Conclusion

Moving Forward: A Guide for Regulatory Policy

Adam Hoffer and Todd Nesbit

The causes of our social and financial problems are myriad; to suggest that regulation is the primary cause of all such societal problems would be irresponsible. Yet our regulatory policies do impose real costs. Those costs should cause us to pause to reconsider the proper role of government. Such an undertaking is likely to lead to the conclusion that regulatory policy be held to a higher standard than the whims of appointed bureaucrats. While many regulations undoubtedly improve public well-being and pass a cost-benefit test, many others neither expand liberties nor come close to achieving the lofty goals set forth by their proponents.

Millions of Americans, particularly those from lower-income households, regularly are prohibited from entering more financially promising careers, are prevented from receiving proper medical care, pay higher prices than necessary, and generally have their daily lives complicated as a result of unjustified or ineffective regulation. A significant share of such unnecessary costs is the outcome of a political process that caters to special interests and is plagued by imperfect information and the unchecked personal ambitions of policymakers.

The chapters compiled in this book apply fundamental economics to evaluate regulatory policy. We incorporate lessons from public choice

theory, law and economics, and constitutional economics, among other fields, to examine the expected behavior of self-interested individuals involved in the enactment and enforcement of regulatory policy. In this final chapter of the book, we summarize some common themes observed across the contributed chapters. We then present some policy recommendations that promise to make regulatory policy less burdensome and more effective at enhancing individual liberties and well-being.

Broad Research Findings

Government intervention, according to standard economic theory, may be justified to correct so-called market failures. In the case of regulation, such failures generally involve information problems and circumstances in which the costs of defining and enforcing private property rights exceed the benefits of doing so. Consequently, the theoretical justification for regulation is much more limited than the practice of regulating has generally been. Consider, for instance, occupational licensing and alcohol sales regulation.

As discussed by Alicia Plemmons and Edward Timmons in chapter 6, the public call for occupational licensing generally centers on a concern for consumer safety based on a presumption that private firms lack proper incentives for adequate training. If this argument is true and providers' inadequate training puts consumers at risk, one would reasonably expect regulators to require more extensive training programs for professions in which inadequately trained providers place consumers at greater risk. We suggest it is fair to assert that the risks of an improperly or inadequately trained emergency medical technician exceed those of, say, an interior designer. Yet occupational licensing requirements often do not match well with the potential for consumer risk:

> For example, Michigan requires 1,460 days of education and training to become an athletic trainer, but just 26 to be an emergency medical technician (EMT). In fact, across all states, interior designers, barbers, cosmetologists, and manicurists all face greater average licensing requirements than do EMTs.[1]

The data clearly show a disconnect between the true motivation for occupational licensing and its theoretical justification.

Equally questionable is the regulation of alcohol sales, which is discussed in chapter 17. Again, such rules are generally motivated by a publicly stated concern for consumer safety. Their proponents often explicitly argue that consumers just do not understand or properly account for the risks. But the regulations often fail to match intentions with outcomes. Alcohol regulation better reflects a situation in which well-intended concerns are exploited to intentionally enrich a select few—a classic bootleggers-and-Baptists example. For instance, Pennsylvania still monopolizes the sale of liquor to state liquor stores, and sales to consumers are limited to no more than a six-pack at retail outlets other than licensed beer distributors.

The personal incentives of elected and appointed public officials at all levels of government rarely square with the goal of promoting the public's interest, should such a single goal inclusive of all individuals even be feasible. Instead, the incentives of politicians and bureaucrats often are more aligned with catering to special interests. For the elected legislator, such behavior is consistent with reelection motives. For the appointed bureaucrat, such behavior is consistent with job security, promotion in rank, and more generous perquisites of office, all of which are influenced heavily or controlled by elected legislators and chief executives. The result is more restrictive, complex, and burdensome regulatory rules that protect the interests of the politically connected (and often wealthy) few at the expense of their smaller, less politically connected rivals and the broader public.

