report. The authors of the World Bank report warn that its results should not be used for exactly the type of extrapolations made by Crain and Crain, because their underlying data are too crude.

The CPR report found that the SBA study:

- **Overstated costs.** To estimate the cost of non-economic regulation, Crain and Crain almost always used the agency estimates of such costs that were submitted to OMB. Although OMB presents these costs as a range, Crain and Crain always used the upper bound estimate, effectively eliminating the agencies’ careful efforts to draw attention to the uncertainties in these calculations. Moreover, cost estimates are typically based on industry data and regulated entities have a strong incentive to overstate costs in this circumstance. Empirical studies have shown that such estimates are usually too high.
- **Omitted benefits of regulation.** While the SBA study presents an inflated calculation of regulatory costs, it completely ignores the monetized benefits of regulations. OMB’s calculations demonstrate that regulation has a significant positive net effect on the economy, in the form of lives spared, hospital visits prevented, and on-the-job accidents avoided. Using Crain and Crain’s methodology, practically any economic transaction—from the purchase of a loaf of bread to the construction of a manufacturing plant—would be counted as a drain on the economy, because they only included the costs and not the benefits. Under this methodology, if an individual company lost \$100 due to a regulation but also gained \$110 from the effects of that regulation, Crain and Crain would simply report a "\$100 cost" and add it to the tally.
- **Peer review rendered meaningless.** The peer review process used by the SBA Office of Advocacy does not support the reliability of the report. Only two people examined the document. The authors ignored a significant criticism raised by one of the two reviewers concerning the reliability of their estimate of economic regulatory costs. The second reviewer's entire comments were: “I looked it over and it's terrific, nothing to add. Congrats[.]”

The CPR report, *Setting the Record Straight: The Crain and Crain Report on Regulatory Costs*, was written by CPR Member Scholar Sidney Shapiro, National Labor College Professor of Economics Ruth Ruttenberg, and CPR Policy Analyst James Goodwin. It is available online at: www.progressivereform.org/articles/SBA_Regulatory_Costs_Analysis_1103.pdf

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