

The Human Cost of Regulations and Some Possible Solutions

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If there was ever an apt aphorism for US regulations, it would be “the road to hell is paved with good intentions.” Apart from their generally accepted negative impacts on commerce and economic growth, regulations against targeted industries often have negative and unanticipated effects on low-income communities and individuals.

Many fair-minded people operate under the misperception that the current economic consequences of regulations are the price that must be paid to protect vulnerable populations and promote higher ideals, like the protection of the environment. While such tradeoffs are necessarily true of carefully designed and appropriate regulations, poorly designed regulatory regimes, larded with red tape, have especially negative, avoidable effects on poor individuals. Unfortunately, when government regulations do real harm to vulnerable populations, these unintended consequences go unnoticed and unreported. Therefore, accountability and reform within regulatory agencies has been slow to materialize.

Far too many Americans continue to place their faith in the notion that most problems and undesirable outcomes can be solved with more government rules, remaining oblivious to the human costs of these policies. For grassroots support for regulatory reform to materialize, it is critical that the public understand that regulations, while surely necessary in some instances, also result in unintended harm to real people. Regulations should be used only as a last resort and should be appropriately designed to achieve social objectives while minimizing economic and human costs. Furthermore, the estimated benefits of new regulations should exceed their costs. This principle would preclude red tape and crony rules, given that they are costly, serve only the needs of special interests, and deliver no benefits to society.

THE REGRESSIVE EFFECTS OF REGULATION

The unintended consequences of regulations can harm businesses, workers, and households of every kind. However, researchers are increasingly discovering that this harm disproportionately affects low-income households and individuals. Economists call such disparate impacts *regressive effects*. Specifically, higher levels of regulation are associated with higher levels of income inequality, higher rates of poverty, and increased mortality rates.

Income Inequality

Until the 1960s, most economists saw regulations as a necessary tool to prohibit undesirable behavior (e.g., pollution), promote worker and consumer safety, and prevent dominant firms from abusing their market power. Although properly designed regulations are necessary to achieve some of these goals, economists in the 1960s and 1970s began to reassess the effectiveness and necessity of many regulations. Two such economists from the University of Chicago, both eventual Nobel Prize winners, had a particularly outsized influence. Milton Friedman correctly pointed out that startup regulations and occupational licensure enabled incumbent producers to restrict market supply, thereby extracting excess profits from consumers and harming the prospects of those producers unfairly prevented from entering the market. George Stigler, a colleague of Friedman, made groundbreaking contributions to economics by empirically demonstrating that regulated industries and professions often failed to deliver lower-priced or higher-quality goods or services. Taken together, regulations that inhibit competition are universally bad for consumers and create both winners and losers among producers. By unfairly extracting hard-earned money from consumers and limiting the earning potential of would-be entrepreneurs, income is unfairly diverted to the beneficiaries of poorly designed regulations, thus resulting in higher income inequality. For those readers interested in a detailed exposition of the mechanisms by which regulations impact inequality, please see a paper I coauthored with Colin O'Reilly.¹

With the development of the RegData dataset in 2012, which measures the number of federal regulatory restrictions by industry, it finally became possible to empirically estimate the impact of regulations on income inequality in the United States. Researchers find that a 10.0 percent increase in federal regulations (that apply to a given state) is associated with a 0.5 percent increase in income inequality (as measured by the Gini coefficient).² For example, between 1997 and 2015, the increased federal regulatory burden on Louisiana resulted in a 7.4 percent higher level of income inequality (as of 2018). Over the same period, states on average experienced 2.9 percent higher income inequality because of growing federal regulations.

Poverty

Given the evidence linking regulations and the distribution of income in the United States, and given that changing income shares benefit higher-income households, it is not very surprising

that researchers have also found empirical evidence linking regulations and poverty. Specifically, researchers find that a 10.0 percent increase in federal regulations (that apply to a given state) is associated with a 2.5 percent increase in the poverty rate.³ In Louisiana, the state most heavily affected by federal regulations, the growth of federal regulation between 1997 and 2015 is associated with an additional 228,951 people living in poverty (as of 2019).⁴ Nationwide, an estimated 6.9 million additional people lived in poverty in 2019 as a result of increased federal regulations over the sample period (1997 to 2015).