Such overregulation—regulatory powers extending beyond the economically justified limits—comes at a steep cost. The costs of regulatory failures and the lessons to be learned from these failures have been detailed throughout this book and are summarized below.

Section I: Regulation, Entrepreneurship, and Opportunity

Entrepreneurship and market exchange are the primary drivers of wealth accumulation and prosperity. Indeed, poverty is the default status in nature, and the pursuit of profit through innovation and

market exchange has lifted a large majority of the world's population far from those dire circumstances. Unfortunately, these benefits have not reached all individuals. The ability of market exchange to create wealth relies on formal and informal institutions, including private property rights and social trust. Regulation can play an important role in enhancing wealth creation in cases where private property rights cannot be defined or properly protected and when social trust is difficult to establish.

Unfortunately, the political marketplace in which regulation is enacted is rife with rent-seeking and suffers from substantial information asymmetries. These characteristics often lead to excessive regulation that hinders entrepreneurship, particularly small business start-ups. Rent-seeking exacerbates the social environment by pitting individuals and groups with stakes in the outcomes of regulatory processes against one another, creating winners and losers in zero- or negative-sum games, further eroding social trust, and undermining markets' ability to function properly.

Consumers don't trust producers because firms lobby government regularly to enact policies that restrict competition, allowing incumbents to increase their prices and profits. Newcomers attempting to enter a trade often are excluded by regulations supported by those already practicing the trade who seek to restrict competition. As a result, the poor often are trapped on the lower rungs of the income ladder. Given the obstacles erected by the political marketplace to contributing legally to wealth creation, many individuals turn their efforts to the shadow economy, where trust is more difficult to establish, the returns on investment are smaller, and the incentives for destructive entrepreneurship are stronger.

In summary, while the rule of law plays an important role in supporting market exchange and enhancing wealth creation, the incentives inherent in the political marketplace often lead to excessive regulation. Overregulation slows economic growth by degrading social trust and redirecting entrepreneurs away from productive activities and toward unproductive and sometimes destructive ones. Individuals who are marginalized politically, most often the poor, are those who suffer the most.

Section II: Regulation and Labor Market Outcomes

Virtually all economic and social regulations tend to reduce employment, on average, in the regulated industry. Their effect on wages is more varied and depends on the specific type of regulation imposed. For example, occupational licensing, minimum wages, and "make-work" rules all tend to increase average wages. At the same time, most other labor market regulations are expected to reduce them.

We draw particular attention to occupational licensing laws. As discussed earlier in this chapter, while some theoretical support can be found for the limited use of licensing, it is reasonably clear that the current extent of occupational licensing far exceeds the level that is beneficial. Workers in states with more expansive occupational licensing have fewer occupational choices and less job mobility, effects that are particularly harmful for minorities who are more likely to experience unemployment. Some of the costs of higher wages are passed on to consumers in the form of higher product prices or are borne by workers in the form of fewer hours of work and less-valuable fringe benefits. However, product or service quality is improved marginally in some cases.

Certificate-of-need (CON) laws are particularly common in the healthcare industry and are found to fail in delivering on the lofty promises of their proponents. CON laws were justified on the basis of improving access to healthcare, particularly in rural areas, while also driving down healthcare costs. Certificate-of-need regulations have, in most cases, done exactly the opposite: reduced access and increased costs. Relaxing or eliminating CON laws would do much to expand access to healthcare, particularly in rural areas.

Section III: Land Use and Energy Standards

Affordable housing is a major policy goal in many large U.S. cities such as San Francisco and New York City. Counterproductive land use regulations have contributed to the shortages of affordable housing. Restrictive zoning laws, minimum unit size requirements, rent controls, and "green space" rules guide urban redevelopment and limit new housing construction. Such regulations indulge the preferences

of constituent homeowner-voters, who seek through regulatory intervention to raise the value of what likely is their single most valuable asset. The direct result is, as intended, elevated real estate prices. The indirect results include pricing the less wealthy out of the market, job immobility for people who occupy rent-controlled housing, and longer commuting times (and more tailpipe emissions), particularly for the less wealthy who must look farther away from the central business district to find affordable housing.

