Consumer Metrics Institute Members News

June 15, 2011: Keeping Perspective and Strangulation by Regulation

Early during the prior week we witnessed a series of daily upward movements in our Weighted Composite Index -- only to see the index subsequently retrace most of its gains. Although swings in the daily numbers can keep things interesting, we always look to our "Contraction Watch" as the way to maintain the proper perspective:

The above chart follows the course of our Daily Growth Index (actually just a 91-day moving average of the Weighted Composite Index, converted from the base 100 index to a +/- percentage) since that index first went into contraction (on January 15, 2010 -- over 515 days ago). The chart also shows what the Daily Growth Index was doing during the consumer contraction that occurred within the formally defined "Great Recession" of 2008-2009. The progress of each event is recorded as a track of Daily Growth Index values commencing on the left margin on the date that the index first went into contraction.

The chart clearly shows both the scale and the duration of the current contraction in on-line consumer demand for discretionary durable goods. The "bottom bouncing" observed in the blue line doesn't begin to meet any reasonable definition of a "recovery." We understand that our data contains some demographic biases (towards younger, higher educated, tech-savvy and English speaking consumers), but we continue to feel that the persistent decline reflects a broader slice of "Main Street" America than our demographics alone might imply.

While we focus on the 91 day (quarterly) Daily Growth Index, we also chart longer term moving averages covering 183 days (six months) and 365 days. Although all three indexes have recently been at historically low levels, the longer term averages are far more sensitive to the extreme duration of the current event:

The above chart clearly shows that the six month and full year moving averages continue to set new record lows day after day. For consumers the "Great Recession" has not ended, and we can't help but wonder how the full GDP will react once the Federal stimuli have fully worn off:

Strangulation by Regulation

(In a number of recent articles we have explored potential "unthinkable" solutions to both the U.S. sovereign debt problem and the fiscal consequences of a suddenly balanced U.S. Federal budget -- given that a balanced budget would suck about 14% out of the country's GDP, meeting the clinical definition of a depression. We discussed the historical backdrop to sovereign debt end-games, and solutions possible without major regime change, others requiring modest regime change, yet more that involve radical regime changes, one that uses regime change to de-securitize the mortgage industry, another that would selectively stimulate "Main Street" America, still another that would stimulate the economy through genuine reform to the health care industry, and most recently one that addressed the costs within the higher education "industry" and the impact that growing student loan debt and defaults are having on U.S. economic growth. As a point of reference we have used the report from the Simpson-Bowles commission as a sample framework for how to balance the budget, and have assumed that to prevent a Simpson-Bowles induced depression some form of non-fiscal stimulus would be needed that could provide excess growth to the U.S. economy on the order of 3% per annum over 5 or more years.)

The toughest economic challenges facing the United States during the next decade can be simply stated:

-- Balance the U.S. Federal budget; and,

-- Simultaneously stimulate the economy.

We have modestly assumed that the current politico-economic "regime" will fail to accomplish this, because:

-- The existing political and economic tools have already proven inadequate to handling either task alone, let alone the vastly more difficult job of doing both concurrently.

-- The "regime" has no interest in new tools that would jeopardize the status quo (i.e., the core problem is political, not economic).

For these reasons we have postulated that a "regime" change on the scale of the Jacksonian 1832 election will be necessary to truly balance the budget and stave off (or unfortunately recover from) the depression that such a drastic reduction in deficit spending would induce. The particulars of a Simpson-Bowles styled budget balancing are irrelevant to this discussion as long as the end result is a balanced budget in the neighborhood of 21% of GDP -- removing an aggregate $2 trillion from the GDP and almost certainly tipping the economy into a deflationary depression.

Our exercise here has been to explore the tools that the current regime would consider "unthinkable" -- under the assumption that eventually a collective "Main Street" sense of betrayal will trigger a Jacksonian scale political revolution.

Again the question: how do we stimulate the economy into *an incremental* 3% annual growth rate without resorting to deficit spending?

