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POLICY BRIEF

Restoring Economic Opportunity in Ohio through Meaningful Regulatory Reform

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As the Ohio General Assembly considers legislation aimed at reducing the growing burden of state regulations,[1] it would do well to consider how regulations contribute to economic disparities in the state. Regulatory reform is a smart way to make Ohio more competitive, boost productivity in the state, and ultimately raise living standards, but it is also likely to reduce economic inequality and raise the incomes of the very poorest state residents. Ohio, like many other states, is struggling with sluggish growth in real income in recent decades; at the same time, inequality has been rising. It seems likely that regulation is contributing to both of these issues, given the empirical connection between regulation, inequality, and productivity, and because Ohio has so much more regulation than the average US state. At the time of writing, the Mercatus Center has analyzed 40 state administrative codes as part of its State RegData project. The average state has 137,336 regulatory restrictions, compared to Ohio with 246,832.[2] In other words, Ohio has about 80 percent more restrictions than the average state.

HOW REGULATION EXACERBATES ECONOMIC DISPARITIES

A 2018 report from an Ohio think tank, Policy Matters Ohio, suggests that wage growth in Ohio has been disappointing in recent years and furthermore that inequality has been on the rise.[3] According to the report, Ohio hourly compensation rose just 3.8 percent over the entire period of 1979 to 2016, and Ohio's top 1 percent of income earners absorbed 86 percent of income growth from 1973 to 2015, compared with 4 percent for the years 1945–1973. This lackluster performance seems to be continuing through a period when national (and state) unemployment rates have been at historically low levels, which suggests that there is a structural problem with the state's economy.

There is good reason to believe that regulation is contributing to a dysfunctional—and inequality-prone—economic environment in Ohio. Many of the proposed solutions to inequality and disappointing wage growth, such as increases in the minimum wage or higher taxes on the wealthy, focus on redistribution and government mandates. Such interventions are merely addressing symptoms, not root causes, and could backfire by increasing unemployment or reducing economic growth, thereby exacerbating the very problems they seek to address.

Regulation is an important driver of underlying economic disparities. The reason is straightforward: regulations establish barriers between individuals and well-paying jobs.[4] Perhaps the most obvious example of this is in the context of occupational licensing. Licensing requirements impose a series of hoops in the form of educational requirements and expensive fees that individuals must jump through before they can enter a profession. Often, the boards that set licensing standards are populated with industry insiders whose primary aim is to keep competitors out of their profession. Regulations make it harder for people to start businesses, which would be one of the best ways for people at the bottom of the economic ladder to achieve upward mobility. Recent analysis also suggests that recidivism, the likelihood that former prisoners will reoffend and return to prison, may also increase as a result of occupational licensing laws,[5] thereby exacerbating inequality.

However, the barriers to opportunity that regulations create extend beyond those imposed by occupational licenses. In fact, there is nothing unique about licensing regulations as far as their regressive impacts or their tendency to redistribute wealth away from less privileged groups toward those with more political clout. Most regulations can be expected to have regressive impacts of one form or another. For example, regulations raise consumer prices.[6] This disproportionately burdens low-income individuals, for whom consumption constitutes a larger portion of their budget relative to higher-income individuals. Regulations also tend to target risks that are of greater concern to well-to-do people, whilst often leaving unaddressed those risks that are most relevant to the least well off in society.[7] One study conducting international comparisons even finds that countries with more stringent business entry regulations tend to experience higher levels of inequality,[8] suggesting that regulation and nationwide inequality are linked as well.

Regulation is also likely to slow down wage growth because of the effect it has on productivity, which is a key driver of rising wages. Previous Mercatus Center research has found that the available statistical evidence, on balance, tends to show that regulations, particularly in product and labor markets, harm productivity performance.[9] Economist Antony Davies performed a statistical analysis using productivity data from the Bureau of Labor Statistics and the Mercatus Center's RegData tool. He finds that industries with lower levels of federal regulation outperform more heavily regulated sectors in a variety of measures of productivity.[10]

A study by David Autor and coauthors finds that mandated employment protections reduce productivity growth.[11] In this case, the introduction of wrongful-discharge protections appears to have altered production choices and caused employers to retain less productive workers, leading to a decline in productivity.

Another form of regulation that has become increasingly onerous in recent decades is environmental regulation. Michael Greenstone and coauthors estimate the effects of air quality regulations on manufacturing plants' total factor productivity levels between 1972 and 1993. They find that stricter air quality regulations were associated with a 4.8 percent decline in productivity at firms in regulated areas.[12]

This is just a small sampling of the research that exists in this area. Numerous other studies have outlined the detrimental effects that regulations have on productivity—far too many to summarize in this short policy brief.[13]

Troublingly, the harmful effects of regulation on productivity may be most profound in those areas that are less technologically developed. Poorer, more rural areas stand to gain the most from reducing regulatory barriers, as this can speed up the process of technology adoption.[14] These effects may be especially relevant to the manufacturing sector,[15] a critical industrial sector in Ohio.

Some have tried to argue that there has been a decoupling of productivity growth and compensation growth in recent decades.[16] This concern is almost certainly overstated, however, for several reasons. First, a careful reading of the data suggests that productivity and compensation have indeed tracked one another very closely in recent years.[17] Second, productivity is difficult to measure,[18] a problem that is growing more difficult over time as things like intangible capital become increasingly vital parts of the modern economy. It's quite possible that productivity growth has been overestimated in recent years,[19] which would explain the slowdown in wage growth and would also imply that there has been no decoupling between productivity and wages.

