

May 5, 2016

The Honorable Bob Goodlatte
United States Representative
Chair, House of Representatives Committee on the Judiciary
Washington, DC 20515

Dear Chairman Goodlatte:

Thank you for the opportunity to testify on February 24 at the hearing “Triple Threat to Workers and Households: Impacts of Federal Regulations on Jobs, Wages and Startups.” I’m happy to provide answers to the post-hearing questions you posed in your letter of April 5.

1. At the hearing, Mr. Weissman said that a regulatory failure led to the great recession. Do you agree? What were the underlying causes of the financial collapse?

The financial collapse has been associated with several actions of the federal government, as well as firms and individuals in the private sector. Monetary policy, regulation of financial markets, and moral hazards arising from government policies interact in such a complicated way that it is easy to claim a specific cause and difficult to actually prove it.¹ However, we can say without a doubt that regulation did not prevent the financial collapse. I have previously documented that, contrary to popular myth, the volume of regulation issued by financial regulators increased by 17.9 percent from 1997 to 2008.² Others have used alternative measures of regulation and found similar results.³

Is it a regulatory failure when the volume of financial regulation increases but a financial collapse still occurs? Perhaps the better question is, “How could regulation have prevented the financial collapse?” In hindsight, many of those regulatory policies that were on the books leading up to the collapse also played a role in creating it. For example, many have pointed to the SEC’s creation and treatment of nationally recognized statistical rating organizations (NRSROs) as part of the problem. A clear regulatory failure would occur if regulators simply assumed that more regulation or less regulation would be the “solution.” Instead, regulators should objectively reexamine existing regulatory policies to ensure that the regulations are reducing risk, not—as a result of

¹ Kling examines the role and interactions of housing policy, capital regulation, monetary policy, industry structure, and innovation in the financial crisis of 2008. See Kling, Arnold. *Not What They Had in Mind: A History of Policies that Produced the Financial Crisis of 2008*. Mercatus Center at George Mason University, 2009. <http://mercatus.org/publication/not-what-they-had-mind-history-policies-produced-financial-crisis-2008>.

² McLaughlin, Patrick A. and Robert Greene. “Did Deregulation Cause the Financial Crisis? Examining a Common Justification for Dodd-Frank.” Mercatus Center at George Mason University, 2013. <http://mercatus.org/publication/did-deregulation-cause-financial-crisis-examining-common-justification-dodd-frank>.

³ See, for example, Calabria, Mark A. “Did Deregulation Cause the Financial Crisis?” Policy Report, Cato Institute, July/August 2009. <http://www.cato.org/policy-report/julyaugust-2009/did-deregulation-cause-financial-crisis>.

moral hazard or opportunistic behavior related to the design of regulations themselves—increasing risk.

2. Dr. Bivens, in his testimony, argued that fossil fuel job losses are more than offset by green energy job creation. But green jobs are the artificial creation of taxpayer subsidies. GAO reports the federal government alone has spent, at least, \$150 billion on renewable energy projects. Dividing that Dr. Bivens' estimate of 115,000 solar jobs created and even adding the 79,000 wind and solar jobs identified by a celebrated 2015 Duke study, that's \$773,195 per job! So isn't that argument misleading?

Government policies can force the reallocation of scarce resources, including labor, from one sector to another. Regulations, taxes, and subsidies all effectively take from some areas of the economy and give to other areas. Government intervention can create jobs temporarily, but the jobs will dissipate without sufficient market demand for the products those workers make. Furthermore, an intervention to force the exchange of resources from one sector to another or from taxpayers to a specific project is never frictionless.

While projections of employment growth in a specific sector often convey the impression of “gross employment growth, they obscure the broader implications for economic welfare by omitting any accounting of off-setting impacts.”⁴ These impacts include the obvious, such as the crowding out of the unsubsidized competitors, but also the more subtle, indirect impacts. For example, if a regulatory intervention causes the price of electricity to increase, downstream producers that use electricity as an input of production will have to adjust to the increases production costs, often leading to fewer jobs in those sectors. Price increases are also passed along to consumers, with the regressive effects detailed in the Chambers and Collins study I referenced in my testimony.⁵

In summary, it is an incomplete accounting of the employment effect of a regulation or a subsidy to only consider the effects of the specific sector that may benefit from the regulation because its products have become relatively less expensive (that is, its rivals' products have become more expensive). When the rivals' employment effects are considered, along with downstream effects from higher prices and the crowding out of investment, the net effect is quite different.⁶ And none of that is even taking into account the effect of collecting \$150 billion from taxpayers to pay for the subsidies mentioned in this question.

