Introduction

An Introduction to Regulation

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Regulatory expansion has been stunning. The *Code of Federal Regulations* (CFR)—the accumulation of rules imposed by the departments and agencies of the federal government—now exceeds 180,000 pages.[1] At a reading speed of two minutes per page, the average American would need more than 250 days of consecutive, around-the-clock reading to wade through the comprehensive list of regulations promulgated by federal government agencies.

The CFR has gotten so long that no individual can possibly comprehend the full set of federal regulations. The CFR does not even include the additional regulations imposed by executive orders, state governments, and local municipalities.

Regulation matters. Functional, evidenced-based regulation can provide significant public benefits, such as protecting uninformed consumers, limiting the effects of monopoly power, improving public health and safety, safeguarding civil rights, and protecting the environment.

Poor regulation can be devastating. Interest groups can convince the government to use its coercive powers to their own benefit and profit at the expense of everyone else. The financial and time costs of complying with regulations can drastically outweigh the benefits. Even regulations created with the best of intentions can have such perverse

effects in the form of eroding the fundamental market processes that underpin the remarkable level of economic development those in the West enjoy, leaving in its wake poverty and civil unrest.

The goal of this volume is to study regulation. We ask fundamental questions that lead us to study not only the actual effects of regulation, but also how regulations are created.

Regulations are not born in a vacuum. Rather, regulation is the result of exchanges taking place in the political marketplace. The participants in this marketplace—namely, politicians, bureaucrats and parties interested in regulatory outcomes—are not benevolent social planners. Volumes of research point to the conclusion that politicians and bureaucrats respond to incentives just as other human beings do. Sometimes these incentives lead the politicians and bureaucrats to promote regulation in the broad public interest. At other times, these incentives lead the same individuals to pursue personal objectives, such as reelection, job security, larger budgets, and more influence. The entire regulatory process is plagued by imperfect information and unchecked self-interest.

Proponents of regulation often point to a distrust of free enterprise and provide anecdotes of "market failures" as justification for a larger regulatory, administrative, or managerial state. Free markets are astonishingly effective at allocating scarce resources in the most efficient manner. Sometimes members of society are not satisfied with that final distribution of resources. Some market characteristics, such as externalities, public goods, market power, and asymmetric information, may indeed lead markets to produce less than efficient results.

The question we must ask is whether we can trust government regulators to create rules that improve on market outcomes. All data point to one answer: no! Americans do not trust "the government" or "elected officials." Opinion surveys showing a deep lack of trust in the United States government are rich and robust (for an example, see table 1).

According to a Pew Research Center poll, trust in the US government is at an all-time low. Only 17 percent of respondents in 2019 reported that they "trust the government in Washington always or most of the time," down from 73 percent for a similar poll in 1958.[2]

Table 1. Trust in US Public Figures

Profession	% of US adults who have a great deal of or a fair amount of confidence that _______ will act in the best interest of the public
The military	85
Scientists	84
Principals (K–12)	84
Police officers	83
Professors	71
Religious leaders	65
Journalists	58
Business leaders	46
Elected officials	39

Source: Lee Rainie, Scott Keeter, and Andrew Perrin, "Trust and Distrust in America," Pew Research Center, July 22, 2019.

Approval of Congress ("Do you approve or disapprove of the way Congress is handling its job?") was 22 percent in March 2020.[3] The congressional approval rating has not exceeded 30 percent in the 11 years preceding the publication of this book.

When government institutions are put head to head with specific product brands and companies, Americans clearly trust private companies more than they do the US government.[4] When people were asked whether they trusted the following (e.g., company, brand, person, institution) "a lot to do the right thing," tech companies like Amazon, Google, PayPal, and the Weather Channel scored among the highest of all surveyed companies, with 35 percent of respondents placing a lot of trust in the company about which they were asked. The United States government earned a lot of trust only from 7 percent of respondents. Seven percent! Roughly 14 out every 15 people do *not* place much trust in the government.

The bottom line of these findings is stunning. Americans have little faith in elected officials or the government. Yet the same government officials that Americans distrust control the ever-growing regulatory landscape designed to "solve" our problems. Regulatory policymaking

proceeds with little oversight, and most policymakers and citizens have little idea about what is written into a regulation.

