


How Does Government Regulation Affect Your Life?

Full Length Text — Part: 6 Chapter: 12
Micro Only Text — Part: 4 Chapter: 9

To Accompany "Economics: Private and Public Choice 11th ed."
James Gwartney, Richard Stroup, Russell Sobel, & David Macpherson
Slides authored and animated by:
James Gwartney, David Macpherson, & Charles Skipton

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Regulation of Business

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Regulation of Business

- **Traditional economic regulation** seeks to fix prices and/or influence entry into specific industries.
- During the 1970s, widespread dissatisfaction with economic regulation led to significant deregulation in the trucking and airline industries.
- This deregulation generated new entry, intense competition, and discount prices.

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Regulation of Business

- **Health and Safety regulation:**
 - Designed to reduce risk and preserve environmental quality.
 - These mandates frequently specify in detail the particular engineering processes required of regulated firms.
 - While traditional economic regulation is now less common, health and safety regulation has been growing.

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The Political Economy of Regulation

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The Political Economy of Regulation

- Regulation involves a complex set of economic and political forces. Public choice analysis provides some insight – it indicates that:
 - Demand for regulation often stems from special-interest and redistribution concerns.
 - Through time, regulatory agencies often adopt the views of the interest groups they regulate.
 - Strong publicity and uninformed voter sentiment can produce regulations that ignore important economic tradeoffs.

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The Political Economy of Regulation

- Regulation involves a complex set of economic and political forces. Public choice analysis provides some insight – it indicates that:
 - Regulation tends to be inflexible to change.
 - Failure to approve a highly beneficial product will cause fewer problems for regulators than approval of a dangerous product. So, agencies approving new products (*like drugs*) generally apply tests that are too restrictive from the viewpoint of consumer welfare.

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The Costs of Regulation

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The Regulation “Tax”

- A regulation that requires businesses to adopt more costly production techniques is similar to a tax.
- If the regulation increases per unit costs by t , the **supply curve** shifts upward by that amount.
- Higher prices ($P_2 + t > P_1$) & less output ($Q_2 < Q_1$) result.

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Regulation – Its Costs and Benefits

- As we just saw, regulation is much like a tax. Because it increases costs, it will lead to higher prices and lower output.
- The same lack of information making private enforcement of rights difficult and thus generating much of the demand for health and safety regulation, also makes it difficult to know the effects of any regulatory action.

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Case Study: Fuel Economy Standards

- Reducing fuel use reduces the production of carbon dioxide, a greenhouse gas.
- A primary way to decrease fuel use per vehicle is to reduce vehicle size.
- Smaller vehicles provide less safety and comfort, but are driven more miles.
- Regulations to cut fuel use have unwanted safety and driving effects, and regulators show little responsiveness to changing needs; tradeoffs like this are inevitable.

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Future Directions for Regulatory Policy

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The Future of Regulation

- Most people concede that regulation, both economic and social, is like a two-edged sword. Regulation can be beneficial, but may also be costly and counterproductive.


Agency	Median cost per life-year saved
Federal Aviation Administration	\$23,000
Consumer Product Safety Commission	\$68,000
National Highway Transportation Safety Administration	\$78,000
Occupational Safety and Health Administration	\$88,000
Environmental Protection Agency	\$7,600,000

Source: T.O.Tengs et al., "Five Hundred Life-Saving Interventions and Their Cost-Effectiveness," *Risk Analysis* 15 (1995), pp.269-290.

- Some regulations are far more costly than others, even when their major objectives are similar.

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Questions for Thought:

1. "Without safety regulations, products such as lawn mowers would be unsafe."
-- Evaluate this statement.
2. Will health and safety legislation mandating workplace and product safety standards reduce the profitability of regulated firms? Who bears the cost and who gains the benefits of such legislation?
3. "Regulatory agencies do not have to make a profit and therefore they can be counted on to serve the general interest of the populace and promote economic efficiency."
-- Is this statement *true*?

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Questions for Thought:

4. When regulatory approval is required before a new product can be introduced, does economic analysis indicate ...
 - a. the regulatory agency will quickly approve products that improve the welfare of consumers?
 - b. the regulatory agency will predictably apply standards that are too restrictive from the viewpoint of economic efficiency?
5. Have regulations mandating stricter emissions standards and greater fuel efficiency for new automobiles ...
 - a. decreased the price of new automobiles?
 - b. induced manufacturers to produce lighter, smaller, and therefore less safe automobiles?

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Questions for Thought:

6. In a competitive industry, will regulations that require businesses to adopt more costly production methods cause ...

- a. consumer prices to rise, but producer profits to remain unchanged in the long run?
- b. producer profits to fall, but consumer prices to remain unchanged in the long run?

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Special Topic 12**

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