

# ECONOMIC DIRECTIONS

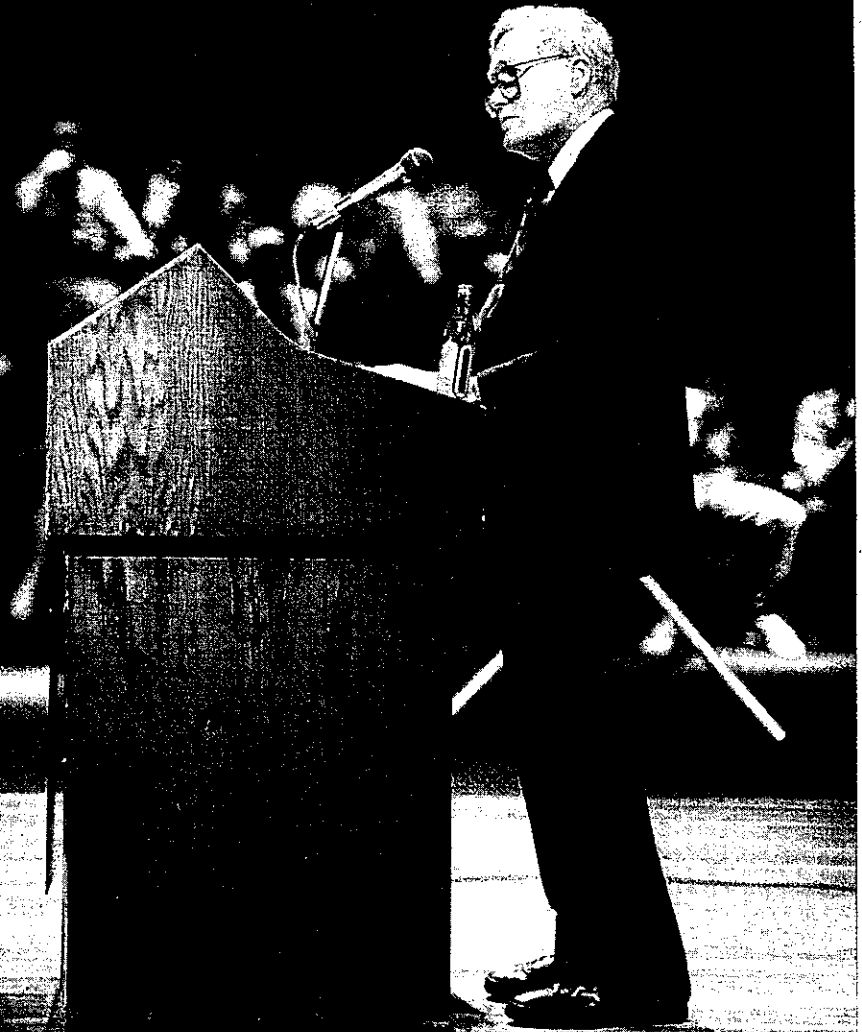
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## THE COST OF REGULATION AND THE BENEFITS OF DEREGULATION

*"But the big cost is the fact that so many of the people who should have been pushing the society forward were at best parasites and frequently were causing harm to society."*



(The following is a transcript of a lecture delivered by Dr. Gordon Tullock, Karl Eller Professor of Economics and Political Science at the University of Arizona, at Saint Vincent College, Latrobe, Pennsylvania, on February 19, 1992. The lecture was the third presentation in the 1991-1992 Alex G. McKenna Economic Education Series of lectures on privatization, taxation, and government deregulation.)

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The term "regulation" has both a good and a bad meaning. None of us so far as I know objects to the regulations that say we must drive on the right side of the road. Although we find visits to England, where we're required to drive on the left side of the road, somewhat annoying, we nevertheless feel it is important that there be a regulation of one sort or another.

