The Daily Dish

Regulatory Relief and Growth

DOUGLAS HOLTZ-EAKIN | AUGUST 7, 2017

Wall Street is evidently catching on to President Trump's ambitious deregulation plans. Trump has said he wants to eliminate up to 75 percent of regulations while in office. According to CNBC "Morgan Stanley analysts estimated that Treasury Department's deregulation ideas alone could increase financial companies' earnings by more than 15 percent." and "Telecom companies are likely to benefit, both in the removal of so-called net neutrality and the Department of Justice's 'considerable influence' over merger policy." That is, the deregulatory efforts may favor some particular firms and sectors.

But what about the economy as a whole? According to AAF the Obama-era regulatory explosion imposed a cumulative $890 billion in additional compliance costs on the private sector. How much did that hurt growth or, similarly, how much would a complete rollback improve the long-run growth rate that is currently pegged at 2 percent? Some have argued that getting rid of the regulations would raise gross domestic product (GDP) by just exactly that: $890 billion.

That's not right. It is best to think of regulations as one thinks of taxes. There are two components: (a) a transfer of income from one party to another, and (b) a change in incentives because of the regulation/tax. If one places a regulation on smokestack emissions, a power company will have to install scrubbers. The purchase of the scrubbers transfers dollars from the utility — or, more precisely, its shareholders — to the sellers of scrubbers. One could get exactly the same transfer by taxing the electric power company and transferring the receipts to the scrubber manufacturer. That is the bulk of the $890 billion tab.

But there is a second effect, a shift in incentives away from investing in additional productive capacity or greater efficiency in generation and toward pollution control. The latter will reduce productivity and output growth. This is the key economy-wide effect of the regulatory push, as is the case for tax policy. For the income tax, a recent survey estimates the loss in output is over 28 percent of the actual income taxes collected. If the regulatory explosion had anywhere near a comparable set of incentive effects, the loss in output would be in the range of $225 billion a year. That's an increase of roughly a percentage point. If gradually achieved over 10 years, that translates into an additional 0.1 percentage point in growth.

While not exactly chump change, it highlights the difficulty in substantially moving the long-term rate of economic growth.