The Economics of Deregulation

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Regulations play a vital role in modern society, and with good design and management, regulations deliver important public benefits. Poor design of individual regulations, however, can lead to rules that create only costs and no public benefits. More importantly, poor regulatory management of accumulated regulations stifles innovation and hinders economic growth. A unique challenge for policymakers today is to find a way to trim unnecessary regulations while preserving necessary public protections.

While there are many regulatory reforms that would improve the regulatory process overall, the primary failure points are twofold: first, should we create a new regulation? And second, should regulations that we have created be preserved, modified, or removed?

While I would be happy to discuss whether regulations should be created in the first place and how that decision should be reached, my testimony today will focus primarily on the part of the regulatory process that exerts the greater economic force: how the accumulated stock of regulations is managed, if at all, and what that does to an economy.

Over past century, as the number of agencies created by Congress has grown, so has the stock of federal regulations on the books. The quantity of regulatory restrictions in the *Code of Federal Regulations*, or phrases within regulatory text that create obligations or prohibitions, such as the word, "shall," or the phrase, "may not," has grown from about 400,000 in 1970 to over 1.1 million today.[1]

Regulatory accumulation refers to the steady and perhaps unintentional growth of regulations over time. Without a systematic approach to reviewing and removing outdated or redundant regulations, the steady buildup of government interventions eventually shows up in economic outcomes ranging from business activities such as investment decisions, startup rates, and productivity growth to household outcomes such as household income and consumer expenditure.

[1] These figures come from the RegData project, hosted at QuantGov.org. For methodology, see: Al-Ubaydli, Omar and Patrick A. McLaughlin, "RegData: A Numerical Database on Industry-specific Regulations for All US Industries and Federal Regulations, 1997 – 2012," *Regulation & Governance* 11 (2017): 109–123; and McLaughlin, Patrick A. and Oliver Sherouse "RegData 2.2: A Panel Dataset on US Federal Regulations." *Public Choice*. 180 (2019): 43–55.

1. The Growth Effects of Regulatory Accumulation

The downsides of regulatory accumulation are well documented. A study that I co-authored with Bentley Coffey and Pietro Peretto, published in the *Review of Economic Dynamics* in 2020, showed that regulatory accumulation slows economic growth by nearly one percentage point annually.[2] Specifically, the study found that the buildup of more and more federal regulations over time distorted business investment decisions, which, in the long run, are the drivers of innovation and productivity growth. As a consequence, the buildup of federal regulations creates a considerable drag on overall economic growth, amounting to an average reduction of 0.8 percentage point in the annual growth rate of the US GDP. This seemingly small annual reduction has large implications. The slower economic growth caused by regulatory accumulation resulted in an economy that was $4 trillion smaller in 2012 than it could have been without such regulatory accumulation. That amount equaled about a quarter of the US economy in 2012, and if it were a nation's GDP, it would have been the fourth largest in the world at that time.[3] This translates to a loss in real income of approximately $13,000 (in year 2012 dollars) for every American.[4] A similar study estimated the effect to be even larger, finding that regulatory accumulation slowed US economic growth by as much as 2 percentage points annually.[5]

This line of research is focused on the totality of regulations and their cumulative effect, rather than the direct compliance and paperwork costs that are typically included in regulatory impact analyses produced by regulatory agencies. This is not to dismiss those direct compliance and paperwork costs—they often are large and noteworthy. For example, the FTC's new Hart-Scott-Rodino rules would have added 68 paperwork hours to the average HSR filing, according to the FTC's own estimate.[6] Because these filings require highly skilled and specialized law firms, that burden can easily reach more than $50,000 in additional paperwork costs per filing.

But when we consider the opportunity cost of regulations—and how they distort business investments and the innovation that comes from them—the total cost of regulations is substantially greater than the sum of the projected compliance costs when each regulation is analyzed on its own. Indeed, forgone innovation eventually makes compliance and paperwork costs seem relatively trivial in comparison.