That is what I would call the good meaning for regulations, but there is also the

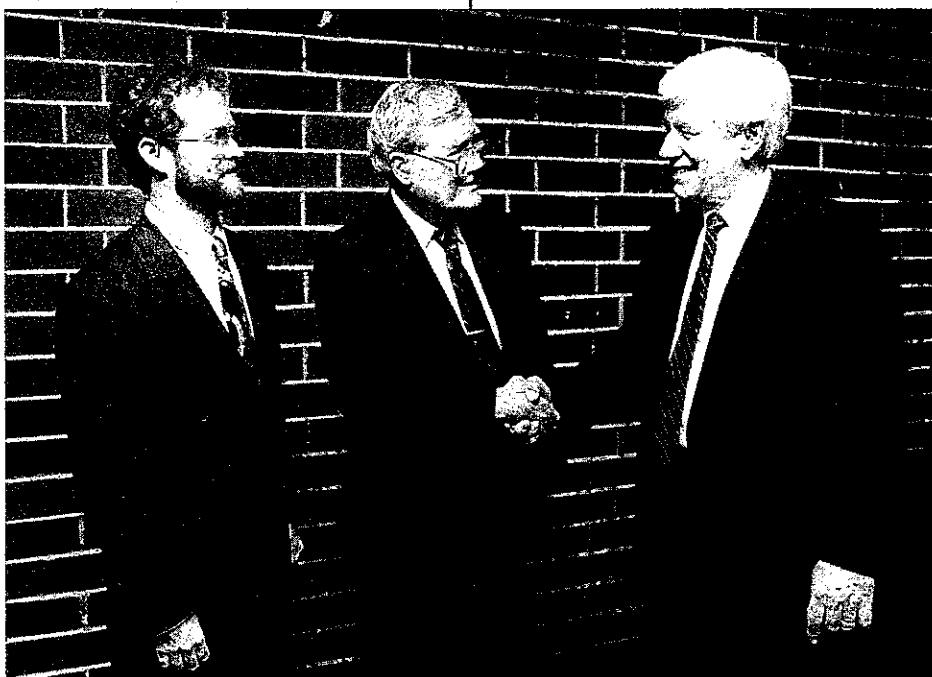
bad. I recently discovered, more or less by accident while attempting to get accommodations for a foreign visiting professor, that the City of Tucson has regulations in its building code which make it impossible to provide really inexpensive housing. In Tucson, if you can't afford housing which is better than that in which some 90% of the world's population live, you are required to either take a bunk in a dormitory provided for the homeless or build a cardboard shack on

one of the river courses. Intermediate level housing is banned by government regulation.

I should say, of course, there is a certain amount of cheating on this. There are people, particularly among the illegal Mexicans, who are living in old buildings under conditions which violate our building code. The building inspectors don't visit them. Basically, however, we have a set of regulations which appears in essence to sharply exaggerate the homeless problem. It is illegal to provide housing which is much better than a bed in one of the large homeless shelters, but nevertheless not up to the standard required by the regulation.

But let us drop the subject of housing regulations. Firstly, most of them - not all of them, but most of them - are strictly local matters and they vary a good deal from place to place, with the result that little can be said of a general nature. Further, unlike federal government regulations, the local governments have very restricted powers and finances. They are not in a position to inflict the really massive costs that federal regulations frequently do inflict.

Let us consider what is everywhere and always the standard example of bad regulations, the farm program. I should begin by saying that bad though our American farm program is, the ones in Europe and Japan are much worse. Indeed, I should now perhaps give you a suggestion for life abroad. As you know, when you are traveling abroad you frequently run into people who criticize the United States. If you are a patriotic American, as I am, you need a reply. Fortunately, there is a simple general pur-



**WELCOME** — Greeting Dr. Tullock (center) to Saint Vincent College were Dr. Gary M. Quinlivan (left), director of the series, and Mr. Robert McGeehan, president of Kennametal Inc. and a member of the Saint Vincent College Board of Directors, who introduced the lecture.

pose answer. You simply say "But what about your farm program?" Every country in the world has a ghastly farm program.

In the United States a well-organized group of relatively wealthy farmers take money from everyone else, including the poor. In Africa a well-organized and reasonably wealthy group of urban dwellers, mainly civil servants, take money away from the farmers who are poor to an extent which most Americans cannot even imagine. Everywhere we find special interest groups using agriculture regulations to obtain profits for themselves and inflicting great cost on society as a whole.

We can begin with a particularly absurd example, the sugar program. Further, I would like to confine myself to one part of the sugar program, the sugar cane industry. It produces about half of the American domestic sugar, with beet sugar producers producing the other half. Both now face considerable competition from corn sweeteners. This competition with the corn sweeteners, from the standpoint of the producers of cane and beet sugar, is somewhat a mixed phenomena. The corn growers are much more powerful politically than the growers of cane sugar or beet sugar and hence are able to get more restrictions and regulations on foreign sugar than could the cane and beet sugar people, but on the other hand they do compete.