Measuring Up to Uganda

In November 1995 the Small Business Administration's Office of Advocacy issued a report by Thomas D. Hopkins that estimated that the total economic costs of complying with Federal regulations were between 6% and 9% of GDP. In 2005 a subsequent study by Mark Crain put the cost at $1.1 trillion, or 8.5% of 2005 GDP. We see no reason to think that the percentage has gone down since then, or that the "Patient Protection and Affordable Care Act" of 2010 will suddenly reverse that trend.

And the high costs of doing business in the U.S. are not exclusively related to health care, the EPA or OSHA. Even the simplest of payrolls results in a bewildering set of forms and filing deadlines**:** Federal W-4s, I-9s, 941s, 940s, W-2s and W-3s, plus state withholding and unemployment insurance forms. In fact, The World Bank's 2011 survey of global business conditions found 61 nations where "Paying Taxes" was less burdensome than in the United States (tied with Uganda at the 62nd ranking).

Furthermore, this provides yet another perspective on the economic disadvantages arrayed against small businesses -- which are a vital engine of economic growth fully capable of creating the kinds of new jobs and incomes essential for true "recovery." Mark Crain's report found that the $1.1 trillion in regulatory economic drag cost small businesses an average of $7,647 per employee per year, while larger firms saw that cost drop to $5,282 per employee per year -- over 30% less. And to at least some extent the larger firms have benefited from much more than the mere efficiency of the specialized resources provided by their scale**:** they have also benefited by virtue of their access to the regulatory process itself (through lobbyists and campaign contributions), allowing them to "game" the regulations to the point that size really matters.

Sadly, the United States has legislation in place that was specifically designed to combat regulatory bloat -- especially as it discriminates against small businesses. The Regulatory Flexibility Act of 1980 (RFA) requires each Federal Agency to conduct semi-annual reviews of any new regulations specifically to identify "... any significant alternatives to the proposed rule which accomplish the stated objectives ... and which minimize any significant economic impact ..." on small businesses. Unfortunately the Regulatory Flexibility Act has no teeth, benefits only politically invisible small businesses, and is buried in the backwaters of the Small Business Administration's Office of Advocacy.

As previously noted, the core problem is political. The devil of regulatory changes is in the details, and any sufficiently complex set of changes can be obstructed indefinitely by vested commercial interests, entrenched bureaucrats, partisan Congressional hearings and (carefully screened) courts -- as the recent media coverage of foot-dragging during the Dodd-Frank regulatory rules process so vividly attests.

(As a point of historical reference, the 1933-1934 Pecora Commission resulted in the passage of the Glass-Steagall Act of 1933, the Securities Act of 1933 and the Securities Exchange Act of 1934 -- the latter only a month after Pecora's hearings wrapped up. A sense of urgency appears to be crucial, as are broad electoral mandates that trump consensus seeking and the delaying tactics used by the vested interests.)

Because of the political nature of the problem, enshrining new commissions to study excessive regulations will simply not work**;** ultimately the best intentions of the deregulation efforts will be stalled or derailed by the same vested commercial interests, entrenched bureaucrats, partisan congressional hearings and selected courts that have benefited the status quo in the first place. Instead, sweeping systemic changes that make the devilish details irrelevant are needed.

If Federal regulations cost 8.5% of GDP to no purely economic purpose -- and assuming that 80% of the social, health and environmental benefits provided by those regulations likely stem from only 20% of them -- then there are clear opportunities to reclaim at least 3% wasted GDP productivity without egregiously jeopardizing the American public. Some currently "unthinkable" options might include:

-- **Glorious Sunsets:** Enact legislation that sunsets *any and all* regulations issued by Federal agencies after ten years. In theory such a law would keep the agencies so busy re-issuing the most beneficial of the older regulations that they would have precious little time to dream up new ones.

