

Why Regulations Fail — Yet Persist

BY AARON STEELMAN

Regulations often do not achieve their intended effects. In fact, sometimes they produce results counter to their goals. Why?

In a lecture delivered at the AEI-Brookings Joint Center for Regulatory Studies in September 2004 and later reprinted in monograph form, economist Sam Peltzman of the University of Chicago argues that regulations fail when they create incentives for “offsetting behavior” — actions that negate some or all of the regulations’ desired effects.

Peltzman offers three examples of offsetting behavior undermining a regulation’s effectiveness. The first is auto safety, an area in which he has written some influential — and controversial — papers. The National Traffic and Motor Vehicle Safety Act of 1966 mandated the installation of seatbelts, collapsible steering columns, and pop-out windshields. Such devices should make the roads safer, right? Yes, if their presence did not alter the behavior of drivers. But Peltzman argued that the safety devices effectively lowered the cost of driving dangerously, since drivers would be better protected in the case of an accident. His prediction has been largely supported by subsequent empirical work. “The actual effect of the safety regulation on the death rate is substantially less than it would be if real people behaved like crash dummies,” he writes.

A second example involves the Americans with Disabilities Act (ADA). The ADA, he argues, has actually reduced employment opportunities for people with disabilities. The logic is as follows. Prior to the ADA, employers could hire people with disabilities and observe whether their value to the company exceeded their wages plus any special costs of accommodating them in the workplace. If it did, they would be retained. If not, they would be let go. But now employers are wary of taking a chance on hiring someone with a disability because companies who terminate a disabled worker are potentially subject to large penalties for employment discrimination. Of course, the companies may also be subject to penalties for not hiring the disabled worker in the first place, but Peltzman argues that such discrimination cases are harder to prove.

Peltzman’s third example has a Fifth District connection. The Endangered Species Act of 1973 is designed to protect animals on verge of extinction and their habitats. One such animal is the red-cockaded woodpecker, native

to the commercial forests of North Carolina. Owners of forests where the red-cockaded woodpecker lives are forbidden to remove trees in those forests. But, of course, woodpeckers fly around and establish nests in nearby forests. If you own a nearby forest, “your incentive is very clear — cut down all those trees now! If you wait and your land becomes habitat for this species, your lumber will be lost.” This is not good for the birds. Nor is it good for the owner of the forest, who might have preferred to allow the trees to grow larger before removing them.

So if such regulations fail to meet their objectives, why do they persist? In some cases, regulations benefit a relatively small group of people who lobby for their survival. Consider the ADA. It may harm people with disabilities who are looking for jobs, while helping disabled people who are already employed. The latter obtain “better working conditions, no lower pay, and an option on a future

antidiscrimination complaint to the Equal Employment Opportunity Commission,” Peltzman writes. “The beneficiaries know who they are. The victims ... often do not.”

This explanation is consistent with many other case studies of the political economy of regulation. But Peltzman argues that a more powerful

force is at work. The enormous progress characteristic of a society with a well-functioning economy can hide the failures of regulation. “As long as the thing being regulated is seen to be working tolerably well — and that will often be the case in a growing economy — then the regulation is safe politically,” writes Peltzman.

If correct, does Peltzman’s argument render economic analysis irrelevant to policy discussions? After all, if the public sees only what is before them and not how life might be different, and perhaps even better, in the absence of regulation — the type of thing that economic analysis tries to do — they are unlikely to push for change.

Peltzman is cautiously optimistic. “It may be true that economic analysis cannot all by itself change a well-entrenched mode of regulation. But economic analysis does often, I believe, play an important catalytic role when regulatory issues become politically salient.” In other words, when a regulation’s failures become manifestly obvious — as was the case with the regulation of the transportation industry in the 1970s — economic analysis can bolster the case for revising or repealing that regulation. **RF**

“Regulation and the Natural Progress of Opulence” by Sam Peltzman.
AEI-Brookings Joint Center for Regulatory Studies, September 2004.