In addition to following zoning and minimum unit size requirements, developers must comply with building codes and energy efficiency codes, which raise construction costs. Likewise, homeowners' appliance choices are limited by energy efficiency standards. Such regulations are well intended and are justified by their proponents as necessary to correct home buyers' and homeowners' biases toward underestimating the long-run benefits of more-energy-efficient systems that increase up-front purchase prices. However, to the extent that consumers do not value energy conservation as highly as environmental activists do (perhaps because time-of-day electricity pricing is not yet widespread) and thus do not face incentives to reduce power consumption, the codes and standards can be counterproductive. Assessing energy efficiency regulations thus raises empirical questions that should be answered by well-informed cost-benefit analyses.

Section IV: Energy Markets and Environmental Regulations

While it is common for regulatory policy to pit against one another individuals and groups with different stakes in the regulatory process, this is particularly true of environmental and energy regulation. Regulations in these areas have consistently favored the goals of one politically-popular group over those of other less-politically-popular groups, regardless of the relative costs and benefits for those affected by the regulation. For example, environmental activists often battle for influence over a proposed regulation with the owners of business enterprises who would incur substantial compliance costs should the regulation be imposed. In other cases, large public utility providers seek protection from competition to take advantage of monopoly

pricing while consumers want to prevent such protections and the resulting higher prices.

"Market-like regulation" is but one approach that has been shown to increase the effectiveness of regulatory outcomes, particularly in the realm of environmental and energy rules, and to foster wealth creation—or, at worst, to impair prosperity to lesser extents. Market-like regulations harness the best aspects of markets and public policy interventions while limiting the worst aspects of political influence on regulatory outcomes. Consider the regulation of electricity markets. The traditional approach for the electricity distribution and retail industries has been to impose and maintain regulation largely on the basis of claims that electricity markets are natural monopolies. However, when competition is introduced at the retail or distribution levels, lower prices, cost reductions, and more robust innovation are observed. Texas's regulatory model for electricity introduces competitive market design at both the wholesale and retail levels and serves as an excellent example of market-like regulation.

Section V: Divisive Cases of Regulating Products and Services

Regulation of the internet, school choice, alcohol, and tobacco and vaping products exemplifies the dangers of overregulation. The pursuit of "net neutrality" was a heavy-handed, top-down approach to regulation. It failed miserably and was repealed just two years after its promulgation. Because opposition to overregulating the internet is far from over, bureaucrats would be wise to employ market-like regulatory strategies to avoid the pitfalls of their first regulatory attempt.

Student performance has benefited from school choice precisely because school choice places competitive pressures on traditional public schools to improve their performances in educating children, many of whom are currently limited to only one option in their geographically defined public school district. Special interests, mainly in the form of teachers' unions, likely have led some states to enact regulations that limit the ability of private or charter schools to compete directly with the public school monopoly. Mandates requiring that students be

admitted randomly to alternative schools and that these schools administer state-approved tests appear to be the most intrusive, leading to substantial reductions in the numbers, qualities, and instructional methods of the private schools participating in school choice programs. To the extent that the regulation of school choice programs is intended to foster better student performance, it is counterproductive and serves little purpose other than to protect public school teachers and administrators from competition.

The political marketplace can make for some strange bedfellows. Religious groups that oppose the consumption of alcohol can find themselves aligned with large breweries or beer distributors that seek to reduce their competition. Similarly, health advocates may have found themselves on the same side politically as big tobacco in support of regulations that simultaneously reduce competition for tobacco companies and increase product prices or restrict the number of tobacco flavors available to consumers. On the one hand, such regulations that benefit politically connected firms are representative of public-and-private-sector cronyism. On the other hand, to the extent that reducing the consumption of such "sin goods" is welfare-enhancing, more efficient and effective alternatives to selective taxes and paternalistic "nudges" are available.

