How Government Regulation Makes Us Poorer

A Conversation With Per Bylund.

MISES INSTITUTE: Why is the concept of the "unseen" so important to understanding the effects of regulation?

PER BYLUND: It is essential for understanding regulation, but the "unseen" is actually fundamental for economic understanding and analysis in general. What's "unseen" is the proper benchmark. We need to consider both what didn't happen but would have happened.

Oftentimes people, including so-called experts, compare apples and oranges by looking at data "before" and "after" an event, for instance, when discussing the effects of raising the minimum wage. So they might say that employment before was similar to after the hike, and then conclude that the change had no effect. But this is wrong, because there are plenty of changes in the economy that took place between the before and after — not only the minimum wage. So in order to figure out the effect of the minimum wage specifically, we must compare the "after" situation with what would have been had there been no minimum wage hike — the unseen.

This of course applies to any change in the economy, and not only regulation. Bastiat, in his classic essay on the broken window fallacy, discusses the effects as a boy smashes a window. But in modern state-planned economies, regulation is by far the most common and most destructive change, so that's where we also find most analysis. As economic analysis is used to assess the effects of regulations before they're implemented, it's important to use the proper comparisons — the seen and the unseen, not the seen at different times (before and after).

MI: You also employ the concept of "the unrealized."

PB: The unrealized is really my own extension to Bastiat's famous analysis, and it is intended to redirect our attention from the macro level of the economy to how changes affect individuals — and especially what options they're presented with. The point of the book is to show that regulating one part of the economy will have effects throughout the economic system, and that this type of artificial restriction will lead to some people being stripped of the choices they otherwise would have.

I exemplify this with the sweatshop, which is often argued against using only "the seen." The working conditions are terrible in a sweatshop, especially compared to our cushy jobs in the West. Ben Powell and others have done great work pointing out that there's also the unseen in the sense that without the sweatshop those workers would be in even worse shape. In fact, they are very eager to get jobs in the sweatshop because they're so much better than all other options they have.

With the "unrealized," however, I think we get a more nuanced picture. I argue that the reason the sweatshop workers make a choice between the hard work in a sweatshop, and something that is much worse, is regulation. Had this been a free market, then there would likely have been *many* businesses offering jobs in sweatshops, and they would probably compete with each other by offering higher pay, better work conditions, and so on. There's obviously money to be made from running sweatshops, so why don't more businesses do this?

The existence of a sweatshop shows that the market is sufficiently developed to support it: the technology and capital structure, including transportation and supply chains, are obviously there. The economic conditions also speak in favor of sweatshops over toiling in the fields and the other much worse options sweatshop workers are presented with. The workers are more productive in sweatshops. So there's really no reason why there wouldn't be competition for their labor by several sweatshops. But, the many options that should be there aren't.

So it's likely that something is restricting the creation of these other options. Those other businesses that never came to be are the unrealized alternatives, and the argument in the book is that these options *would* have been available had it not been for regulation.

Moreover, those regulations can really be very distant from these workers, since a restriction redirects economic actors to other, and comparatively less valuable, actions. In turn, the regulations have ripple effects — a type of Cantillon effect, you might say — throughout the economy as seen actions replace the unseen, or what should have been.

These other things happen instead of what *should* have happened, if actors had not been arbitrarily restricted by regulations. But, these "other things" are suboptimal and harm people since they're not what people would have chosen to do in the absence of the regulations. In this sense, a regulation *anywhere* in the economy causes harm, and this harm primarily affects those with little or no influence over policy or the means to avoid it. So the major harm is on poor people in poor countries, even where regulations *appear* to be limited to relatively rich people in rich countries.

MI: In the case of a business being regulated, how much of that burden falls directly on that business? Are other groups — such as the customers — affected by the regulations also?

PB: It really depends on the business. Regulations make it costlier to act — and therefore some actions are no longer profitable when they would have been otherwise. So, for those businesses that lack political influence and aren't the most effective, a regulation may decide whether there is a business or not. At the same time, businesses that survive the regulation might benefit from a protected situation because the regulation raises barriers to entry. This is why, for instance, it is rational for Walmart to support a high minimum wage — it will hurt Walmart's competitors more than it hurts Walmart.

The real losers are common people who, as consumers, do not get the valuable goods and services they otherwise would have, and, as producers, cannot find the jobs they otherwise would. The winners are the incumbents, at least short-term, and — as always — the political class.

MI: You refer to markets using terms like "messy," "approximate," and "imperfect." Isn't this an argument against markets? Can't government regulation give us more rational results?

PB: On the contrary, the messiness is an argument for markets. Rational government planning might be doable in an economy with fixed boundaries. That is, where there is no growth, no new value creation, and thus the "extent" of the market stays the same. But there are no such economies in the real world, and I'm not sure it is even possible long-term. An economy is really the combined uses of resources devoted to satisfying wants. So, it is inconceivable to have an economy that doesn't get better over time — or which malfunctions and declines. In an entrepreneurially driven and creative market process, there is no basis for planning an economy through a governmental central plan. I elaborate on how this process of market expansion happens in my previous 2016 book, *The Problem of Production: A New Theory of the Firm* (Routledge).

Growth and entrepreneurship in a market is not so much about allocating existing resources within the market as it is about speculating about how resources can be created and used in more valuable ways. The market is a creative enterprise always aiming for the future and satisfying more wants and newly discovered wants. Thus, a governmental regulator or central planner has no data to use in making a "rational" plan because the data doesn't exist yet. That's the problem with central planning — you cannot plan with only unknowns and unknowables. That's also why markets are messy, but decentralized decision-making within a profit-and-loss system generates the very structure needed for such decision-making.

MI: But in a purely unregulated economy, won't businesses exploit workers?

PB: I conclude exactly the opposite in the book. There's a case to be made for Marxist-type exploitation of workers in factories, perhaps more so in countries where there are sweatshop-style factories than elsewhere. But, the reason for this exploitation is regulation. Had the workers not been stripped of their choices — the unrealized — they wouldn't be satisfied with the sweatshop jobs they're relatively content with as things are today.

Exploitation is not so much a result of capitalists paying workers less than they otherwise could have been paid. It is a result of the workers' options having been taken away. The business with a sweatshop in a poor country isn't the party taking away workers' options. The business is the one giving workers an option. It's not as good as it otherwise would've been, but that's not necessarily the fault of the business. What hurts the workers — and keeps them poor by not putting sufficient competitive pressure on the business — is regulation, which restricts competition, and thus empowers business at workers' expense.

So the issue of exploitation, and especially how to get rid of it, is a matter of finding the real and ultimate cause of the situation. It's usually not a matter of employers having "power" over the worker. Such power does not occur naturally, but is caused by something, and my argument suggests that the employers' economic power is a symptom, but not the cause. The real cause is government regulation.

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