Mortality

Economists have long recognized a positive correlation between income levels and various measures of human welfare, including life expectancy and general health. The correlation between regulations and income inequality and poverty suggests that there may be a negative association between regulations and mortality. Indeed, researchers who constructed an index of state mortality find that a 1 percent increase in federal regulations (that apply to a given state) is associated with a 0.53 percent to 1.35 percent increase in this mortality index.⁵ Moreover, these results are robust to the measure of mortality. Interestingly, the authors find that these effects were most pronounced in poorer, southern US states.

POSSIBLE SOLUTIONS

Despite the grim, unintended consequences stemming from decades of regulation, there is reason to hope that lasting and consequential regulatory reform is possible. The oldest and perhaps best model of reform comes from the Canadian province of British Columbia (BC).

Fed up with stagnant economic growth, high taxes, and excessive red tape, voters elected a new government in 2001, which pledged sweeping reforms. Atop their agenda was a commitment to slash the province's 382,000 regulations by one-third. To achieve this goal, agencies were required to remove two regulatory restrictions for every new restriction imposed. Once the one-third reduction goal was achieved, the policy transitioned to a one-in-one-out rule. The government required that new rules be "necessary, outcome-based, transparently developed, cost-effective, evidence-based, and supported the economy and small business." To hold each agency accountable, agency heads reported their progress to the premier at each cabinet meeting. Finally, extensive feedback was sought and obtained from private individuals and firms to help identify red tape. Through sustained effort and commitment to reform, the new government successfully changed the culture of the BC bureaucracy. Instead of simply focusing on the drafting of rules, regulators understood that they were regulatory portfolio managers who had a duty to constantly reevaluate past rules and eliminate regulations that failed to deliver positive benefits (net of costs).

As a result of these reforms, economist Laura Jones reports that business incorporations rose while bankruptcies declined, and BC's rate of economic growth went from below average to above average in the six years after these reforms were enacted (2002 to 2008).⁶

US Examples

Following the success of British Columbia, the federal government and several US states implemented regulatory reform initiatives of varying scope and ambition. At the federal level, President Donald Trump signed Executive Order 13771, known as the “2-for-1” rule, which required federal agencies offset the cost of new rules by eliminating at least two existing rules. This, combined with other reform initiatives (e.g., the embedding of regulatory reform officers within federal agencies) resulted in less than 1 percent growth in federal regulatory restrictions during the four years of the Trump administration.

At the state level, multiple states including Arizona, Idaho, Kentucky, Ohio, Rhode Island, and Virginia have initiated comprehensive reviews of their existing regulations and have set regulation reduction targets ranging from 15 percent to 30 percent and have rolled out regulatory budgets.⁷ For the sake of brevity, I will focus on just three of these states: Arizona, Idaho, and Ohio.

Arizona's road to reform began in 2015 when Governor Doug Ducey signed an executive order that placed a moratorium on new state regulations and encouraged state agencies to conduct reviews of existing rules. In each subsequent year, Governor Ducey renewed his executive order, resulting in the repeal of over three thousand regulations and cumulative business savings of over \$169 million as of 2022.⁸ To ensure that progress on regulatory reform was durable, the Arizona legislature passed and Governor Ducey signed HB 2599, which codified a slew of regulatory reform initiatives into law, including a 1-in-3-out rule for new regulations.

In 2019, Idaho did something that no other US state had ever done: it allowed all its existing regulations (which have sunset provisions) to expire. In one stroke, over 1,800 pages of regulations were eliminated. After reauthorizing legally necessary and critical regulations, the Gem State had eliminated 75 percent of all regulations, thus surpassing South Dakota as the least regulated state in the nation.⁹ Governor Brad Little also signed two key executive orders, which instituted a 1-in-3-out rule for new regulations and greatly eliminated occupational licensing restrictions.

After several years of legislative battles, Ohio passed SB 9 in 2022, which sets a serious 30 percent regulatory reduction target over the next three years. Agencies that fail to meet this reduction target are subject to a 1-in-2-out rule for new regulations. The new law also sets a cap on total state regulations after the conclusion of the aforementioned three-year period. One of the noteworthy features of Ohio's reform strategy is the codification of the reform requirements into state law, as opposed to reliance on executive orders, which can be easily repealed by new governors.