Not coincidentally, research shows that regulatory accumulation disproportionately burdens small businesses—including the startups that are often the fountainheads of innovation—and that

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[2] Bentley Coffey, Patrick A. McLaughlin, and Pietro Peretto, "The Cumulative Cost of Regulations," *Review of Economic Dynamics* 38 (2020): 1–21.
[3] Patrick A. McLaughlin, "What If the US Regulatory Burden Were Its Own Country?" (Mercatus Data Visualization, Mercatus Center at George Mason University, April 26, 2016).
[4] Coffey et al. e, "The Cumulative Cost of Regulations."
[5] John Dawson and John Seater, "Federal Regulation and Aggregate Economic Growth." *Journal of Economic Growth* 18 (2013): 131–177.
[6] https://www.federalregister.gov/documents/2024/11/12/2024-25024/premerger-notification-reporting-and-waiting-period-requirements

this burden grows at an increasing rate as regulation accumulates (i.e., the negative effect of each new regulation grows larger as the stock of regulation grows larger).[7]

There are other reasons to be concerned about regulatory accumulation. Scholarship from the fields of psychology, economics, and organizational science suggests that people are more likely to make mistakes and are less motivated and able to comply when they are required to follow too many rules simultaneously.[8] For example, one study found that the growth in regulation in the nuclear power industry actually reduced safety.[9] New regulations distracted workers from their most important duties. In such circumstances, it became harder for workers to focus on averting the greatest risks, as an increasing share of their attention was diverted to recalling all the rules they were supposed to follow.

2. Household Effects of Regulatory Accumulation

While regulation significantly affects business-related economic outcomes, regulation also has direct impact on American households, especially households with lower incomes. By creating barriers or hurdles that limit the ability of new individuals or companies to enter a market, regulatory accumulation can raise prices, slow wage growth, and diminish economic opportunities for low-income workers.

Regulation typically increases the production costs of goods, and these costs are passed on to the consumer in the form of higher prices. A study published in 2017 combined data from the Bureau of Labor Statistics, the Bureau of Economic Analysis, and the RegData database to study the relationship between prices and consumer choices.[10] It found that a 10 percent increase in total regulation leads to a nearly 1 percent increase in consumer prices. Furthermore, they found that the effects of these price increases are regressive: The poorest income groups experience the highest proportional increases in the prices they pay. This is consistent with spending patterns broken down by income level. Low-income households tend to spend a greater portion of their incomes on necessities such as utilities, food, and healthcare; unfortunately, these goods also tend to be more regulated than other consumer and household goods.

It is perhaps not surprising, then, that regulatory accumulation also has a positive statistical relationship with poverty rates; as regulation grows, poverty rates also tend to rise.[11] Regulatory accumulation can also contribute to income inequality as wage growth shifts from low-income

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[7] Dustin Chambers, Patrick A. McLaughlin, and Tyler Richards, "Regulation, Entrepreneurship, and Firm Size," *Journal of Regulatory Economics* 61 (2022): 108–134.
[8] Patrick A. McLaughlin, "How Regulatory Overload Can Make Americans Less Safe" (Mercatus Policy Brief, Mercatus Center at George Mason University, November 2018).
[9] Michael Lavérie and Roger Flandrin, "Relations Between the Safety Authority and the Nuclear Power Plant Operators," *Nuclear Engineering and Design* 127 (1991): 215–18.
[10] Dustin Chambers, Courtney A. Collins, and Alan Krause, "How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation," *Public Choice* 180 (2017): 1–34.
[11] Dustin Chambers, Patrick A. McLaughlin, and Laura Stanley. "Regulation and Poverty: An Empirical Examination of the Relationship Between the Incidence of Federal Regulation and the Occurrence of Poverty Across the US States." *Public Choice* 180, no. 1–2 (2019): 131–144.

workers to compliance-related workers such as managers, lawyers, and accountants.[12] Indeed, a recent study in the *European Journal of Political Economy* found that a higher incidence of federal regulations on a state's economy *causes* greater income inequality.[13]

3. The Economic Effects of Deregulation

Several subnational jurisdictions have reversed or at least slowed regulatory accumulation over the past two decades. Considering the mounting evidence on the harms of regulatory accumulation, some states have implemented regulatory reform initiatives designed to identify and weed out red tape that had accumulated over the years. We can look to some of these subnational reforms to learn about the economic effects of deregulation.

