MERCATUS CENTER
George Mason University
Bridging the gap between academic ideas and real-world problems

TESTIMONY

REGULATIONS CONTRIBUTE TO POVERTY

PATRICK A. MCLAUGHLIN
Senior Research Fellow, Mercatus Center at George Mason University

House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Hearing: Triple Threat to Workers and Households: Impacts of Federal Regulations on Jobs, Wages, and Startups

February 24, 2016

Chairman Marino, Ranking Member Johnson, and members of the committee: thank you for inviting me to testify today. As an economist and senior research fellow at the Mercatus Center at George Mason University, my primary research focuses on regulatory accumulation and the regulatory process, so it is my pleasure to testify on today's topic.

My testimony focuses on how our regulatory process, contrary to what many expect, contributes to poverty.

Some people maintain the notion that the costs of regulation are limited to compliance costs, and that these costs are paid primarily by businesses. This belief is incorrect. I will highlight two specific ways that the costs of regulation can actually be regressive, meaning that the costs are disproportionately borne by low-income households:

1. Regulations have regressive effects by increasing the prices of basic necessities, such as electricity, housing, and telephone services, which typically consume a larger share of the budget of lower-income households than of wealthier households.

2. Some types of regulations are associated with higher levels of income inequality, most likely because entrepreneurs at the lowest segments of the income distribution have relatively greater difficulty surmounting costly barriers to entry created by regulations.

With those points in mind, I hope to present this problem as an opportunity for policymakers to take positive steps toward regulatory reform—steps that will reduce the harm of federal regulations that are acting to impoverish, rather than help, low-income households.

For more information or to meet with the scholar, contact
Robin Bowen, 703-993-8582, rbowen@mercatus.gmu.edu
Mercatus Center at George Mason University, 3434 Washington Blvd., 4th Floor, Arlington, Virginia 22201

The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

THE REGRESSIVE EFFECTS OF REGULATION

In contrast to the belief that businesses pay the costs of regulation, regulatory growth is in fact associated with increases in the prices of all goods to all consumers. While economists have long known that regulations increase prices, researchers have only recently been able to actually estimate the effect in a comprehensive manner. In a recent study, which I've attached, economists Dustin Chambers and Courtney Collins found that a 10 percent increase in the quantity of federal regulations is associated with an approximately 0.7 percent increase in prices.[1] While 0.7 percent may sound small, consider that this same study found that regulations affecting households grew by 33.6 percent between the years 2000 and 2012.[2] That implies that price inflation of 2.31 percent has been associated with federal regulatory growth over that time period.

That percentage is the average across all households. But the price inflation associated with regulation is worse for low-income households because those households spend more of their income on heavily regulated goods than high-income households. For the most part, these are basic necessities.[3] For example, electricity costs make up more than twice as much of the budgets of low-income households compared to high-income households, with the former spending just over 4 percent of their budgets on electricity, whereas high-income households spend less than 2 percent on it.[4] Similarly, telephone services take up about three times as much space in the budgets of poorer households (about 3.25 percent) relative to that of high-income households (1.1 percent). All of these goods, many of them essentials, are heavily regulated, so the price inflation associated with regulation is also relatively high.

Price volatility is a problem as well. The same study found that regulations are positively correlated with price volatility. Budget-constrained households need to plan future spending, and price volatility hurts them in that regard as well. Low-income households are not only more budget constrained, but they also spend about 15 percent more than high-income households on goods with the highest price volatility.[5] If regulations are contributing to that price volatility, then this is another way that they are contributing to poverty.

REGULATION AND INCOME INEQUALITY

Regulations can also contribute to income inequality. In a study that I have attached, a coauthor and I recently examined a sample of 175 countries to learn more about the relationship between regulation and income inequality. We found that those countries with more stringent entry regulations tend to experience significantly higher levels of income inequality.[6] The explanation for this is pretty straightforward: regulations can act as barriers to entry, and the higher those barriers to entry, the costlier it is for an entrepreneur to start a business. When entrepreneurs cannot legally open a business because of the cost of dealing with regulations, they may abandon the idea altogether.

