*WHY GOVERNMENT REGULATION IS GOOD FOR BUSINESS*

*By* **GEOFFREY JAMES** **MONEYWATCH** *October 25, 2010, 10:58 AM*

# Government Regulation is Good for Business

*Last Updated Oct 25, 2010 11:04 AM EDT*

Yes, you read that right. Government regulation is **good** for business...depending on how you define the term "business" and on how the regulations are written.

Many people (and especially the "business" press) tend to use the umbrella term "business" to mean any organization that tries to make a profit. But that usage is, like most generalizations, misleading.

There is very little commonality of self-interest between, say, a mega-billion dollar company like Walmart, and a locally-owned boutique.

Quite the contrary. Business conditions that help Walmart to be successful are almost always going to make it more difficult for that boutique to survive.

It's much more accurate to say that there are two broad segments of profit-making organizations: big businesses and small businesses.

This is an important distinction to make because majority of business activity in the United States takes place in small business. According to the U.S. Department of State:

*Fully 99 percent of all independent enterprises in the country employ fewer than 500 people. These small enterprises account for 52 percent of all U.S. workers, according to the U.S. Small Business Administration (SBA). Some 19.6 million Americans work for companies employing fewer than 20 workers, 18.4 million work for firms employing between 20 and 99 workers, and 14.6 million work for firms with 100 to 499 workers. By contrast, 47.7 million Americans work for firms with 500 or more employees.*

What does this have to do with government regulation? Everything.

A lack of government regulation is almost always to the advantage of big businesses and to the disadvantage of small businesses. Such a condition always results in the formation of monopolies and the suppression of smaller firms, even if those firms might be highly innovative.

As the great Adam Smith pointed out: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

Does this mean that all government regulation is favorable to small business? Of course not.

In fact, government regulations are often intentionally written so that they favor big businesses over small ones. This always happens because legislators and regulators are usually "owned" by big businesses, either through campaign contribution bribery or the promise of future employment.

A perfect example of this is Sarbanes-Oxley, the financial regulation enacted after the Enron debacle.

Even though the culprits of the debacle were very much from the world of big business, the net effect of Sarbox on small businesses was to add a fixed cost (massive accounting fees) to going public, an expense that large companies could easily afford, but which was (and is) burdensome on smaller firms.

The problem is that the elected government of the United States has become like the elected government of Imperial Rome. All the forms of the republic remain in place, but the actual decisions are made elsewhere.

In this case, though, it's not an emperor that is pulling the strings, but the forces of big business. Those forces would prefer to have no regulations, but if that's not possible (for political reasons) will tolerate regulations that favor big business.

So here's the reality of today's situation: if you work for or own a small business, when it comes to government regulation, it's a classic "heads they win, tails we lose" situations. To a greater or lesser degree, it's the small businesses who are going to get screwed, no matter what.

On the other hand, there have been times in the history of the United States, where the government has enacted regulations (and laws) that help small businesses. The anti-monopoly regulations, for example, help small businesses at the expense of large ones, which is exactly why they're so seldom invoked any longer.

Trade tariffs are also useful to small businesses that don't have the resources to globalize. Big businesses, of course, love free trade because it gives them license to move their manufacturing overseas. However, such movement often means the collapse of local small business.

To summarize, here are the rules of the game:

* No government regulation = good for big business, bad for small business.
* Most government regulation = good for big business, bad for small business.
* Some government regulation = bad for big business, good for small business.

As you can see, there's no situation under which some segment of the business world doesn't prosper. Government regulation either favors big business or (very rarely) favors small business. Therefore, government regulation is good for business.

Now, if politicians and regulators really wanted to help the most number of businesses and employees, they'd enact regulations that would favor small businesses, since that's where the majority of the economic activity takes place.

However, since both parties are "owned" by big business, that will never happen, so the choice will be between the Republican idea of deregulation (which will vastly favor big business) and the Democratic idea of regulation (which will also favor big business, as shown by the laughably impotent attempt to "regulate" Wall Street).

What we won't see -- barring Teddy Roosevelt rising from the grave -- is government regulation that favors small businesses. And that's a shame, because that's probably the only kind of government activity that's likely to rebuild the middle class and create substantial numbers of jobs in the United States.

