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POLICY BRIEF

Regulatory Accumulation and Its Costs: An Overview

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Federal regulators often have good intentions when they propose new rules. However, at best, policymakers only consider the implications of each regulation on its own before it is implemented. They pay little attention to how the buildup of regulations over time has hindered innovation and damaged economic growth.

Research by the Mercatus Center at George Mason University indicates that the accumulation of rules over the past several decades has slowed economic growth, amounting to an estimated $4 trillion loss in US GDP in 2012 (had regulations stayed at 1980 levels).[1] The accumulation of regulation has disproportionately disadvantaged certain groups, such as unskilled workers and low-income households. Unless Congress and agencies pursue substantive reform,[2] regulatory accumulation will continue to stifle economic growth.

For several years scholars at the Mercatus Center have been examining how regulations and the regulatory process affect American consumers and businesses, and they have identified several adverse consequences. Recent research from the Mercatus Center, for example, adds to a growing body of scholarship that points to regulatory accumulation as a significant issue for the US economy.[3]

REGULATORY ACCUMULATION DETERS ECONOMIC GROWTH

According to the Mercatus Center's RegData—a tool that uses text analysis to quantify the federal regulations targeting each industry in the United States—total regulatory restrictions have increased by nearly 20 percent since 1997, to more than 1 million.[4] Several studies have quantified how the accumulation of rules can slow economic growth:

- A study published in the *Journal of Economic Growth* in 2013 finds that between 1949 and 2005 the accumulation of federal regulations slowed US economic growth by an average of 2 percent per year.[5] Had the amount of regulation remained at its 1949 level, 2011 GDP would have been about $39 trillion—or 3.5 times—higher than it was.
- A 2016 study commissioned by the Mercatus Center uses an endogenous growth model to examine regulation's effect on firms' investment choices. By distorting the investment choices that lead to innovation, regulation creates a considerable drag on the economy. This study estimates that cumulative regulations are associated with an average reduction of 0.8 percent in the annual growth rate of the US GDP since 1980. This seemingly small annual reduction has large implications. The slower economic growth estimated by this model results in an economy that was $4 trillion smaller in 2012 than it could have been without such regulatory accumulation. That amount equaled about a quarter of the US economy in 2012, and if it were a nation's GDP, it would be the fourth largest in the world.[6] This translates to a loss in real income of approximately $13,000 per American.[7]
- A 2005 World Bank study finds that a 10-percentage-point increase in a country's regulatory burdens slows the annual growth rate of GDP per capita by half a percentage point.[8] Based on this finding, an increase in regulatory burdens can translate into billions of dollars in lost GDP growth in less than a decade, depending on the size of the economy.

CONSUMER PRICES INCREASE WHILE THE POOR PAY

Proponents of regulation often cite the need to protect society as a whole, and particularly low-income individuals, as justification for regulating despite potential economic costs. However, numerous regulations disproportionately burden poor Americans, who are least able to afford them, by raising the prices of basic goods such as food and utilities.

- Federal regulations often address small risks that concern a targeted group, but impose the costs on everyone. A Mercatus study finds that these rules cost as much as six to eight times more as a share of income for low-income households than for high-income households.[9]
- Another study commissioned by the Mercatus Center finds that increases in the total volume of regulations—that is, regulatory accumulation—are strongly associated with higher prices. This effect hits low-income households harder than high-income households because low-income households spend a larger share of their income on basic goods.[10] As US regulations increased by a third between 2000 and 2012, this study estimates that price inflation associated with this increase could be as much as 10 percent. As a result, low-income households had to spend more of their incomes on regulated goods, leaving less available to save and use to reduce risk in other ways.

THE LABOR MARKET IS DISTORTED AND WORKERS ARE HARMED BY REGULATORY ACCUMULATION

The rapid growth in the quantity of federal rules has likely hindered the struggling labor market. An increasing regulatory burden can harm workers in various ways. A 2013 Mercatus study explains how:[11]

- Regulation adds to costs, increasing prices for regulated goods and services and reducing the final amounts of these goods and services being bought and sold. As production declines, so does the demand for workers engaged in production. This shrinkage in the size of the market can decrease employment, not only in regulated industries but also in industries downstream that use the now-more-expensive goods and services.
- More regulation also leads to a shift of workers from production to regulatory compliance jobs, which reduces overall economic efficiency. Even if displaced workers eventually find new employment, they often face permanent losses in lifetime earnings, which can be as much as almost three years of their previous annual income. This is largely due to skill mismatches between the jobs lost and the new jobs created in the economy.

BURDENSOME REGULATIONS CAN INCREASE INEQUALITY

Regulations that make entry into the market more difficult may increase inequality by corralling low-skilled workers into low-paying, less regulated fields or forcing them to operate illegally and incur the higher costs of doing so.

- A recent Mercatus study finds that an increase in the effective federal regulatory burden upon a state is associated with an increase in the poverty rate. This unintended rise in poverty associated with additional regulations should be factored into the regulatory decision-making process.[12]
- A recent Mercatus study find that countries requiring a higher number of procedures to start a new business tend to experience higher levels of income inequality.[13] If entry regulations require expensive education, testing, and fees, workers may choose instead to accept jobs that pay less and don't take full advantage of their skills.[14]
- A recent study for the Mercatus Center finds that an increase in the number of steps necessary to legally open a business is associated with an increase in the inequality of income distribution.[15] The accumulation of regulatory requirements can lead to income inequality because regulations can act as barriers to entry, and the higher barriers to entry become, the costlier it is for entrepreneurs to start a business. When entrepreneurs cannot legally open a business because of the cost of dealing with regulations, they may abandon their ideas altogether.[16]

ENTREPRENEURS FACE DIFFICULTY STARTING NEW BUSINESSES AND COMPETING

Regulatory accumulation may be particularly detrimental to economic prosperity to the extent that it deters entrepreneurship. If larger existing firms can overcome the costs of complying with regulations more easily than new, small firms, the startups that often drive innovation and job growth might never emerge.

- According to a recent Mercatus study, small firms seem to have a harder time coping with higher regulatory growth than large firms. Regulatory accumulation has a compounding effect, suggesting that regulatory accumulation disproportionately burdens small businesses at an increasing rate. Small businesses tend to be more common in low-income areas and provide important opportunities for economic advancement. Choking off small businesses diminishes economic mobility for the poor.[17]
- A 2015 Mercatus study finds that existing firms can benefit from regulation because it deters new market entrants. It also shows that as complication in regulation grew, there was a decline in the number of new firms. This decline, however, came in the number of small firms; the increase in complication of regulation had no effect on large firms.[18]
- Moreover, an increase in regulation is associated with a decrease in hiring among all firms, including small firms.

CONCLUSION

Federal regulations have accumulated over many decades, resulting in a system of duplicative, obsolete, conflicting, and even contradictory rules. The consequences to the economy—and to the workers, consumers, and job creators who drive economic growth and prosperity—are costly. Regulatory accumulation is a consequence of a complicated regulatory process and creates a serious problem for the US economy.

Even the best-designed individual rule can create adverse effects by its interaction with the system of rules already in effect. In light of the several adverse effects already identified in this line of research, policymakers should more fully consider the consequences of regulatory accumulation and how the regulatory process results in such accumulation before adding to an already sizable pile of rules.

ABOUT THE AUTHORS

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NOTES

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