MERCATUS CENTER
George Mason University

September 23, 2016

The Honorable Bob Goodlatte
United States Representative
Chair, House of Representatives Committee on the Judiciary
Washington, DC 20515

Dear Chairman Goodlatte:

Thank you for the opportunity to testify on July 6 at the hearing "Assessing the Obama Years: OIRA and Regulatory Impacts on Jobs, Wages and Economic Recovery." I'm happy to provide answers to the post-hearing questions you posed in your letter of August 19.

1. The American Action Forum found that 36 major regulations were estimated to increase consumer prices by more than $11,000 per consumer – everything from a more expensive car ($3,100), and mortgage ($362), to a microwave ($14), and air conditioner ($320). How do these data points fit in with the Mercatus Center's work on the regressive effects of regulation?

The American Action Forum's estimates of greater costs for ordinary household purchases stemming from the implementation of major regulations is entirely consistent with Mercatus Center scholars' analysis of regulation's regressive effects. Mercatus has published two studies recently in which researchers find that low- and moderate-income households bear a disproportionate cost from regulations that increase consumer products prices, when compared with the burden borne by high-income households.[1]

One example illustrates the problem. The recently implemented energy efficiency standards for household appliances (based on the Energy Independence and Security Act of 2007, P.L. 110-140) have begun to increase the costs of ordinary necessities such as washing machines, toasters, refrigerators, and other appliances many would view as necessities. This increase in costs may not be a concern for families in the top 20 percent of the income distribution (at or above $105,722 dollars). However, for families in the bottom two income quintiles (incomes up to $19,854), the percentage of income that must be devoted to pay for the higher cost could well crowd out new clothes, discretionary medical care, or higher quality food.[2]

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[1] See Diana Thomas, "Regressive Effects of Regulation" (Working Paper, Mercatus Center at George Mason University, Arlington, VA, November 2012); and Dustin Chambers and Courtney A. Collins, "How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation" (Working Paper, Mercatus Center at George Mason University, Arlington, VA, February 2016).

[2] The income levels for the upper and lower 20 percent of the population are starting values for those intervals. The mean money income before taxes for the 80th percentile is $120,634 and for the 20th percentile is $15,806. Nearly 79 percent of income in the bottom 20 percent is taken up paying for only for expenditure items: housing, food, transportation and healthcare. Thus, changes in prices for these necessities crowd out spending in other categories, for example clothing (3.1 percent of income), education (2.9 percent), and household furnishings (2.8). See Bureau of

When the burden of a government-imposed cost falls more heavily on lower-income families than higher-income families, the effect is called "regressive." We may be more familiar with this term when used in tax analysis. A sales tax is more difficult to pay for low-income individuals than it is for high-income individuals. Payroll taxes (or the taxes that provide revenues for Social Security, Disability Insurance, and Medicare Part A) are more burdensome for low-income workers than high-income workers. Both of these taxes are called regressive, even though advocates of payroll taxes argue that low-income individuals receive benefits that are proportionally more generous than the benefits received by high-income retirees.

However, the regressive effects stemming from regulation differ from those arising in the tax arena in one important respect. While the financial burden from regulation decreases as income rises, the benefits of many regulations may be the same at all income levels. For example, everyone enjoys similar benefits from cleaner air and water, from presumably less volatile financial markets, and from safer products. This similarity in benefit, however, means that high-income families often get more "bang for their buck," or a better return on the percentage of income that goes to pay for the higher costs than do low-income families. Suppose the benefit from operating an energy-efficient refrigerator is $50 in lower electrical costs per year. A high-income family that pays 2 percent of its income to purchase the refrigerator has a better deal than a low-income family that pays 8 percent of its income for the same appliance. The deal is worse for a low-income family that pays four times more to see its electrical bill fall by the same dollar amount, while a high-income family pays 2 percent of its income to realize the same $50 benefit.

2. What is your view of the propriety of agencies using behavioral economics in rulemaking?

I oppose the use of behavioral economics in rulemaking and have several reasons for this view.

Researchers publishing in the relatively new field of behavioral economics are shedding considerable light on how consumers make economic decisions. Sometimes those decisions support the traditional economic model of a rational, utility-maximizing individual. At other times, they support the view that consumers make irrational decisions not in keeping with their own best interests or the clear signals from markets. In other words, economists can no longer assume that all economic action stems from rational, self-interested individuals whose decisions, on average, redound to their well-being.