-- **Sagacious Ombudsmen:** Put the implementation of an enhanced Regulatory Flexibility Act into a body with the same kinds of political independence currently afforded the Federal Reserve. Grant that body the authority to stay any regulations that fail a "minimize economic impact while optimizing the common good" test articulated in a revamped RFA charter. The American electorate understands that the U.S. is a better place as a consequence of at least some of the efforts of the EPA and OSHA, and that those agencies have also had significant negative economic impact on certain industries. But the electorate also understands common sense (or the lack thereof) when they see it. Giving the new RFA enforcement-body a sagacious board of ombudsmen exempt from political pressure and charged with protecting the common good (and common sense) would go a long way to creating the kinds of balance the electorate would like to see.

-- **"The first thing we do, let's kill all the Lobbyists ..."** *(what Shakespeare actually meant to say in Henry VI, Part 2)***:** If American voters have no problem in depriving prostitutes of their calling, why should lobbyists be given a free pass -- given that (with apologies to the slightly older profession) the most material difference may be the direction of the cash flows? The real problem may lay in the definition of lobbying, and here we would simply defer to Justice Potter Stewart's wisdom regarding pornography**:** "I know it when I see it." If completely banning the profession seems a bit harsh for the local D.C. economy, how about zoning the practitioners into a "Green Light District" in Georgetown, where the comings and goings of legislators could be more closely monitored?

And lastly, the real bottom line:

-- **Substantive Electoral Reforms:** If the core problem is political, the only real solution to regulatory reform is reforming the political process itself. For starters, restrict the making of campaign contributions (direct or indirect) to only those entities eligible to vote. Then limit the amount of contributions that any such voter can make to any given candidate to somewhere near 10% of per capita GDP -- currently in the neighborhood of $5,000. (The biennial economic impact of such reforms on local TV station revenue might be substantial -- to the delight of the previously besieged electorate.)

As a quick reminder, the First Amendment to the United States Constitution reads something like this:

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

We notice a reference to "the people," but we see no specific references to corporations or political action committees -- which (to the best of our knowledge) also have no legal standing at the polls themselves. We suspect that the framers of the Constitution actually intended the First Amendment to protect the rights of the voting citizenry.

Furthermore, there is a substantial body of legislative precedence for restricting political contributions**:** commencing with Theodore Roosevelt's 1905 call for a ban on corporate contributions (which led to the Tillman Act of 1907), followed by the Federal Corrupt Practices Act of 1910, the Hatch Act of 1939, the Smith-Connolly Act of 1943, the Taft-Hartley Act of 1947, the Federal Election Campaign Act (FECA) of 1971, the FECA amendments from 1974 and more recently the 2002 Bipartisan Campaign Reform Act ("McCain-Feingold"). This is hardly a new problem, and the shear persistence of reform efforts indicates both the importance of obtaining relief and the intransigence of the opposition.

(Recent rounds of electoral reformation efforts have run into some opposition in the U.S. Supreme Court (as exemplified by its 1976 ruling on Buckley v. Valeo) over whether campaign contributions are a First Amendment protected form of free speech. More recently, however, a strengthening minority within the Court has broadly held that such restrictions on campaign contributions can pass "constitutional muster" should they not infringe the personal rights of individual candidates as provided by the First Amendment. Ultimately the "constitutional muster" test can in any event be passed by amending the Constitution, however drastic that step may be. And should a Constitutional amendment become necessary, introducing term limits for members of Congress suddenly becomes another viable option.)

Economic growth in the U.S. can be boosted substantially by materially reducing the 8.5% of U.S. GDP currently spent complying with Federal regulation. Unfortunately those regulations are part and parcel of the current political (and financial) environment, which is arguably the real root cause of the lingering economic downturn. And to minimize the drag imposed on the U.S. economy by Federal agencies it is almost certainly necessary to craft a clean and simple law that incorporates the intent of all of the electoral reform legislation cited above**:** to minimize the corrupting influence of big money on the political (and hence regulatory) process.