Prescribing Better Regulatory Policy

The broader takeaway from this book is that the regulatory process could be vastly improved by decreasing the influence of special interests and increasing the dedication to a set of general guiding principles. We conclude the book with a discussion of those guiding principles of regulation.

An obvious potential solution to at least some of the regulatory issues discussed in this book is to repeal or substantially limit the extent of the regulations in question. However, such a generic suggestion does very little to advance the discussion of improving regulatory policy, in part because policy decisions are made in the political marketplace. We want the present volume to offer politically feasible yet truly helpful policy prescriptions and guiding principles. These are what we attempt to offer in the remainder of this chapter.

First-Best Solutions

The first three policy prescriptions would provide the greatest benefits, but implementing them may prove politically challenging.

1) Mandate sunset provisions. All regulations should include automatic sunset provisions; such provisions cannot be routinely extended or renewed. Policymakers should view attempts to solve societal problems by public policy interventions—regulatory or otherwise—as experiments, best undertaken at the state or local levels of government. Any policy's outcomes and implications cannot be known or anticipated fully before it is put in place. Individuals may respond in unexpected ways. Innovators may create new technologies. Pandemics may happen.

A multitude of scenarios could play out that render the regulation ineffective or perverse. The regulation could be too restrictive or inflexible. It might not be restrictive enough. One size does not fit all. Or maybe the regulation will become no longer desirable or needed. A sunset provision prevents us from being locked into a bad policy or one that has become obsolete given unpredictable changes in society over time. Such a requirement should not only be imposed on new regulations, but also be phased in retroactively for existing regulations.

We propose that every regulation be automatically repealed after X years. The sponsoring agency should be allowed to resubmit the regulation for another X years through the normal approval process, but the proposal will then need to include evidence that the regulation has mitigated the targeted "market failure" and generated positive net benefits.

The length of time for sunsetting may need to be tailored to the problem addressed. Whereas five years may be enough time to determine whether a regulation has effectively reduced informational barriers and improved efficiency in a particular industry, such a time frame may be too short for

many environmental, pharmaceutical, and medical device issues. Measuring the effects of a policy on climate change, population changes for slow-reproducing species, and other issues will likely require at least ten years of observation. It may take a generation for any adverse effects of approved prescription drugs and healthcare procedures to materialize.

2) Require cost-benefit analysis. As has been true since Ronald Reagan issued Executive Order 12291, all new significant regulatory action at the federal level should be subject to sound cost-benefit analyses to provide evidence that the proposed regulation will produce greater benefits than costs. At a minimum, only regulations that produce positive net benefits should be implemented. A more restrictive alternative would mandate not only that all regulations produce positive net benefits but also that their net benefits be larger than those expected from other reasonable alternatives. This proposed policy is not all that different from Executive Order 12866, which has been signed by every president since Clinton. (Presidents Carter and Reagan also signed similarly motivated orders during their terms.)[2] Executive Order 12866 applies to significant regulations (i.e., those with potential impacts of $100 million or more on the economy in any given year), but we suggest that its application be broadened to all regulations. Conducting the necessary regulatory impact study is costly; should such a cost not be warranted given the extent of the problem, the issue is inframarginal and should be left unaddressed by regulatory policy.

Requiring cost-benefit analyses is certainly not a panacea. The accuracy and reliability of the estimates could vary substantially across agencies and over time. Regulatory economist Jerry Ellig used the Regulatory Report Card, published by the Mercatus Center at George Mason University, to quantify the quality of the analysis in regulatory impact analyses of regulations falling under the provisions of Executive

Order 12866. He finds that of federal agencies conducting more than five regulatory impact analyses, the Department of Energy produced the best analyses while the Department of Health and Human Services produced the worst.[3] Despite the varying quality of the regulatory impact analyses, the requirement is a step in the right direction and, at a minimum, it should help agencies avoid implementing the most damaging regulations and meanwhile increase the transparency of the regulatory process.