Almost all cane sugar in the United States is grown in two states, Florida and Louis-

iana. There are less than 3,000 farms in Florida and Louisiana which produce more than 60% of the total. A small cane farm in south Florida is 500 acres; a typical 1,000-acre cane farm might have \$2-3 million invested in land and equipment. Only 130 or so farmers grow sugar cane in south Florida.

The industry is highly concentrated and run by fairly wealthy people. It has obtained a complex of regulations, import control, and subsidies which impose heavy costs on the American consumer. The import controls and other regulations put the price of sugar in the United States almost 4 times as high as the world price. Further, even that is not enough. The direct subsidies to the sugar growers amount to twice the world price. In other words, putting it all together, sugar costs the average American something like 6 times its world price.

The situation has aroused comment and the sugar producing lobby has thought the matter over and has produced a proposal under which there would be a world sugar cartel. The underdeveloped areas which now produce most of the world's commercial sugar will be asked or required to reduce their production. Thus, the American government would enter into a conspiracy with foreign sugar producers against American consumers. It's as if we positively asked OPEC to raise oil prices.

This is an extreme case, of course. Granted the fact that the poor consume sugar, it is another example of a regulation which



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*"The cost of the sugar quota is so great that we could probably pay the owners of sugar plantations enough so they would be willing to switch from sugar to some other crop out of the social cost of a couple of years of the program."*

injures everybody, including the poor, for the benefit of some rather well-off people. The group that is well off is rather small. On the other hand, however, we see the relatively short-term nature of the profits.

When these regulations were put in, it meant that people who were raising sugar immediately made a profit. But it also meant that other people would enter into the business, the level of machine and fertilizer intensity would go up, and, after a while, we would reach a new equilibrium in which the return on the resources devoted to sugar was no higher than that for anything else. The profits for setting these regulations in place were transitory. On the other hand, removing the regulations would impose a true disaster on the American producers of cane sugar. They couldn't possibly raise sugar for sale at the prices on the world market and hence would have to shift to some other occupation.

We have here, as we have in so many of these regulations, a situation in which, when the regulation is imposed, special interest groups make large transitional gains. Once the society has adjusted to these gains, however, the special interest group makes no larger a return than it would have if it invested in something else. Indeed, in many cases these sugar farms have been purchased by their current owners at a price which took into account this protection.

On the other hand, repeal of these regulations would be a disaster for the current owners, even if everyone else gained. We

have the thing start with a temporary or transitional gain, then have a period in which no one is gaining anything in particular and the society as a whole is being injured severely by the inefficiency. If the restrictions are removed, there will be a large loss concentrated on a small limited group.

The farm program is full of situations like this, not only in the United States but everywhere else. Most of them are empirically of much greater significance than the cane sugar industry that I have just been discussing. Wheat restrictions, for example, raise the price of most baked goods which are, after all, consumed in higher percentages by the poor than by the rest of us.



Note that in most of these cases, if we could find out some way of doing it, we could buy the present beneficiaries off with net social gain. The cost of the sugar quota is so great that we could probably pay the owners of sugar plantations enough so they would be willing to switch from sugar to some other crop out of the social cost of a couple of years of the program. It should, however, be admitted that such a direct payment would be administratively quite difficult. Note I say difficult and not impossible.

How did we get into this mess? The answer is in a special field of economics which is referred to as rent seeking. Although this was first introduced into economics by your speaker, the general ideas will not surprise anybody very

much. Indeed, a political scientist, Schattschneider, did a splendid analysis of the Smoot-Hawley tariff in 1932 which even today can be read with gain and I should say also a good deal of amusement. He was well aware of the absurdity of many of the strategies that he described.

The importance of the new work in this field is the realization that from the interest group's standpoint these things are not anywhere near as profitable as had previously been thought and hence there are not even any large gainers although there will be some gainers. Let us consider the situation where we get one of these special sets of regulations put in to provide us with additional income.

Indeed, let's be a little narrower - let us suppose I work out a plan for benefitting the United States as a whole by providing supplements to the salaries of holders of endowed chairs in the social sciences at the University of Arizona. I am sure all of you will agree that this is a clear-cut example of something which is socially desirable.

The first thing to be said is that if this additional supplement to my salary were, let us say, \$50,000 a year, I should be willing to invest a good deal of time, labor, and other resources in trying to get it. The principal result of a successful investment of these resources is that money would be transferred from you, the general taxpayer, to my pocket. While I would think this highly desirable, I am

not positive that all of you would agree with me.

