



POLICY SPOTLIGHT

Regulation's Unintended Consequences Can Hurt Everyone—the Poor Most of All

PATRICK A. MCLAUGHLIN | APRIL 2018

Regulators and policymakers often justify regulations that slow innovation or economic growth on the grounds of protecting society, especially its poorest and most vulnerable members. But despite these good intentions, regulation many times ends up hurting the very people it seeks to help—the poor. Regulatory burdens are often regressive, disproportionately borne by the members of society least able to do so. Increased levels of regulation detract from the quality of their lives in at least four ways: sluggish wage growth, diminished employment opportunities, higher consumer prices, and disproportionate burden on small businesses.

SLUGGISH WAGE GROWTH FOR UNSKILLED WORKERS

Regulation leads to slower wage growth, a burden borne disproportionately by low-wage workers. This is because regulation shifts resources toward compliance activities, leaving a smaller share of the firm's budget for workers' wages.

DECREASED EMPLOYMENT OPPORTUNITIES FOR THE POOR

Occupational licensing—one particular kind of regulation—such as that of childcare workers not only raises prices for individuals purchasing childcare services, but can also cost childcare workers hundreds of dollars in fees and hundreds of hours in mandated training. Licensing has an especially damaging impact on poor entrepreneurs. Entry regulations impede the ability of individuals to create new businesses (and the new jobs that come with them).

- State regulation of child daycare can include prescribing maximum child-staff ratios or requiring a high school diploma for staff members, even though these approaches are much less effective at improving childcare than other approaches such as teacher training. These regulations harm low-income workers because they create legal requirements, such as continuing education, that increase the expense of qualifying to become a childcare worker.
- The high costs associated with such regulation often price low-income families out of the childcare market, potentially limiting their employment opportunities.

HIGHER CONSUMER PRICES FOR LOW-INCOME HOUSEHOLDS

Regulation also raises prices. The poor can thus find that their wages are stagnant and that their paychecks don't go as far as they once did.

It is estimated that a 10 percent increase in regulation is associated with a nearly 1 percent increase in consumer prices. Such price increases affect nearly everyone in society, but they have an especially negative effect on the poorest households, which tend to spend a larger proportion of their income on those goods and services that tend to be among the most heavily regulated, such as basic necessities.

- The cost of electricity, which is highly regulated, makes up twice as much of the budgets of low-income households as of high-income households. Consequently, low-income households feel the regulatory price inflation much more than other households.
- The Food and Drug Administration banned the use of chlorofluorocarbons as propellants in medical inhalers with the goal of improving environmental quality. The price of asthma inhalers subsequently tripled. This higher price disproportionately harms lower-income Americans, who have the greatest difficulty in absorbing the price change and who may stop buying inhalers as a result.

HIGH COSTS FOR SMALL BUSINESSES

Regulations have disproportionately high costs for small businesses because many of the costs of compliance have economies of scale.

- Many regulations impose fixed costs on businesses, and larger businesses can spread these costs over a larger volume of output.
- Compliance with regulation can often require that a business seek out legal advice, and larger businesses are more likely to have lawyers on staff while smaller companies must resort to contracting legal services.
- Increases in regulation are associated with a negative effect on the number of small businesses.

To make matters worse, this association is not proportional to regulatory growth—as the rate of regulatory growth increases, the effect on small businesses grows at an increasing rate.

Low-income areas tend to have smaller businesses than other areas, so disproportionate costs for small businesses are likely to hit low-income areas harder. Small businesses provide an important mechanism for economic mobility, particularly in poorer communities where households have little access to capital. Higher regulatory costs for small businesses reduce economic opportunity for low-income households.

FURTHER READING

Dustin Chambers and Courtney A. 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, 2016).

Dustin Chambers, Patrick McLaughlin, and Tyler Richards, “Regulation, Entrepreneurship, and Firm Size” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2018).

Dustin Chambers, Patrick A. McLaughlin, and Laura Stanley, “Barriers to Prosperity: The Harmful Impact of Entry Regulations on Income Inequality,” *Public Choice*, <https://doi.org/10.1007/s11127-018-0498-4>.

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 States” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2018).

Patrick A. McLaughlin, “Regulatory Reform Can Amount to a Progressive Tax Refund, If Done Right” (Testimony before the House Committee on the Judiciary, Mercatus Center at George Mason University, Arlington, VA, March 2, 2015).

Patrick A. McLaughlin and Robert Greene, “The Unintended Consequences of Federal Regulatory Accumulation,” *Economic Perspectives*, Mercatus Center at George Mason University, May 8, 2014.

Diana Thomas, “Regressive Effects of Regulation” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2012).

ABOUT THE AUTHOR

Patrick A. McLaughlin is a senior research fellow and the director of the Program for Economic Research on Regulation at the Mercatus Center at George Mason University. He holds a PhD in economics from Clemson University.



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