3) Create a federal regulatory approval agency. Some readers may be perplexed by the suggestion of more bureaucracy as a solution to bureaucratic problems. Bear with us. Again, our goal is to promote institutions and rules that improve regulatory policy. While a regulatory approval agency would not be foolproof, it should lead to improved regulatory policy. Reaching this goal need not require the creation of a new agency. Rather, implementing this recommendation could take the form of expanding the existing Office of Information and Regulatory Affairs (OIRA). We suggest that it may be time to establish an independent agency, likely OIRA, to review all federal regulation concerning fiscal policy. At minimum, it is time to expand the definition of which regulations meet the significant regulatory action criteria such that more regulations are reviewed.

We provide here a broad idea of how such an approval agency might work. All existing bureaus and agencies would remain in place with their same duties, but without authority to implement the regulations they craft. Any agency would be able to draft and recommend a new regulation; however, that regulation would have to be submitted to the federal regulatory approval agency for review and approval.

All regulatory proposals would need to include a cost-benefit analysis, as we suggested in solution number 2. Any individual or organization that opposes a proposed regula-

tion would be able to object to the proposed regulation and present arguments against it to the federal regulatory approval agency. All hearings and documents would be open to the public for full review and comment before any final ruling. The federal regulatory approval agency itself could not create any new regulations; it would be authorized only to approve or not approve those submitted to it. The review process likewise would apply to proposals to renew sunsetting regulations.

The federal regulatory approval agency's structure could be similar to that of the Federal Reserve, with independent member-experts located in regional offices across the country (and perhaps with specialties in different industries). The agency would review regulatory impact analyses to confirm that the sponsoring agency has adequately justified the provisions contained within proposed regulations—in this way it would be similar to OIRA. Indeed, expanding and restructuring OIRA, rather than creating a new agency, is likely the most efficient means of establishing the prescribed federal regulatory approval agency.

As Ellig notes, it is reasonable to expect the regulatory approval agency to return regulations to the sponsoring agencies and demand higher-quality analysis when it is operating under a presidential appointee rather than a career civil service administrator.[4] Ellig finds empirical support for the hypothesis that the quality of regulatory analysis improves when OIRA is headed by a political appointee. He finds, further, that the primary benefit of OIRA is to ensure "that agencies base their estimates of benefits on more careful analysis, develop alternatives, and explain how their analysis affected decisions."[5] We expect that a broader federal regulatory approval agency likewise might improve the quality of regulatory impact analyses, which also should lead to sounder final regulations.

Second-Best Solutions

Even if the first three policy prescriptions prove too difficult politically to implement right away, substantial gains in regulatory quality can still be achieved by pursuing the following policies in the meantime.

> *4) Reduce the volume of the current regulatory code.* Multiple politicians have suggested eliminating one or more existing regulations for every new one promulgated. In our opinion, that approach is an inefficient way of lightening the regulatory burden because it does not necessarily get rid of the most problematic regulations. However, mandating the elimination of old regulations before a new one is implemented would send the correct message to regulatory agencies: namely, that the regulatory drag on the economy needs to be taken seriously and reduced where and when possible.

> *5) Institute broad reciprocity for licenses at the state and local levels.* Household mobility is restricted greatly by current occupational licensing rules. Instituting broad reciprocity for licenses and professional certifications will open employment opportunities for people who move or travel across state or city borders, especially to locations where their skills are in short supply; businesses will have an easier time operating in new locations. As highlighted by the reciprocity offered to most doctors and nurses during the COVID-19 pandemic, removing barriers to employment can offer significant benefits with low or zero costs.

Rules of Thumb

Each of the above five policy prescriptions involve action by the legislative branch and, thus, may take substantial time to gain enough political support to enact. However, the sponsoring regulatory agencies can improve regulatory outcomes by following the following rules of thumb.