Assume temporarily that we regard the cost to the taxpayers and the benefit to me as more or less canceling each other. The resources that I invest in attempting to get this have no effect on increasing the GNP. In other words, they are pure waste.

The situation can very readily be worse, however. I do think that whatever you people may think about my salary, you will agree that increasing it will not cause any positive harm to the country as a whole. It will take money out of your pockets and put it in mine, but not reduce the total GNP. In this respect my salary supplement is much better than the sugar program which leads to large resources being devoted to producing sugar in Florida, when the same amount of sugar could be produced quite cheaply a few miles south of Florida.

There is another aspect here. It might be that the taxpayers would organize a lobby against my efforts to get this money. The cost of this lobbying should also be put down as a net waste because if I had not proposed the program then nothing would be done about it. On the other hand, groups of people lobbying against something like the sugar subsidy would not truthfully be net waste because if they are successful it would benefit us.

This is a rather fanciful example. But if we look around the world we find a great many things of this nature. I mentioned the sugar program and our agricultural program. There is also the Central Arizona

Project which, at the expense of you taxpayers here, will provide water for various people in Arizona with the amount that it's worth to them being probably about 3% of its actual cost. This is only a single example of the very elaborate and expensive water works in the far West which, since the time of Theodore Roosevelt, have had such a major effect in lowering the total wealth of the United States while increasing the wealth of various people who live in certain parts of the West.

I can easily go on. For myself, I am in favor of maintaining a military machine of suitable strength, a strength which can be somewhat lower now than it could have been 10 years ago. But anyone paying attention to military matters realizes that a great many of the expenditures are for the benefit of suppliers and special factors rather than the national defense. Indeed, there is the bizarre situation in the United States in which we have one officer for every seven enlisted men with these officers in general being in staff bureaus where they impede the provision of supplies. Protective tariffs are a very general, very old example of this kind of thing and most countries have them.

Further, we in the United States are relatively lucky in that we don't have very many of these things. Contrast our situation with other countries and we find that on the whole we are doing very well. Indeed, that is one of the reasons we are wealthier than anyone else.

Singh compared 29 developing countries for which he had measures of the degree which government programs distorted

prices. These were things like our agricultural program. With a very elaborate statistical procedure he found very significant differences with the countries with a lot of what they no doubt think of as socialism and what we think of as bad regulation doing much worse than those that did not.

Singh is not alone. Gerald Scully has done quite a number of studies of this sort and shows clearly that economic freedom leads to higher growth periods. The costs are sometimes quite small if one thinks of them just as changes in the growth rate. But when you think of the prospect of 50 years in which country A grows at 1.5 percent higher rate than country B, you realize that this single variable could explain most of the differences between national wealth in one country and another.

Some of the new generation of economists in the former colonial empires have learned about rent seeking, and are making studies in which they look into the costs of such things. A student from Ghana calculated the cost of this kind of special regulation in Ghana and came to the conclusion that it was something on the order of 40% of GNP. In other words, they are poorer by that amount than they would be if they simply got rid of these things. For people as poor as Ghana's are, this is of course a major cost.

This, however, in my opinion does not come close to the real cost. It's an interesting fact that most of the people who did early work in the rent seeking area, myself, Anne Krueger, and Baghwati — all have had extensive contact with Asiatic civilizations. All of us have had personal experience of places where highly civilized people who have been civilized for a long time and had immense accomplishments in art and culture, but who were bitterly poor. The question of why China, which in 1750 was probably rather ahead of