The trend was arguably inspired by the Canadian province, British Columbia, which in 2001 recognized a need to cut some of the regulatory red tape that had built up over years.[14] British Columbia's groundbreaking red-tape reduction initiative succeeded in reducing the quantity of regulations on its books by about 40 percent within three years.[15] A recent study on the topic found that the red-tape reduction caused the province's economic growth rate to increase by over one percentage point, converting British Columbia from economic laggard to leader in just a few years.[16] And the new, higher growth rate was maintained for several years thereafter.

The states that have enacted successful regulatory reforms have primarily adopted two similar approaches: targeted red-tape reductions and regulatory budgets. The former—a targeted reduction—typically involves developing a quantitative measurement of accumulated regulation and then setting an explicit target for reduction, such as 25 percent or 30 percent relative to the initial baseline. The latter—regulatory budgeting—comes in a variety of forms, but it also typically requires first coming up with a quantitative metric of total regulatory burden and then tracking changes as new regulations are made or old regulations are modified or eliminated.

These approaches are effective, as the data in figure 1 show (using data from the State RegData project).[17] Those states that do not have a robust process in place for reviewing old regulations (Status Quo States) tend to accumulate more and more regulations over time, whereas those

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[12] James B. Bailey, Diana W. Thomas, and Joseph R. Anderson, "Regressive Effects of Regulation on Wages," *Public Choice* (2018): 1–13; Dustin Chambers, Patrick A. McLaughlin, and Laura Stanley, "Barriers to Prosperity: The Harmful Impact of Entry Regulations on Income Inequality, *Public Choice* 180, no. 1–2 (2019): 165–190; and Sean Mulholland, "Stratification by Regulation: Are Bootleggers and Baptists Skill-Biased?" *Public Choice* (2018): 1–26.

[13] Choudhury, Sanchari, "The Causal Effect of Regulation on Income Inequality Across the US States," *European Journal of Political Economy* 80 (2023)

[14] Laura Jones, "Cutting Red Tape in Canada: A Regulatory Reform Model for the United States?" (Mercatus Research, Mercatus Center at George Mason University, November 11, 2015).

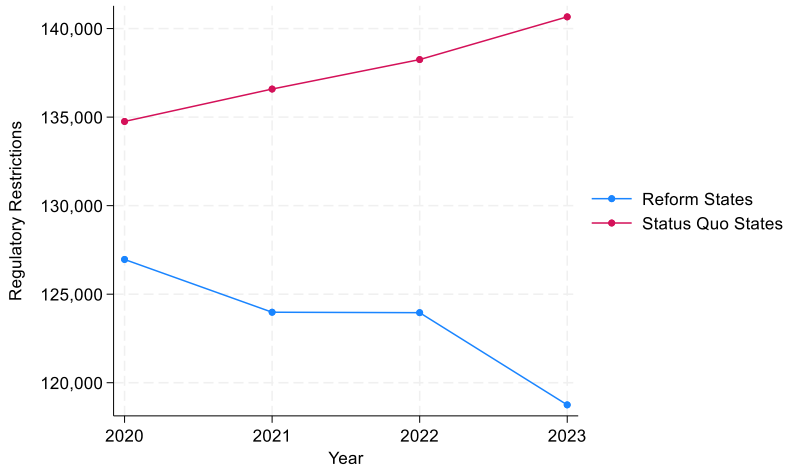
[15] Bentley Coffey and Patrick A. McLaughlin, "Regulation and Economic Growth: Evidence from British Columbia's Experiment in Regulatory Budgeting" (Mercatus Working Paper, Mercatus Center at George Mason University, May 2021).

[16] Coffey and McLaughlin, "Regulation and Economic Growth."