A) Base rulemaking on reliable, scientific evidence. Relying on scientific evidence as the basis for evaluating rulemaking will help minimize the influence of vested interest groups' efforts to nudge the process by misinforming regulators. This principle comes with two caveats. First, this is not to suggest that all lobbying is without value; indeed, lobbying can provide useful information and can permit large numbers of less wealthy individuals to have their voices heard. However, given the existing political climate, the voices that dominate the policy process tend to be the individuals and businesses that are already successful and that seek to block the entry of new competitors or to drive existing rivals from the market. Such influence has led to inefficient and exclusionary regulatory policy.

Second, we by no means argue that science is uninfluenced by the political process. While scientists are often viewed as benevolent truth seekers, scientists are bound by the shortcomings common to all humans, including the limitations often referenced in the public choice literature. In a recent article published in the academic journal *Public Choice*, Diana Thomas and Michael Thomas argue that scientists can be best characterized as self-interested individuals who participate in coordination processes similar to those that participate in markets and politics.[6] Indeed, the institutions of scientific disciplines sometimes create incentives for researchers to participate in rent-seeking activities. Consequently, science itself can be complicit in the lobbying process, either as special interest group itself or selectively justifying the intentions of other interest groups. That scientists are not the ideal truth seekers we want them to be is no reason to throw scientific evidence out the window; however, it does suggest that rule makers should bear in mind that scientific researchers may be influenced by political biases and should therefore seek out more evidence rather than relying on the popular study of the day.

B) Avoid blunt or broad regulation. Regulatory policy is most effective when it targets a very specific problem precisely; it is less effective when its language is broad. This is not to argue for command-and-control rules that dictate the exact measures a firm must take. Rather, we suggest that regulation be written such that it cannot be later interpreted to apply to other industries not originally under consideration. For example, if youth smoking and vaping is the concern, tailor policy to youth rather than to all smokers and vapers. Precise, targeted regulation will lessen the frequency and extent of unintended consequences and improve the overall efficiency of the policy.

C) Incentivize state and local coordination. Given the existing political marketplace, homeowner-voters have strong incentives to support local policies that raise their own home values without regard to the spatial spillovers imposed on neighboring jurisdictions or on the less wealthy. Consequently, state governments can contribute in major ways to limiting the inefficiencies stemming from local regulations. For example, states may provide guidelines regarding economic development and land use policies.

D) Establish market-like regulation. Market-like regulations in energy and education, to name just two areas, facilitate competition and innovation while limiting the costs of the political marketplace. Competitive pressures encourage firms to control costs and limit price increases while still innovating and improving product quality. Furthermore, choices about which technologies to invest in and what risks to take are left in the hands of the people who stand to gain or lose rather than subjected to political whim. Market-like institutions will improve the efficiency of the means used to achieve the intended goals of regulatory policies.

E) Incorporate more analysis of economic risk. Rulemaking should incorporate an analysis of risk to determine the extent of regulation needed. When the risk of negative outcomes is economically small, regulation should be minimal or nonexistent. When the risk of negative outcomes is economically large, regulation might be more involved. The fact that the risk of negative outcomes is large does not guarantee that regulation is wise, because the costs of the regulation can have the unintended effect of lowering income and increasing the risk of harm and death in other ways. In a recent Independent Institute Briefing, economists Kevin Gomez, Diana Thomas, and Ryan Yonk use the example of chemical regulations to detail how regulations have the potential to cause far more harm than the estimated risks that the regulations are crafted to mitigate.[7]

F) Avoid uncertainty. Our final rule of thumb is twofold. First, regulations should be clear about what is permitted and what is not. Second, regulators should not erect burdensome regulation to protect individuals from the uncertain; doing so often prevents people from developing private solutions to deal with unwanted uncertainty. If a private solution shows a good deal of promise for abating or minimizing a problem, there is little need for regulation to begin with. Further, market innovations may address the problem in the near future, making restrictive regulation not only unnecessary but also inefficient.