

RESEARCH SUMMARY

How Increasing Federal Regulation Has Increased Income Inequality at the State Level

US income inequality has risen over the past two decades. During that same period, federal regulatory restrictions have risen as well. Dustin Chambers and Colin O'Reilly argue that the two are linked. In “[Regulation and Income Inequality in the United States](#),” they demonstrate that states exposed to more federal regulation tend to have higher income inequality as measured by the Gini coefficient.

Government regulation often seeks to ensure that firms comply with minimum standards for providing goods and services. Many of these well-intentioned regulations can increase costs. Unfortunately, these costs often fall hardest on small businesses and low-income individuals. Regulations can also protect established firms from having to compete with small firms trying to expand and startups trying to enter the market, resulting in higher prices for consumers.

REGULATION HURTS ENTREPRENEURSHIP, SLOWS EMPLOYMENT GROWTH, AND INCREASES POVERTY

- *Small businesses.* Regulations disproportionately affect small businesses. For example, the costs of complying with regulations are 29 percent higher per employee for small businesses than they are for large firms.
- *Fewer startups.* An increase in industry-specific regulations is associated with fewer small firms. It is also associated with a reduced number of workers in small firms.
- *Barriers to entry.* Occupational licensure increases the cost of entering a profession. The wages of existing license holders also tend to increase.
- *Higher poverty rates.* States exposed to greater federal regulations (owing to the particular mix of industries in that state) tend to have higher poverty rates. A 10 percent increase in regulatory burden is associated with a 2.5 percent increase in the poverty rate.

QUANTIFYING THE IMPACT OF FEDERAL REGULATIONS ON INCOME INEQUALITY IN THE STATES

To test whether states exposed to more federal regulatory restrictions have higher levels of income inequality, Chambers and O'Reilly use the Federal Regulation and State Enterprise (FRASE) index, which quantifies the regulatory restrictions that apply to each US state by industrial composition. Examining all 50 states for the years 1997 to 2015, the authors found the following:

- A 10 percent increase in federal regulation is associated with a 0.5 percent increase in income inequality.

- An increase in income inequality of 0.5 percent is typically associated with a two-position decline in the state's inequality ranking.
- Given the substantial increase in federal regulations over the past two decades, federal regulations may be responsible for about a 4 percent increase in income inequality over the same period.

KEY TAKEAWAY

The topic of income inequality has received particular attention in recent years, but the effect of regulation on income inequality has not been tested. This study finds that more federal regulations, even if they are well intentioned, may help explain some of the increase in income inequality at the state level in the past 20 years.