We need a clear understanding of regulation and its effects to draw conclusions about its contributions to economic well-being and to create beneficial public policy. Unfortunately, regulation's scope is notoriously difficult to quantify. Broad empirical studies of federal regulations have been impractical until only recently.

Technological advances in machine learning facilitated the creation of RegData,[5] a revolutionary and evolving dataset that quantifies regulatory restrictions and identifies the specific industries affected by them. For the first time, researchers are able to employ this new dataset to build on the existing literature consisting of individual event and case studies. The empirical findings can now provide to the public and policymakers more reliable estimates of the direct and indirect effects of regulatory policy.

The present volume collects scholars to answer essential empirical questions related to how regulations are created and the effects of a growing regulatory state. The goal of the book is to increase awareness of the consequences of regulatory policies and encourage a more informed debate about such policies. It is important to evaluate public policy outcomes as they are rather than as proponents might wish them to be.

Outline of the Book

We organize *Regulation and Economic Opportunity* in five sections:

Section I: Regulation, Entrepreneurship, and Opportunity

We begin our examination of the effects of regulation with a look at entrepreneurship, given the critical role that it plays as a driver of innovation, economic prosperity, and overall economic growth. In **chapter 1**, Russell Sobel examines not only how regulations affect the market economy, but also how the political process influences the nature of the regulations promulgated. Sobel, using the public choice model of regulation, goes on to show that the incentives inherent in the political process generally lead to inefficient regulations that tend

both to stay on the books and to encourage unproductive rent-seeking. Given the substantial costs involved in rent-seeking, the political environment tends to favor large, established firms at the expense of new start-ups that otherwise might have brought about more innovation, competition, and cost reductions. Sobel's key takeaway is that the current regulatory environment is costly—much more so than it superficially appears.

In **chapter 2**, Steven Horwitz and Magatte Wade expound on one of those costs, which is often overlooked by many others: that regulation blocks at least some entrepreneurial upward mobility and thus perpetuates poverty. The authors explore the role that regulatory restrictions play in causing two outcomes: (1) many households, particularly nonwhite households, in the West persistently fall below the Western poverty line, while others enjoy greater income mobility, and (2) that many households and even entire countries in the Global South, particularly in Africa, have been unable to achieve anything close to Western levels of material comfort.

Regulation, particularly for those who are poor and marginalized in the political process, has stood in the way of the market innovation and creative destruction that was instrumental in the Great Enrichment. The effect of regulation in the United States has been highly regressive and tends to trap many people in poverty. In Senegal, regulatory burdens, in terms of both time and financial resources, are so heavy that it is nearly impossible to start a small business. Consequently, many entrepreneurs choose to remain in the extralegal sector with no legal rights or protections. Furthermore, large multinational firms in Senegal are able to use their financial advantages and influence not only to better navigate the regulatory environment but also to gain special exemptions unavailable to small entrepreneurs. The result is an underdeveloped legal small business sector and an economic climate rife with distrust and corruption.

Chapter 3 extends and generalizes the discussion of regulation and distrust of market exchange. As mentioned earlier in this chapter, a major motivation for government interventions is the absence of trust in other market participants. For example, if consumers do not trust

sellers not to defraud them, they may appeal to government to impose regulations to prevent such fraud. However, chapter authors Peter Calcagno and Jeremy Jackson suggest that regulation also can, in theory, degrade social trust by magnifying economic and political inefficiencies. They test the causal relationship between social trust and regulation empirically. While they present some evidence that less social trust causes regulation, the evidence that regulation reduces social trust is more convincing. That finding is important because other research has indicated that countries with more social trust tend to experience faster economic growth. Calcagno and Jackson's results likewise offer additional support for the finding that regulation hinders entrepreneurial activity, discussed in chapter 1.

Horwitz and Wade mention in chapter 2 that regulatory burdens have, in part, encouraged many Senegalese entrepreneurs to operate outside the legal sector. That observation is far from unique to Senegal. In **chapter 4,** Travis Wiseman explores how overregulation leads to perverse incentives encouraging individuals to engage in socially unproductive activities and in the shadow economy. Wiseman, expanding on William Baumol's distinction between productive and unproductive entrepreneurship,[6] argues that in the face of an increasingly overregulated economic environment, otherwise productive entrepreneurs respond by engaging in rent-seeking to influence future regulations and by moving some of their activities underground or offshore in order to engage in productive, unproductive, and sometimes destructive activity.

