Joint Economic Committee Republicans
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Smothering Economic Growth One Regulation at a Time

The United States has gone from an economic backwater of a few relatively small colonies to the largest, most prosperous economy in the world. Through much of the post-World War II period, the United States economy has been the envy of the world. However, our recent economic history has been disappointing. The current expansion has been hampered by high taxes and regulation. Two recent Joint Economic Committee (JEC) studies demonstrate that excessive government is harmful to economic growth and worker's incomes[1]. Serious economic reform must reduce the size and scope of the federal government.

Of particular concern to many entrepreneurs is the federal regulatory burden. In a recent poll, fifty-two percent of mid-sized firms said that government regulation was their biggest concern. They were more concerned about regulations than about making a profit, paying taxes, or controlling health-care costs. Clearly, reducing the regulatory burden is vital to create the basis for robust economic growth.

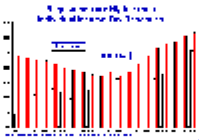
Economic Growth and Regulation

Regulations work like taxes. It makes no difference to the entrepreneur, or the economy, whether the entrepreneur must write a $5,000 check to the government for taxes or a $5,000 check to comply with a regulation. Forcing the entrepreneur to comply with regulations diverts resources to less-productive uses. Unwise regulations destroy wealth as it diverts resources, labor and capital, into unwanted uses.

Economic growth is created by entrepreneurs efficiently providing goods and services to their consumers. Regulations interfere with the basic process of production. Furthermore, the economic well-being of consumers is maximized by satisfying their wants at the lowest possible costs. Regulations raise costs and hinder entrepreneurs from supplying many consumer goods. Higher costs slow economic growth. The slow down in economic growth reduces incomes and makes everyone poorer.

The Costs of Regulation

The costs of federal regulations are enormous. Thomas Hopkins, an economist at the Rochester Institute of Technology, estimated that regulations cost more than $600 billion per year. Other economists estimated the regulatory costs amount between $810 billion and $1.7 trillion[2]. The figure below demonstrates that regulatory costs, using Hopkins' more conservative figure, are higher than federal individual income tax revenues. It also shows that the impact of federal regulations are growing faster under Clinton than after the declines of the 1980s.

Click here to see Figure.

Although regulatory costs are damaging to economic growth, another problem is that federal regulators often take little or no account of costs. A compelling example was Regulation Q by the Federal Reserve. Regulation Q prohibited banks from paying interest on checking deposits and set a ceiling on interest paid on savings accounts. The effects of Regulation Q were particularly harsh during the high inflation period of the 1970s. Consumers lost billions of dollars when their money was deposited with banks and savings and loans. Regulation Q also contributed to the savings and loan disaster. Many consumers took their money out of S&Ls and deposited them with money market mutual funds.

In another example, the Environmental Protection Agency directed Amoco to spend $31 million to remove benzene from its waste water in its treatment plant. Amoco showed that it could remove four times as much benzene from its waste water in other areas of the plant for only $6 million. Clearly, it would be better for the health of the community to reduce more benzene. Amoco's argument was that the interests of the community lie in lower levels of benzene. However, the interests of the regulators were to have the company comply with the mandated regulations. Regulators too often follow the book rather than look at the interests of the community. If Amoco were allowed to flexibly meet environmental goals, they could have saved $25 million while improving the health of the community.

Small Business and Regulation

The costs of regulation are not spread evenly over the population. Many businesses suffer excessively from federal regulations. In a study by Dr. Hopkins, he estimated that small- and mid-sized businesses suffer disproportionately. He estimated that businesses that employ more than 500 workers pay on average $2,921 per employee to comply with federal regulations. Businesses with 20 to 499 employees pay on average $5,195 to comply and businesses with fewer than 20 employees pay $5,545 to comply. For many regulations the cost is the same for all sizes of companies; so the cost of compliance is disproportionately higher for small- and mid-sized firms.

Many regulatory laws include small business relief by exempting businesses with relatively few employees. Although these exemptions are critical to allow many small businesses to continue to operate, they are a significant impediment to growth for these businesses. Many small business owners are reluctant to hire additional employees and incur additional regulatory headaches. Rather, they limit their expansion or contract their services to outside firms.

Innovation and Regulation

Regulation is also damaging to innovation. The purpose of federal regulation is to change economic behavior in ways Washington bureaucrats think are appropriate. However, the very nature of innovation is its unpredictability. Future innovations cannot be directed by bureaucrats in any one city. Rather, innovations emerge from entrepreneurs striving to compete for consumer businesses by providing the best possible good or service at the lowest possible cost.

Many features of federal regulation are stifling to innovation. Environmental regulation traditionally identified methods whereby industries were to achieve pollution reduction. In one instance, industries were forced to install expensive smoke scrubbers to remove sulfur from plant exhaust. However, there were cheaper methods to achieve the same outcome. The reason for the language of regulation often has little to do with improving safety or economic well-being. It is to reward a favored constituency.

Recently, environmental laws have been written with a recognition that the market can better determine the most cost-effective way to achieve pollution reduction. The Clean Air Act allows firms that can reduce pollution at lower costs to be able to sell the rights to their emissions to firms where pollution reduction is at a higher cost. These tradeable permits create incentives for every firm to reduce their polluting emissions as much as is cost effective. Some firms will reduce pollution below federally-mandated levels. Others will find it too expensive and will purchase permits on the open market. The result of the flexible approach is a lower level of pollution at a significantly lower cost.

The Benefits of Regulatory Rollback

The benefits of reduced regulation are clearly evident where regulation, especially price and supply restriction, has been reduced in the past. For years, airline, trucking, and railroad rates were regulated by the federal government. In the 1980s, many transportation regulations were eliminated. Critics of regulatory relief painted a dismal picture of the future of transportation with higher prices and lower quality. However, the benefits of deregulation are readily apparent. The costs of transporting goods and people have fallen dramatically. More people are flying and railroad companies are experiencing a surge in demand. The reduction in regulation has benefited both consumers and producers. The transportation sector is a clear example of the benefits of fewer regulations.

Our international competitors are suffering from the impacts of their burdensome regulation. In Germany, a country whose economic policies are admired by President Clinton and Secretary of Labor Robert Reich, the economy is barely growing and unemployment is increasing. The reason is that employers are reluctant to hire new employees. Mandated benefits are 85 percent of the typical employee's salary. Labor costs, because of these mandates, are 50 percent higher than in the United States. Japan and other European economies are suffering from this same regulatory disease. Japan's economic growth rate has been anemic. Unemployment is up dramatically in Europe and Japan. International competition demands a climate of lower taxes and regulation to remain productive. The productive economy is an economy with minimal regulation.

Conclusion

The JEC has issued many reports highlighting the direct and indirect cost of big government. The stagnation of family incomes under Clinton are the direct result of his Administration's failure to curb the size and scope of the Federal government. If we are concerned with the inadequate rate of economic growth, we must recognize that the single greatest impediment to economic growth is the size and scope of the Federal government. Unless we can reduce the extent of regulation and introduce some economic rationality to important regulations, we cannot hope to see incomes rise to provide a better future for our children and future generations.

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Endnotes

1. *The Impact of the Welfare State on the American Economy, 1995*. Joint Economic Committee; and *The Impact of the Welfare State on Workers, 1996*. Joint Economic Committee.

2. "Regulatory Overkill is Smothering Business." *Wichita Business Journal*. January 13, 1995.