The widespread finding that consumers often do not act in their own best interests has given rise to employing behavioral concepts in rulemaking. For example, the EPA causes the costs of using certain products to rise above their market price in order to "nudge" consumers away from high utilization of scarce resources or products that degrade air and water quality standards. In other areas, regulators incentivize obese consumers to eat "smarter," or to consume fewer carbohydrates and so forth.

These nudges stem from the presumption that consumers do not know what is best for themselves and that regulators do. Another way to put this is to think of nudges and incentives as regulators' attempts at corrections of the marketplace. Regulators who apply behavioral economics explicitly

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Labor Statistics, Consumer Expenditure Survey for 2015, table 1110, http://www.bls.gov/cex/2015/combined/decile.pdf, accessed November 8, 2016.

reshape market results by causing market actors to respond to the nudges in addition to the other signals that the relevant market is giving them. This form of regulation stands in contrast to the traditional approach that lays down broad guidelines within which markets are relatively free to work.

Traditional regulatory practice makes heroic assumptions about the regulator's knowledge of consumer tastes, needs, capacities, tradeoffs, and so forth. Nobel prize–winning economist Friedrich Hayek called this assumption of knowledge the fatal conceit of modern government, since it is impossible for regulators to know anything other than a small fraction of the relevant information of even a small subset of market transactions.

This conceit is even greater among regulators who employ behavioral economics. They not only assume they possess all of the relevant information to make rational, utility-maximizing decisions for other people, but they also assume that their nudges will work flawlessly with other market signals to produce outcomes that are superior to those of markets without nudges. If traditional approaches failed on the knowledge test, behavioral approaches fail even more.

It is difficult to know if consumers who overuse natural resources or who eat themselves into severe health problems are making the wrong decisions. We do know, however, that markets will price up resources as they become scarcer through use, and that the higher price will invite the development of lower-cost substitutes. We also know that many individuals with health problems associated with their weight ultimately seek dietary or surgical solutions that restore their health. In other words, there's a non-paternalistic alternative to behavioral economics, and that alternative is a well-functioning, free market.

3. Has the Obama Administration's rhetoric on addressing overregulation matched its actions?

The answer is an emphatic no.

The Obama administration has repeatedly stated that it has reviewed and thinned out the regulations that inhibit economic growth. In 2011, President Obama argued:

> What I have done—and this is unprecedented, by the way; no administration has done this before—is I've said to each agency, "Don't just look at current regulations or don't just look at future regulations, regulations that we're proposing. Let's go backwards and look at regulations that are already on the books and if they don't make sense, let's get rid of them."[3]

The record demonstrates otherwise. Rather than lead the charge against regulations, the Obama administration has outperformed every presidential administration since Jimmy Carter in adding new rules and regulations.

[3] Robert Farley, "President Barack Obama Claims His Regulatory Review is Unprecedented," *Politifact*, June 29, 2011.

Mercatus scholars have estimated that regulatory restrictions (as measured by Mercatus's RegData project) have grown by **over 80,000** since the start of the Obama administration.[4] This growth in regulatory restrictions is part of a 40-year bipartisan trend across presidential administrations of regulatory accumulation.

Specifically looking at President Obama's administration, the government has imposed a total of 20,642 new regulations since 2009, of which 566 are considered major rules (costs in excess of $100 million per year economy-wide). Of these 566, only 26 reduced the financial burden on households and businesses, while 229 clearly increased that burden. The decreased burden saved Americans $3.4 billion annually, but the increased burden took $112 billion annually out of otherwise private use.[5]

The data clearly show that the administration is adding to, not reducing, the problem of too much regulation.

I hope this additional information is helpful in the committee's consideration of the economic effects of regulation. Please feel free to contact me if I can provide any additional information.

Sincerely,

William W. Beach
Vice President for Policy Research
Mercatus Center at George Mason University

[4] Patrick McLaughlin and Oliver Sherouse, "The Accumulation of Regulatory Restrictions across Presidential Administrations," Mercatus Center at George Mason University, August 2015.
[5] James L. Gattuso and Diane Katz, "Red Tape Rising 2016: Obama Regs Top $100 Billion Annually" (Backgrounder No. 3127, Heritage Foundation, Washington, DC, May 23, 2016).