Many labor-market regulations discussed in section II, such as occupational licensing, scope-of-practice restrictions, and minimum wages, commonly lead to participation in the shadow economy. Although the size of the shadow economy is sometimes difficult to gauge accurately, it can be a reliable indicator of the onerousness of public policy as it relates to earning income or making a business profit.

On the one hand, the existence of the shadow economy serves as an escape valve or a substitute for legal markets, permitting trade in many items that would be too costly or offer too low of a profit in the legal sector. On the other hand, operating in the shadow economy increases the risk of being defrauded, undermining social trust.

Moreover, investments in both human and physical capital are abridged in shadow economies, leading to slower growth as well.

Section II: Regulation and Labor Market Outcomes

We begin our analysis of labor market regulations in **chapter 5**. James Bailey provides a broad analysis of how regulation affects labor markets by answering two questions: Does regulation kill or create jobs, and does regulation raise or lower wages? Consistent answers to those questions are not easy to find in the literature. To find answers, we must first acknowledge that many types of regulations affect labor market outcomes and that their effects vary substantially. Bailey categorizes regulations into seven types: (1) cost-increasing regulations, (2) bans, (3) entry barriers, (4) occupational licensing, (5) minimum wages, (6) mandated employment benefits, and (7) make-work regulations. After walking through the consensus about regulation's effects on jobs and wages for each type of regulation, Bailey acknowledges that we still have a lot to learn regarding the overall consequences of regulatory growth on employers and employees.

In **chapter 6,** Alicia Plemmons and Edward Timmons provide a more detailed introduction to occupational licensing, expounding on the research addressing the expansion of such regulations since the early 20th century. Support for occupational licensing has its roots in protecting and promoting individual liberty; licensing therefore should not necessarily be viewed as bad policy. Plemmons and Timmons's analysis is consistent with arguments made by Christopher Tiedeman, the 19th-century classical liberal author and student of constitutional law: the legitimate purpose of licensing is to limit the frequency of injurious trade by restricting from the market incompetent traders who seek to defraud consumers.

Plemmons and Timmons show that the number of occupations requiring licenses and the stringency of the requirements for obtaining these licenses has expanded dramatically in recent years. The authors explore the effects of occupational licensing on numerous economic measures: occupational choice, job mobility, wages, consumer access, and product or service quality, to name a handful. While some of the research

findings highlighted by Plemmons and Timmons support that occupational licensing is associated with improved service quality select industries, the consensus in the relevant literature suggests that the growth in licensing almost certainly extends beyond the legitimate purpose described by Tiedeman.

The coverage of occupational licensing laws continues in **chapter 7**, in which Kathleen Sheehan and Diana Thomas examine the laws' effects on the so-called gender and race wage gaps. Occupational licensing is a barrier to entry that reduces the supply of labor in the licensed industry. Basic economics indicate that wages will rise for workers who are able to gain entry into the industry. However, wage gains will not necessarily be equally distributed among all workers. Furthermore, less entry into the field can lead to more unemployment—and that effect, again, may not be the same across all races and genders.

Chapter 8 discusses regulation employed widely in the healthcare industry: certificate-of-need (CON) laws. Alexander Ollerton and Christopher Koopman examine how CON laws can be reformed to improve access to care. These laws regulate the building, expansion, and modernization of healthcare facilities and of the medical equipment available to these facilities. The original intent of CON laws was to improve access to healthcare facilities, particularly in rural areas, while also driving down healthcare costs. Ollerton and Koopman argue that CON laws instead have, in many cases, reduced access and raised costs. The authors suggest that states with these laws should follow the lead of the 14 states that have repealed their CON laws. If this proves unachievable, states should consider phasing the requirements out over time or removing them for specific types of providers, to improve access to needed care.

Section III: Land Use and Energy Standards

Section III is a three-chapter unit that covers land use, building codes, and energy standards. Emily Hamilton begins her treatment of land use regulation in **chapter 9** with an analysis of how such regulations affect housing affordability. Hamilton discusses how zoning and other land use regulations, such as minimum unit size or lot size requirements, have contributed to the elimination of many of the market innovations

that can provide affordable housing options in cities with otherwise high land prices. Ultimately, the land use restrictions, largely supported by homeowners seeking to increase the value of their principal asset, have limited new housing construction and driven up housing prices and rents. Rent controls, introduced to combat some of the housing price effects of other regulations, have contributed to less housing and job mobility; rent-controlled properties often are repurposed (as condominiums or other owner-occupied dwellings) and sold at higher prices than rental housing not covered by such controls. However, as Hamilton discusses, some local and state efforts to liberalize land use regulations have shown promise.