FINAL THOUGHTS

Regulations are a necessary feature of a well-functioning society. However, regulations come at both an economic and human cost, which underscores the need for judicious application of carefully designed regulations. Failure to heed this reality has resulted in a substantial buildup of red tape at both the federal and state levels, which in turn has been shown to be associated with higher levels of income inequality, poverty, and mortality. Fortunately, several US states have embarked on serious and comprehensive campaigns to identify and eliminate unnecessary and costly regulations and impose regulatory budgeting rules that require state agencies to continuously reevaluate and eliminate poorly performing regulations before promulgating new rules. As of this writing, Idaho is that fastest-growing US state and enjoys such large budget surpluses that rebates are being sent to taxpayers and a flat tax is being initiated. Likewise, Arizona's fiscal health is in great shape; the state has added 400,000 jobs since 2015 and is sitting atop a "rainy day" fund of \$1.4 billion.¹⁰ This has enabled the Grand Canyon State to rollout one of the nation's lowest flat taxes, at 2.5 percent. Ohio's relief efforts, while only a few months old, coincide with some exciting economic developments in the state, including the announcement by Intel that it is building a \$20 billion silicon manufacturing plant in Ohio, billed as the largest such facility on earth.¹¹ Moreover, Intel may invest up to \$100 billion in the Buckeye State.¹²

Although these experiments are only quite recent, the early results are very encouraging, and they show a path forward that will limit the unintended costs of regulations on lower-income American households.

ABOUT THE AUTHOR

Dustin Chambers is a professor of economics in the Perdue School of Business at Salisbury University and a senior affiliated scholar at the Mercatus Center at George Mason University. Chambers is an applied econometrician who has published widely on the topics of income inequality, poverty, and economic growth. His most recent research focuses on the regressive effects of government regulations, including their unintended impact on consumer prices, entrepreneurship, and social mobility vis-à-vis income inequality and poverty. He earned his MA in economics from UCLA and his PhD in economics from the University of California at Riverside.

NOTES

1. For a short survey of this literature, see Dustin Chambers and Colin O'Reilly, "The Economic Theory of Regulation and Inequality," *Public Choice* 193, no. 1-2 (2021): 63-78.
2. Dustin Chambers and Colin O'Reilly, "Regulation and Income Inequality in the United States," *European Journal of Political Economy* 72 (2022): 102101.
3. 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): 131-44.
4. For additional details related to these inequality and poverty estimates, see Dustin Chambers and Colin O'Reilly, "The Regressive Effects of Regulations in Louisiana" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, April 2022).
5. James Broughel and Dustin Chambers, "Federal Regulation and Mortality in the 50 States," *Risk Analysis* 42, no. 3 (2022): 592-613.
6. Laura Jones, "Cutting Red Tape in Canada: A Regulatory Reform Model for the United States?" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, November 2015).
7. For a comprehensive review of red-tape-cutting strategies employed across US states, see James Broughel, "Cutting Red Tape in the States: A Menu of Options" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, April 2022).
8. Arizona Office of the Governor, "Governor Ducey Issues Executive Order to Wipe Out Needless Regulations," news release January 19, 2022, <https://azgovernor.gov/governor/news/2022/01/governor-ducey-issues-executive-order-wipe-out-needless-regulations>.
9. Idaho Office of the Governor, "Idaho Cuts and Simplifies 75 Percent of Rules in One Year, Becomes Least-Regulated State in Country," press release, December 4, 2019, <https://gov.idaho.gov/pressrelease/idaho-cuts-and-simplifies-75-percent-of-rules-in-one-year-becomes-least-regulated-state-in-country/>.
10. Letter from Douglas A. Ducey, Governor, Ariz., to Robert Woods, Dir., Ariz. Dep't of Revenue (Sept. 29, 2022) (https://azgovernor.gov/sites/default/files/accelerated_tax_relief_for_arizona_families_letter.pdf).
11. Ariel Zillber, "Intel to Build \$20 Billion Chip Factory in Ohio: 'Largest on the Planet,'" *New York Post*, January 21, 2022.
12. "Intel to Invest up to \$100 Billion in Ohio Chip Plants," CNBC, January 21, 2022.