⁴ Frondel, Manuel, Nolan Ritter, Christopher M. Schmidt, and Colin Vance. “Economic Impacts from the Promotion of Renewable Energy Technologies: The German Experience.” *Energy Policy* 38, no. 8 (2010): 4048–4056. Quote from 4053.

⁵ Chambers, Dustin and Courtney A. Collins. “How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation.” Working Paper, Mercatus Center at George Mason University, 2016. <http://mercatus.org/publication/how-do-federal-regulations-affect-consumer-prices-analysis-regressive-effects-regulation>.

⁶ A study by CBO director Keith Hall explains some of these and other labor effects of regulation. See: Hall, Keith. “The Employment Costs of Regulation.” Working Paper, Mercatus Center at George Mason University, 2013. <http://mercatus.org/publication/employment-costs-regulation>.

3. Dr. Bivens, in his testimony, argued that private sector job growth shows that regulation is not harmful. But doesn't that ignore the quality of those jobs? The *New York Times* says that “the strongest employment growth during the sluggish recovery has been in low-wage work, at places like strip malls and fast-food restaurants. . . . In essence, the poor economy has replaced good jobs with bad ones.” Isn't that a problem?

An economy is a reflection of the production of individuals and firms. Private sector job growth is a surrogate endpoint—it is a measure of activity within the economy, but it is not a measure of production of the economy. Whether that job growth is correlated with economic growth depends on what the individuals in those jobs produce. And in the long run, it also matters if the individuals in those jobs have opportunities to improve their skill sets, take on more responsibilities, and increase both their productivity and their incomes.

Unfortunately, policymakers often fail to consider the dynamic responses of firms and individuals. For example, while the recently proposed overtime pay rule from the Department of Labor may have been intended to encourage additional hiring and increase pay, economic theory and empirical evidence suggest that the responses of firms will not match the expectations of the Department of Labor. A recent study noted that by increasing the cost to firms by shifting salaried compensation to hourly compensation, employers will respond by reducing base pay, reducing overall compensation (by cutting fringe benefits or performance bonuses), or replacing some workers with machinery or a smaller number of higher-skilled workers.⁷

4. Dr. Bivens, in his testimony, wrote that, by 2020, EPA’s Clean Power Rule will “have helped create 360,000 net new jobs.” That sounds very high for a single rule. Can you cite a peer-reviewed, retrospective analysis offering a precedential case in which a single rule actually created that many jobs once implemented?

No, I am unaware of any peer-reviewed, retrospective analysis in which a single rule created that many jobs. In point of fact, most peer-reviewed studies of regulation tend to look at “regulatory programs” as an entire unit, rather than individual rules. For example, Walker (2010) examines the effect of the 1990 Clean Air Act amendments on labor outcomes like job growth and displacement (finding a 15 percent decline in employment in the regulated industries).⁸ Greenstone (2002) similarly looks at the Clean Air Act, although it’s a different set of amendments, and finds job losses induced by them to equal about 590,000—but again, this covers a large number of individual rules.⁹ Morgenstern et al. (2002) examine environmental regulations that affect four different sectors (finding no statistically significant effect on employment).¹⁰ One peer-reviewed study that I am familiar with that does examine the employment effects of a single rule is by Gray

⁷ Boudreaux, Don, and Liya Palagashvili. “An Economic Analysis of Overtime Pay Regulations.” Working Paper, Mercatus Center at George Mason University, 2016. <http://mercatus.org/publication/economic-analysis-overtime-pay-regulations>.

⁸ Walker, W. Reed. “Environmental Regulation and Labor Reallocation: Evidence from the Clean Air Act.” *American Economic Review* 101, no. 3 (2011).

⁹ Greenstone, Michael. “The Impacts of Environmental Regulations on Industrial Activity: Evidence from the 1970 and 1977 Clean Air Act Amendments and the Census of Manufactures.” *Journal of Political Economy* 110, no. 6 (2002): 1175–1219.

¹⁰ Morgenstern, Richard, William A. Pizer, and Jhih-Shyang Shih. “Jobs Versus the Environment: An Industry-Level Perspective.” *Journal of Environmental Economics and Management* 43, no. 3 (2002): 412–436.

et al. (2014).¹¹ They examined the Cluster Rule of 2001, finding small employment declines (around 3 to 7 percent) in the paper and pulp industry.

I hope this additional information is helpful in the committee's consideration of the impact of regulations on workers and households. Please feel free to contact me if I can provide any additional information.

Sincerely,

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¹¹ Gray, Wayne B., Ronald J. Shadbegian, Chunbei Wang, and Merve Meral. "Do EPA Regulations Affect Labor Demand? Evidence from the Pulp and Paper Industry." *Journal of Environmental Economics and Management* 68, no. 1 (2014).