The contributions of **chapter 10** are twofold: First, Matthew Holian analyzes the effects of building codes designed to reduce household energy consumption. Second, in the process of presenting that analysis, Holian walks readers through the main steps in a sound cost-benefit calculation, which is a method used widely in regulatory analyses. Building and energy codes can be defended, in part, on efficiency grounds. Specifically, home buyers are at an informational disadvantage relative to builders because buyers cannot easily observe how much insulation or what type of wire or ductwork was used in the construction. Furthermore, homebuyers may underestimate the long-run benefits of improved energy efficiency, focusing on the up-front costs only, leading to less demand for energy-efficient building materials or heating and cooling systems. However, Holian also notes that energy efficiency regulations can be counterproductive because consumers change their behaviors in predictable ways that offset the benefits of regulatory standards. Determining which effects dominate thus becomes an empirical question. Holian demonstrates a cost-benefit analysis of building energy codes in Florida.

James Broughel continues the discussion of energy-efficiency standards in **chapter 11**. Rather than examining building efficiency standards as Holian does in chapter 10, Broughel focuses on standards for appliances. The Department of Energy asserts that consumers and businesses exhibit irrational behavior in energy markets. However, those claims of irrationality depend on myriad assumptions, including

assumptions about a product's use over its lifetime, quality differences between more- and less-efficient devices, and the consumer's or business's discount rate.

Broughel concludes **chapter 11** with a longer-run, intertemporal analysis, rather than adopting the typical static analysis. He provides an intriguing approach that deserves more attention, because such an intertemporal analysis leads to the possibility that stringent energy efficiency regulations can produce faster economic growth and therefore improve future well-being at the expense of decision makers today. One must then question how much present sacrifice is appropriate in the pursuit of these benefits and, what is more important, who is in position to make such a determination: private individuals or government regulators?

Section IV: Energy Markets and the Environmental Regulations

In **chapter 12**, Jordan Lofthouse and Megan Jenkins discuss how the typical approach to public policy, particularly environmental policy, often pits individuals and groups against one another. That need not be the case, however. Regulatory policy can be developed in ways that lead to cooperation and joint achievement of collective goals rather than cutthroat political competition. Markets work well when private property rights can be well defined and protected; however, many cases, especially concerning environmental issues, can be identified wherein such rights cannot be well defined. Thus, public policy often is the next best option, but its effectiveness frequently is tarnished by the political process. Lofthouse and Jenkins's solution is to employ "market-like regulations" that merge the best aspects of markets and public policy while limiting the worst aspects of politics. They adopt the American Prairie Reserve as a case study. The authors finish the chapter with a discussion of how existing laws and regulations can be reformed in similar manners and lead to more-cooperative outcomes.

The electricity distribution and retail power industry has long been argued to be a natural monopoly, and its prices and conditions of service have generally been regulated by public utility commissions across

the United States since the 1930s. In only 13 states can most consumers choose their electricity supplier, but even in those states electric power distribution is a publicly regulated monopoly. In **chapter 13**, Jerry Ellig advances the discussion of competition in electricity markets. In both models he examines—one in which suppliers compete for retail customers on a regulated wire network monopoly and another with duopolistic competition between electric utilities with overlapping wire networks—additional competition is associated with cost reductions, lower prices, improved innovation, and more product differentiation.

Michael Giberson and Lynne Kiesling continue the discussion of electricity market regulation in **chapter 14**. Like Ellig in the previous chapter, the authors challenge the traditional natural monopoly governance framework for electricity markets, arguing instead that competition can improve efficiency. They specifically examine the electricity market in Texas, which they identify as the only US state with a fully competitive market design at both the wholesale and retail levels. They argue that Texas's policy has encouraged network governance that has expanded investment in transmission infrastructure and new energy generation technologies (such as wind and solar projects). While Texas's institutional framework is not perfect, it serves as an example of the "market-like regulation" that Lofthouse and Jenkins describe in chapter 13 and can serve as a model for other states.

