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RESEARCH SUMMARY

THE REGRESSIVE EFFECTS OF REGULATION: Who Bears the Cost?

DIANA THOMAS

Assistant Professor of Economics, Utah State University

In a market economy, regulations are often thought of as a useful tool in correcting the imbalance of power between large, entrenched interests and consumers. Federal agencies are supposed to create universal rules of the road that protect the health, safety, and welfare of customers and employees, secondary considerations for companies focused on profits. Recent Mercatus Center research casts doubt on whether the regulatory process actually achieves these goals.

In her study "Regressive Effects of Regulation," Diana Thomas illustrates an important fact about regulation: those who are least able to afford it are often forced to bear the costs, while seeing relatively few benefits. Thomas's research highlights the dangers of regulating without considering the real-world impacts on consumers, particularly the poorest and most vulnerable.

Thomas notes that regulations often burden low-income households disproportionately, either by increasing costs of goods and services, lowering wages, or both. Consequently, the most vulnerable households have less money on hand to implement the choices that would improve their welfare the most.

Below is a brief summary of Thomas's paper. To read it in its entirety and learn more about the author, see "Regressive Effects of Regulation."

HURTING THOSE WE'RE TRYING TO PROTECT

While there is plenty of debate about what, exactly, federal regulation should try to accomplish, most would agree that regulation should not make society's most vulnerable individuals less safe. Unfortunately, that is exactly what happens sometimes.

Low-income households benefit the most when they act to reduce their exposure to the greatest risks they face, such as relatively common events and activities that cause illness, injury, and death, many of which can be traced to living in unsafe neighborhoods. In contrast, high-income households generally focus more on small risks—for example, tiny environmental risks that are far less likely to occur and generally affect fewer people at the exposure levels regulations address.

LOWER INCOME HOUSEHOLDS BEAR MORE OF THE COSTS OF REGULATION

Regulation focused on small risks delivers benefits to a limited group but spreads the costs across everyone. As a result, regulation effectively transfers money from low income households, who need to prevent larger risks, to high income households, who are concerned about small risks. Low income households are, in a sense, paying for the lifestyle preferences of the wealthy.

Such regulation increases consumer prices and lowers worker wages.

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- Regulations act like a regressive sales tax, with middle and lower income households bearing much of the cost of rules that focus on the risk preferences of wealthier households, since they all pay the same, higher prices.
- Cost of regulation as a share of income is estimated to be as much as six to eight times higher for low-income households than for high-income households.
- Thomas estimates that households can mitigate the same level of mortality risks privately for about one fifth of the cost of public risk-reduction strategies.

PRIVATE RISK MANAGEMENT IS SUPERIOR

The most powerful tool for improving health and safety is a consumer's ability to use his or her own money to purchase the goods and services that best serve the individual's needs. Private decisions about risk management are capable of solving a wide range of health and safety issues facing consumers, while public risk management through regulation often focuses on narrow issues.

- A consumer making the decision to move to a different neighborhood may enjoy numerous benefits, ranging from lower rates of violent crime to better-performing schools, resulting in a simultaneous reduction in multiple risks.
- Public risk management forces consumers to expend limited resources on complying with a mandate, such as the one requiring rearview cameras in cars, that benefits people in a few, very specific, situations, and does nothing to address the highest risks facing the poorest households.

SUGGESTED SOLUTIONS

Regulators must consider the unintended consequences and hidden costs of their rules. This requires an active effort to understand who ultimately bears the costs of regulation.

- Regulations should respect an individual's ability to determine their own needs and work to improve the options of consumers rather than limit them.
- Policy makers should consider whether the costs expended on reducing tiny risks with public health and safety regulation could be better spent by households more cost-effectively for larger risks.
- Policy makers should consider not only the total costs of regulation, but who will actually be forced to bear those costs. This is superior to any attempts, post enactment, to compensate for losses caused by the regulation, which will further complicate assessments of benefits and costs and interfere in risk mitigation that is better left to individuals who know their own risks best.

CONTACT

Robin Bowen, (703) 993-8582, rbowen@mercatus.gmu.edu
Mercatus Center at George Mason University
3351 Fairfax Drive, 4th Floor, Arlington, VA 22201.

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