[17] State RegData is also part of the RegData project, available at Quantgov.org.

states that have a proactive review process in place (Reform States) have reversed that process. For this comparison, Reform States includes that have reduced regulatory restrictions by at least five percent since the first year the state was included in State RegData and had made some sort of policy announcement related to the red-tape reduction efforts. The states that qualified are, in alphabetical order: Idaho, Kentucky, Missouri, Nebraska, Ohio, and Oklahoma.[18] The remaining states are grouped into the non-reform category, Status Quo States.

Figure 1: States without review process (Status Quo States) v. states with review process (Reform States)



The state of Idaho offers an instructive example of successful regulatory reform in the United States. Idaho today is the least regulated state in the nation. However, when the State RegData project began in 2016, Idaho did not hold that title. It required deliberate reform of the regulatory process, which has been a hallmark of Idaho Governor Brad Little's time in office. Over the past several years, Idaho has implemented a bold regulatory reform agenda, resulting in a reduction of its regulatory restriction count by more than 50 percent. With one of his first executive orders, Governor Little implemented a one-in, two-out regulatory policy, requiring that for every new regulatory restriction introduced, two must be eliminated. This approach eventually evolved into a form of regulatory sunsetting called "zero-based regulation," modeled after zero-based budgeting. Under zero-based budgeting, all state agencies must review all their regulations once every five years. If an agency wants to keep a rule on the books, the burden of proof is on the agency to show that the regulation is necessary and that the least restrictive alternative has been chosen.[19] The results helped Idaho reduce its regulatory complexity and foster a more dynamic business environment, especially for small- and medium-size enterprises. Not coincidentally,

[18] Note that, as of this writing, State RegData runs through 2023. If we had more recent data, it is likely that a few more states' recent deregulatory efforts would put them in the reform category, including Iowa, Virginia, and perhaps one or two more.

[19] For more details on Idaho's approach, as well as the more recent reforms implemented in the state of Virginia, see Alex Adams and Reeve Bull, "Regulatory Modernization That Works: Lessons from Idaho and Virginia," (Regulatory Transparency Project of the Federalist Society, May 10, 2024).

Idaho's economic growth outpaced national averages, and the state became a magnet for investment and entrepreneurship. Likewise, the other states that have successfully cut red tape have experienced a relatively higher growth rate when compared to the states that have not. Because these are relatively recent changes, more careful study will still be necessary to determine the degree to which deregulation caused this difference in growth rates across the two groups of states.

4. Concluding Remarks

Deregulation offers the potential for a win-win: a more dynamic economy and relief for those most burdened by the status quo. Regulatory accumulation has been a significant drag on U.S. economic growth for decades, slowing business investment, impeding the formation of new firms, and acting as a hidden tax on consumers and workers.

At the same time, the costs of heavy regulation are not borne equally – they fall hardest on small businesses and low-income households, contributing to higher poverty and income inequality. These findings make a compelling case that reforms to curtail excessive regulation are not just about efficiency and growth, but also about economic opportunity.

The experiences of British Columbia, Idaho, and other reforming subnational jurisdictions demonstrate that meaningful reduction in regulatory burdens is achievable. Clear goals, measurement, and high-level commitment are critical. When done right, deregulation can stimulate competition, lower consumer prices, and increase productivity and wages – all without sacrificing important health, safety, and environmental protections. Indeed, a leaner regulatory code can enhance focus on the truly important rules, as both regulators and regulated entities are able to focus on what matters most, rather than drowning in paperwork.

In conclusion, regulatory accumulation represents a significant, albeit often invisible, headwind of our own making. By recognizing it as such, and by pursuing deregulation and better regulatory management, policymakers can remove impediments to growth and ensure that the regulatory state serves the public without inadvertently holding it back. Several policy options are on the table, from one-in, two-(or more) out regulatory budgets to sunset reviews, and the evidence from subnational reforms offers a hopeful example that the tide of regulatory accumulation can be turned. A more efficient, competitive economy with rising household incomes and enhanced opportunities need not come at the expense of protections; rather, it can be achieved by making regulation smarter, not just more plentiful. The economics of deregulation makes a strong case that less can indeed be more.