# Federal Regulations Have Made You 75 Percent Poorer

## U.S. GDP is just $16 trillion instead of $54 trillion

[**Ronald Bailey**](https://reason.com/people/ronald-bailey/all) | June 21, 2013

The growth of federal regulations over the past six decades has cut U.S. economic growth by an average of 2 percentage points per year, according to a new [study](http://www4.ncsu.edu/~jjseater/regulationandgrowth.pdf) in the Journal of Economic Growth. As a result, the average American household receives about $277,000 less annually than it would have gotten in the absence of six decades of accumulated regulations—a median household income of $330,000 instead of the [$53,000 we get now](http://quickfacts.census.gov/qfd/states/00000.html).

The researchers, economists John Dawson of Appalachian State University and John Seater of North Carolina State, constructed an index of federal regulations by tracking the growth in the number of pages in the Code of Federal Regulations since 1949. The number of pages, they note, has increased six-fold from 19,335 in 1949 to 134,261 in 2005. (As of 2011, the number of pages had risen to 169,301.) They devise a pretty standard endogenous growth theory model and then insert their regulatory burden index to calculate how federal regulations have affected economic growth. (Sometimes deregulation extends rather than shortens the number of pages in the register; they adjust their figures to take this into account.)

Annual output in 2005, they conclude, "is 28 percent of what it would have been had regulation remained at its 1949 level." The proliferation of federal regulations especially affects the rate of improvement in total factor productivity, a measure of technological dynamism and increasing efficiency. Regulations also affect the allocation of labor and capital—by, say, raising the costs of new hires or encouraging investment in favored technologies. Overall, they calculate, if regulation had remained at the same level as in 1949, current GDP would have been $53.9 trillion instead of $15.1 in 2011. In other words, current U.S. GDP in 2011 was $38.8 trillion less than it might have been.

Let's use those results as the starting point for some rough calculations. The Bureau of Economic Affairs estimates that real GDP in 1947 was $1.8 trillion in 2005 dollars. The real GDP growth rate between 1949 and 2011 averaged 3.2 percent per year. Compounded over the period, that would yield a total real GDP of about $13.3 trillion in 2011; that's the same figure the bureau gives for that year. If regulation had remained fixed at 1949 levels, GDP growth would have averaged 2 percent higher annually, yielding a rate of about 5.2 percent over the period between 1949 and 2011. Compounded, that yields a total GDP in 2005 dollars of approximately $43 trillion, or $49 trillion in 2011 dollars, which is in the same ballpark as the $53.9 trillion figure calculated by Dawson and Seater.

But let’s say that the two economists have grossly overestimated how fast the economy could have grown in the absence of proliferating regulations. So instead let’s take the real average GDP growth rate between 1870 and 1900, before the Progressives jumpstarted the regulatory state. Economic growth in the last decades of the 19th century averaged 4.5 percent per year. Compounding that growth rate from the real 1949 GDP of $1.8 trillion to now would have yielded a total GDP in 2013 of around $31 trillion. Considerably lower than the $54 trillion estimated by Dawson and Seater, but nevertheless about double the size of our current GDP.

All this means that the opportunity costs of regulation—that is, the benefits that could have been gained if an alternative course of action had been pursued—are much higher than the costs of compliance. For example, the Competitive Enterprise Institute's report [Ten Thousand Commandments 2013](http://cei.org/studies/ten-thousand-commandments-2013) estimates that it costs consumers and businesses approximately $1.8 trillion—about 11 percent of current GDP—to comply with current federal regulations. That's bad enough, but it pales in comparison to the loss of tens of trillions in overall wealth calculated by Dawson and Seater.

Defenders of regulation will argue that regulations also provide benefits to Americans: lower levels of air pollution, higher minimum wages, and so forth. But the measure devised by Dawson and Seater accounts for both the aggregate benefits and the costs of the regulations. The two researchers note their results "indicate that whatever positive effects regulation may have on measured output are outweighed by negative effects." There may be some unmeasured positive outputs that result from regulation. But the benefits would have to be hugely substantial to offset the loss of $39 trillion in output in 2011 alone. Is that plausible?