Consider the long-standing reputation of America as the land of opportunity—where you can lift yourself up by your bootstraps with enough hard work. Indeed, entrepreneurship has historically been one of the best paths from rags to riches.[7] If regulations are inhibiting this process, that means people with low incomes have fewer opportunities to rise from the low end of the income distribution to middle and high levels. In fact, the possibility that regulations are hindering this process is consistent with the growing evidence that regulatory accumulation creates substantial drag on economic growth by impeding innovation and entrepreneurship, as I have previously testified before this subcommittee.[8]

1. Dustin Chambers and Courtney Collins, "How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, February 2016).
2. Author's calculation based on data in column 4 of table 4 of Chambers and Collins, "How Do Federal Regulations Affect Consumer Prices?" Total regulations in 2000 were 83,890, and by 2012 they had grown to 112,092—a difference of 28,202, or 33.6 percent.
3. Ibid., table 2, 25.
4. Ibid., table 2, 25.
5. Ibid., 20.
6. Patrick A. McLaughlin and Laura Stanley, "Regulation and Income Inequality: The Regressive Effects of Entry Regulations" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, January 2016).
7. Vincenzo Quadrini, "Entrepreneurship, Saving, and Social Mobility," *Review of Economic Dynamics* 3, no. 1, (2000): 1–40.
8. Patrick A. McLaughlin, "The Searching for and Cutting Regulations That Are Unnecessarily Burdensome Act of 2014" (Testimony

CONCLUDING REMARKS

In conclusion, I have just discussed how regulations are contributing to poverty. First, they have regressive effects caused by increasing prices, particularly for those items that low-income households purchase most. Second, regulations can contribute to income inequality by increasing the costs of starting a business. This makes it more difficult for entrepreneurs to start their own businesses and begin the climb up the income ladder.

Although these facts are surely disheartening, there is good news. Because regulations disproportionately harm low-income households, regulatory reform offers a feasible opportunity to enact a policy that would effectively act like a tax refund by virtue of reducing the price inflation associated with regulations. Additionally, regulatory reform could lead to gains in job growth, increased entrepreneurship, and greater innovation. However, unlike a one-time tax refund, the benefits from regulatory reform would repeat year after year, they would not increase the deficit, and they would be progressive in their nature—accruing foremost to low-income households.

The regulatory process in the United States leads to regulatory accumulation. Federal regulatory code currently contains over 1 million individual regulatory restrictions.[9] If you were insane enough to read regulations as a full-time job, it would take you over three years to read through the entire code.[10] The accumulation of regulation is both undesirable—because of a bevy of unintended consequences associated with it—and avoidable.[11] If this accumulation of regulation is harming not only the economy overall but especially low-income households, it is certainly time to consider ways that we can eliminate regulations that are obsolete, duplicative, ineffective, or otherwise undesirable.

before the House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law, Mercatus Center at George Mason University, Arlington, VA, February 11, 2014).
9. Omar Al-Ubaydli and Patrick A. McLaughlin, "RegData: A Numerical Database on Industry-Specific Regulations for All United States Industries and Federal Regulations, 1997–2012," *Regulation & Governance* (December 2015).
10. Patrick A. McLaughlin, "The Code of Federal Regulations: The Ultimate Longread," Mercatus Center at George Mason University, April 1, 2015, http://mercatus.org/publication/code-federal-regulations-ultimate-longread-game-thrones-hunger-games.
11. For several of the unintended consequences of regulatory accumulation, see Patrick A. McLaughlin and Robert Greene, "The Unintended Consequences of Federal Regulatory Accumulation," Economic Perspectives, Mercatus Center at George Mason University, May 8, 2014, http://mercatus.org/publication/unintended-consequences-federal-regulatory-accumulation. McLaughlin and Williams, among others, offer suggestions on how such regulatory reform could be achieved. See Patrick A. McLaughlin and Richard Williams, "The Consequences of Regulatory Accumulation and a Proposed Solution" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, February 2014).