CONCLUSION: BOOSTING OPPORTUNITY THROUGH REGULATORY REFORM

When the evidence that regulations reduce productivity, and by extension wage growth, is combined with the evidence that regulation imposes barriers to upward mobility and exacerbates income inequality, the case for reforming the regulatory system in Ohio grows ever stronger and more urgent.

According to data from the Mercatus Center, Ohio has 100,000 more regulatory restrictions in its administrative code than the average US state. This must have an impact on the state's competitiveness. But more importantly, there is a human toll that regulation takes. Lower wage growth and higher levels of inequality can lead to a sense of hopelessness, making people feel that the course of their lives is beyond their control. In other words, when too many barriers are erected, the American dream goes unrealized.

The Ohio legislature is considering important legislation that would reduce some of the burdens that state regulations impose on residents. This is a noble goal that, if successful, should have beneficial effects on growth and opportunity in the state. Most importantly, it will free up individuals to pursue the kind of life that they deem most desirable for themselves and their families.

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NOTES

1. See S.B. 1, 133d Gen. Assemb., Reg. Sess. (Ohio 2019); and H.B. 166, Gen. Assemb., Reg. Sess. (Ohio 2019).
2. These regulatory restrictions refer to instances of the words and phrases *shall*, *must*, *may not*, *prohibited*, and *required* in legal text.
3. Amy Hanauer and Grace Chu, *State of Working Ohio 2018: Inequality amid Job Growth* (Cleveland, OH: Policy Matters Ohio, 2018).
4. Steven Horwitz, "Breaking Down the Barriers: Three Ways State and Local Governments Can Improve the Lives of the Poor" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2015).
5. Vittorio Nastasi and Samuel R. Staley, *Bridging the Divide: Licensing and Recidivism* (Tallahassee, FL: James Madison Institute, 2019).
6. 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, no. 1–2 (2019): 57–90.
7. Diana Thomas, "Regressive Effects of Regulation," *Public Choice* 180, no. 1–2 (2019): 1–10.
8. 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): 165–90.
9. Steven Globerman and George Georgopoulos, "Regulation and the International Competitiveness of the U.S. Economy" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).
10. Antony Davies, "Regulation and Productivity" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2014).
11. David H. Autor, Adriana D. Kugler, and William R. Kerr, "Do Employment Protections Reduce Productivity? Evidence from U.S. States" (NBER Working Paper No. 12860, National Bureau of Economic Research, Cambridge, MA, January 2007).
12. Michael Greenstone, John A. List, and Chad Syverson, "The Effects of Environmental Regulation on the Competitiveness of U.S. Manufacturing" (NBER Working Paper No. 18392, National Bureau of Economic Research, Cambridge, MA, September 2012).
13. See, for example, Stefano Scarpetta and Thierry Tressel, "Boosting Productivity via Innovation and Adoption of New Technologies: Any Role for Labor Market Institutions?" (Social Protection Discussion Paper No. 0406, World Bank, Washington, DC, March 2004); Christopher Kent and John Simon, "Productivity Growth: The Effect of Market Regulations" (Research Discussion Paper No. 2007-04, Reserve Bank of Australia, Sydney, Australia, June 2007); Markus Poschke, "The Regulation of Entry and Aggregate Productivity," *Economic Journal* 120, no. 549

(2010): 1175–1200; Baláza Égert, “Regulation, Institutions, and Productivity: New Macroeconomic Evidence from OECD Countries,” *American Economic Review* 106, no. 5 (2016): 109–13; Sotiris K. Papaioannou, “Regulations and Productivity: Long Run Effects and Nonlinear Influences,” *Economic Modelling* 60 (January 2017): 244–52; Giuseppe Nicoletti and Stefano Scarpetta, “Regulation, Productivity and Growth: OECD Evidence” (OECD Economics Department Working Paper No. 347, Organisation for Economic Co-operation and Development, Paris, January 13, 2003); Petar Vujanovic, “Policies to Tame the Housing Cycle in Switzerland” (OECD Economics Department Working Paper No. 1279, Organisation for Economic Co-operation and Development, Paris, February 12, 2016), 1.

14. James Broughel and Adam Thierer, “Technological Innovation and Economic Growth: A Brief Report on the Evidence” (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2019).

15. Patrik T. Hultberg, M. Ishaq Nadiri, and Robin C. Sickles, “Cross-Country Catch-Up in the Manufacturing Sector: Impacts of Heterogeneity on Convergence and Technology Adoption,” *Empirical Economics* 29, no. 4 (2004): 753–68.

16. See for example, Economic Policy Institute, “The Productivity-Pay Gap,” August 2018, https://www.epi.org/productivity-pay-gap/.

17. For an excellent summary of the measurement issues involved in this exercise, see Scott Winship, “Has Inequality Driven a Wedge between Productivity and Compensation Growth?,” *Forbes*, October 20, 2014.

18. Kemal Derviş and Zia Qureshi, *The Productivity Slump—Fact or Fiction: The Measurement Debate* (Washington, DC: Brookings Institution, 2016).

19. For example, some scholars believe that the US economy is experiencing a slowdown in technological progress more generally. See Tyler Cowen, *The Great Stagnation: How America Ate All the Low-Hanging Fruit of Modern History, Got Sick, and Will (Eventually) Feel Better* (New York: Penguin, 2011); Robert Gordon, *The Rise and Fall of American Growth: The U.S. Standard of Living since the Civil War* (Princeton, NJ: Princeton University Press, 2016).