Dawson and Seater explicitly do not attempt to separately measure the benefits of regulation in their study, only its overall effects on output. But the Office of Management and Budget does claim to measure the costs and benefits of federal regulation. In the most recent Office of Information and Regulatory Affairs (OIRA) [report](http://www.whitehouse.gov/sites/default/files/omb/inforeg/2013_cb/draft_2013_cost_benefit_report.pdf), the highest estimates for costs and benefits for regulations adopted from 2002 to 2012 are $84 billion and $800 billion respectively. Let's be extremely generous in calculating regulation's benefits and assume that they provide not just $800 billion in total benefits over 10 years, but that much in just one year. Then, just to be sure that we haven't overlooked any non-monetized benefits unaccounted for the OIRA, and to take into account of the fact that number of pages in the CFR have risen six-fold, let's multiply that by 6, yielding an estimated annual regulatory benefit of $4.8 trillion.

That's just a bit more than a quarter of the current GDP. Recall that Dawson and Seater have calculated that if the regulatory burden had remained the same as it was in 1949, the U.S. economy would be about $38 trillion bigger than it currently is. So the upshot of this wildly optimistic set of assumptions regarding the benefits of regulation is that Americans have foregone $33 trillion in income that we otherwise would have had. Or in the alternative case, where a lower rate of growth results in a GDP of only $31 trillion, that would mean that Americans have foregone about $10 trillion in income due to overregulation.

Whatever the benefits of regulation, an average household income of $330,000 per year would buy a lot in the way of health care, schooling, art, housing, environmental protection, and other amenities.

Since GDP growth rates in other industrialized countries more or less track U.S. growth rates over the period, I asked both Dawson and Seater via email if it would be fair to conclude that those countries had also adopted a similar suite of regulations that also slowed their potential GDP gains. Being careful not to go beyond the data in the study, Dawson replied, "Similarity of growth rates really doesn't tell us anything about the growth effects of regulations in the different countries. However, it would be fair to say that many studies (cited in our paper) examine the effects of regulation in many European countries and find large negative effects on employment, investment, rates of new business start-up, and so on."

For example, a 2004 World Bank study of the effects of regulation in a large sample of industrial and developing countries constructed an [index of severity of regulation](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2005/02/07/000090341_20050207082757/Rendered/PDF/wps3469.pdf). It revealed that increasing a country's index of regulation by one standard deviation (34 percent) reduces its per capita GDP growth by 0.4 percent. Dawson and Seater's article, in comparison, finds that "an increase in total regulation of 600 percent reduces growth by just 2 percentage points. Relatively speaking, our effect is smaller." With appropriate caveats about differences in various studies, Seater told me via email, "The uniform message that comes through from all the studies I have seen is that regulation has strong negative effects on economic growth."

So if the effects of regulation are so deleterious to economic growth and the prosperity of citizens, why do countries enact so much of it? Dawson and Seater's paper mentions three theories: Arthur Pigou's notion that governments enact regulations to improve social welfare by correcting market failures, George Stigler's more cynical view that industries capture regulatory agencies in order exclude competitors and increase their profits, and Fred McChesney's argument that regulations are chiefly aimed at [benefiting politicians and regulators](http://www.jstor.org/discover/10.2307/724475?uid=3739704&uid=2129&uid=2&uid=70&uid=4&uid=3739256&sid=21102344391951). I asked if their results fit most closely with McChesney's. Dawson replied: "This could be the conclusion that one reaches based on our empirical results (since they show a net cost of regulation over time), but again we did not set out to prove or disprove any particular theory." Seater added that their research does not address the question of "why society allows excessive regulation....It's an important [issue], but it is one for the public choice people to study, not for macroeconomists like me and my coauthor."

One such public choice theorist, Mancur Olson, argued in [The Rise and Decline of Nations](http://www.amazon.com/exec/obidos/ASIN/0300030797/reasonmagazineA/) (1982) that economic stagnation and even decline set in when powerful special-interest lobbies—crony capitalists if you will—capture a country's regulatory system and use it to block competitors, making the economy ever less efficient. The growing burden of regulation could some day turn economic growth negative, but in a note Dawson and Seater suggest that in the long run that will "not be tolerated by society." Let's hope that they are right.

[**Ronald Bailey**](https://mail.google.com/mail/?view=cm&fs=1&tf=1&to=rbailey@reason.com) is a science correspondent at Reason magazine and author of [**The End of Doom**](http://reason.com/eod) (July 2015).