Section V: Divisive Cases of Regulating Products and Services

The fifth and final section of the book is reserved for four areas of regulation that have generated heated debate in recent years. Ted Bolema in **chapter 15** discusses an internet regulation known as "net neutrality," promulgated in 2015 and repealed in 2017. Both net neutrality's promulgation and its repeal were contested hotly and generated lively debates among policy wonks. However, much of the discussion likely left audiences confused, given the technical nature of the controversy. Bolema begins the chapter by defining *net neutrality* before dissecting the economic analysis presented in the Federal Communications Commission's 2015 Open Internet order, which established the policy.

Bolema argues that internet consumers have benefited from the 2017 repeal of net neutrality, but the battle is far from over.

Corey DeAngelis and Lindsey Burke discuss in **chapter 16** the unintended consequences of regulating private school choice programs. The competition introduced by school choice programs generally has been found to improve student achievement. Regulations restricting school choice programs threaten to limit these benefits. Such regulations include open-admission mandates, state testing or a nationally normed testing requirement, random-admissions mandates, and rules that participating schools must accept vouchers as tuition payments in full.

DeAngelis and Burke review the empirical evidence on the effects of school choice program regulations and find that the preponderance of the evidence suggests that such regulations are associated with reductions in the quantities, qualities, and specialties of private schools participating in choice programs. The two most intrusive program regulations are found to be random-admissions mandates and state testing mandates.

Chapters 17 and 18 address the regulation of vice. In **chapter 17**, Steve Gohmann and Adam Smith examine state alcohol regulations before James Prieger explores the regulation of tobacco and vaping in **chapter 18**. The passage of the 21st Amendment left the control of alcohol in state hands and created numerous peculiar variations in public policies across the states. The three-tier system (wholesale, distribution, and retail), however, has been a mainstay across the majority of states. Gohmann and Smith apply the "Bootleggers and Baptists" model to analyze the regulatory constraints on alcohol. In that model, an odd alignment of political interests occurs between an economic interest group—the Bootleggers—who seek to reduce competition and a moral interest group—the Baptists—who seek to achieve some social ideal. The authors detail some recent events in Kentucky (restrictions on brewery ownership by distributors) and Indiana (restrictions on cold beer sales and Sunday alcohol sales) to demonstrate the applicability of the Bootleggers-and-Baptists model.

Arguments for regulating e-cigarettes and vaping often are made on paternalistic grounds, buttressed by claims that users do not properly

understand the long-term consequences of their behavior. But, as Prieger discusses, the consequences of regulating e-cigarettes are not so simple. To understand the consequences one must establish whether and to what extent e-cigarettes are complements to or substitutes for tobacco cigarettes and determine the health effects of vaping relative to smoking, the dangers of exposure to second-hand vapor or smoke, and the potential unintended consequences of regulation, such as exacerbation of illicit trade. Given Prieger's answers to these questions, the costs of regulating e-cigarettes and vaping very likely exceed the benefits. Prieger concludes by presenting seven steps to informed regulation of e-cigarettes and vaping. It is important to note here that, as in many of the other cases examined in the book, Prieger's alternatives are not limited to the status quo (current regulation) or no regulation at all. Rather, his goal is improved regulation: his prescriptions permit some nonzero level of regulation.

The conclusion summarizes the major themes and policy prescriptions offered throughout the book, as identified by the editors and this introduction's authors, Adam Hoffer and Todd Nesbit. One consensus revealed throughout is that the costs associated with overregulation or unjustified regulation are substantial. Consequently, many existing regulations should be scaled back or eliminated altogether—though this might prove difficult given vested special interests and the existence of the transitional gains trap. That is not to say that all regulation should be eliminated; far from it. Many good regulations exist and many more would exist if rules were rewritten to take advantage of market-like forces to minimize the costs associated with political divisiveness.

Conclusion

We hope to provide readers of this book with analyses related to regulation in a wide array of industries and applications. Regulation has been difficult to study empirically owing to a lack of data and computational abilities. Consequently, we believe that individuals have been quick to accept regulations as easy, politically palatable solutions to societal problems. However, the benefits of regulation often are overpromised, and its costs often hidden from public view.

The primary purpose of this book is to present a more complete analysis of the benefits and costs of public regulation—both the seen and the unseen—such that the actors engaged in the political process can form better conclusions concerning the appropriateness of regulatory policy. Our expectation is that this book will provide the analysis of the regulatory environment and regulatory policy necessary to motivate improved policymaking.