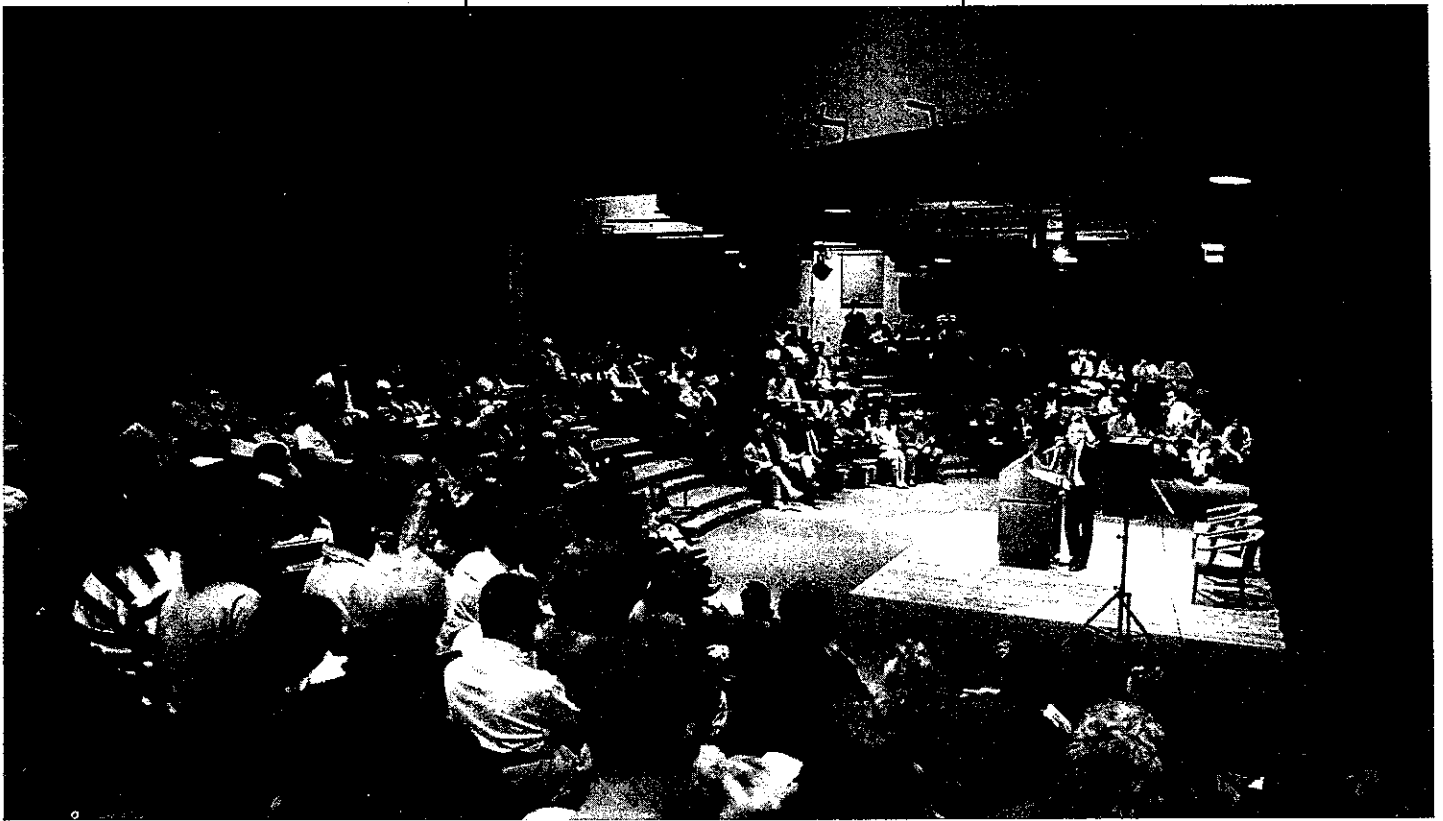


**STUDENT TRIO** — Greeting Dr. Tullock (second from right) are, from left, James T. Meredith, Robert C. Baldini, and John R. Gierl, all students at Saint Vincent College.

## About the Series

*The Alex G. McKenna Economic Education Series is presented by the Center for Economic Policy Education at Saint Vincent College. These periodic lectures are open to the general public and their purpose is to explore the role of free markets in solving many of the social problems confronting the United States and the world today. Dr. Gary M. Quinlivan, associate professor of economics at Saint Vincent, directs the series.*

*The Alex G. McKenna Economic Education Series is made possible by a grant from the Philip M. McKenna Foundation Inc. of Latrobe, Pennsylvania.*



FULL HOUSE — A large crowd gathered in the Science Center Amphitheatre for Dr. Tullock's lecture.

*"Let us consider what is everywhere and always the standard example of bad regulations, the farm program."*

Europe, is now far behind automatically occurred to us. Rent seeking provides an answer on two dimensions.

Firstly, there is the simple fact that very large amounts of resources are wasted. Turning to the United States temporarily, consider the sugar program. First, it clearly is a net cost to the United States' people and quite a large one. Secondly, however, there is another cost: the cost of getting it enacted. Sugar people maintain a suitable representation in Washington and, of course, put pressure on their congressmen with great regularity. Further, in order to put the program through they had to make deals with various other people who have similarly wasteful programs. The net effect of all of this is that very large costs are involved in getting such programs. Now, of course, it is no

longer getting the gain, it is protecting themselves against loss.

The basic problem in many of the Asiatic countries is that for many generations the principal way to get ahead in the society is to go into this industry. The ambitious hard-working young man who in the United States might decide to start a store hoping it will eventually become a chain or to invent something useful, in those societies would try to get some special privilege out of the government. Since the special privilege usually, although not always, actually lowered total GNP, they would be inflicting a cost. But the big cost is the fact that so many of the people who should have been pushing the society forward were at best parasites and frequently were causing harm to society.

We may be moving into the same kind of society ourselves, although fortunately once again we are far better off than most of these countries. But I'd like now to deviate again to discuss a special characteristic of these programs. Above, when I talked about the special payment to social science professors holding endowed chairs at the University of Arizona, the payment would be in cash. Clearly my benefit would be exactly the cost which was inflicted on the taxpayers. In a more typical case the benefit is not cash.

Turn again to the cane sugar industry. The eventual gain to the people who owned land suitable for cane sugar raising at the time this system was adopted was quite

modest. The cost to society was very great. We would have been vastly better off if instead of setting up this program we had simply given them all pensions. The same is true of all of the agricultural programs. If we simply paid the farmers the net gain they get out of these programs, the cost to the taxpayers would be much less than the total cost of the present program. The farmers obviously would be as well off.

Why don't they see the direct cash payments instead of these complex programs? The apparent reasons for these inefficient methods is simply that ignorant and badly informed as the voters are there are some things they would see through. A proposal simply to pay people who were thinking of raising sugar cane in southern Florida something on the order of \$200,000 a year if they promise not to simply would not get through. It is essential that the matter be camouflaged.

How can we get rid of these programs? The first suggestion that will occur to almost any economist is that we buy the privileges back. The owner of a sugar farm in Florida has put a good deal of time and energy into a piece of property which, if we simply repeal the regulations, will become worthless. Not only does it seem somewhat unjust to destroy his capital, but if we propose to do it he can be depended upon to fight hard to maintain his special privilege. Thus, it will be hard - maybe impossible - to get rid of it. If, on the other hand, we offered him full market

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value it is likely there would be little objection from him to the project.

Note that in general the harm inflicted on society by these special regulations is considerably greater than the benefit received by the beneficiaries. There is a profitable opportunity if society buys back his special privilege. There are two objections to this. The first is moral; one might argue that our sugar program is immoral and the people who are benefitting from it should not be compensated when it is canceled. For myself, I have no objection on these grounds but many people might.

There is, however, a more substantive objection. If we do buy these special privileges back, that would mean that people who created such special privileges in the future would assume that they would either keep the privilege or be paid for giving it up and hence the privilege would be worth more than if it was decidedly risky. Thus there would be more money invested in attempting to get these special privileges in the future and we



might end up worse off. Once again, I do not think that this is an overwhelming argument, but some people in the audience may.

Getting rid of these abolitions would be a very large benefit for the United States as a whole. Indeed, there are so many of them and so many beneficiaries that it's possible for most of the people who benefit that the abolition would benefit them so much on the money they make on the abolition of other peoples' privileges that it would more than compensate them for the abolition of their own.

Thus, rather ironically, it's probably easier to get rid of all these things simultaneously than it is to fight them down one by one. But we have been, to some extent, successful in getting rid of them on a one-by-one basis. Railroads, trucks, and railways are

pretty largely deregulated now and the cartels for all three of those industries which were formerly operated by the federal government are now inoperative. We have been able to get our tariffs and other trade barriers reduced over the last 40 years, although not as fast as I would like.

Thus the situation, although undesirable, is not hopeless. England faced somewhat similar problems to our own in the early part of the 19th century and was able to move to an almost completely free market economy with the only regulations in existence being the kind I referred to above as good regulations. She of course then reversed course and went back to an even more controlled economy than she had in 1800. So there is a precedent for moving towards a freer and more open economy. Let's hope that the future looks back on our present situation as another precedent.

But regardless of whether or not we actually succeed, there is something to be said for fighting a good fight. We should all attempt to get rid of these undesirable regulations but keep in mind that attempts have not been successful in the past. We cannot guarantee success now but we can at least try.

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