Government Regulation: The Good, The Bad, & The Ugly

Regulatory Process Working Group

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Introduction

The American free enterprise system has been one of the greatest engines for prosperity and liberty in history, and has the potential to deliver a promising future for the United States and the world.[1] Through protecting property rights and fostering healthy competition, democratic capitalism rewards work and ingenuity which improves our lives and has liberated more people from poverty than any other system.[2]

Yet, the United States faces growing challenges in an increasingly competitive global economy. Recent decades have seen a decline in economic growth and innovation, and one important cause is poorly-designed government policies. Large swaths of the American economy are distorted by government mandates and incentives, and the vast majority of binding "laws" are not enacted by our elected representatives in Congress, but are promulgated by agencies as regulations.

Sensible, evidence-based regulations that respect the fundamental role of free-market competition can provide vital public benefits – such as protecting the environment, public health and safety, civil rights, consumers, and investors. Yet, despite the best intentions, government regulation too often disrupts the marketplace or picks winners and losers among companies or technologies. When regulators behave this way, they invariably cause unintended harms. Poorly designed regulations may cause more harm than good; stifle innovation, growth, and job creation; waste limited resources; undermine sustainable development; inadvertently harm the people they are supposed to protect; and erode the public's confidence in our government.[3]

This paper examines the important role regulations play in a vibrant economy, how they differ from other government programs, why they can produce unintended consequences, and how reforms could help us achieve the benefits regulations can provide with fewer negative outcomes. With a better regulatory system, we can enjoy a healthy environment, safe workplaces, more innovative products, and greater opportunities and prosperity for all Americans.

I. Regulation can be an important government function.

The federal government has two main vehicles for diverting private resources to achieve policy goals. The first is through *spending programs*. The IRS collects compulsory taxes, and the revenues are spent on desired public functions such as parks, roads and other infrastructure, schools, law enforcement, homeland security, and scientific research, as well as welfare and social insurance programs such as Social Security, Medicare, Medicaid, food stamps, and unemployment assistance.

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[1] Paul R. Noe, "Smarter Regulation for the American Manufacturing Economy," Indiana University School of Policy and Environmental Affairs, U.S. Manufacturing Public Policy Conference, National Press Club (Sept. 14, 2016).

[2] See Fred L. Smith, Jr., "Countering the Assault on Capitalism," Institute of Economic Affairs, Blackwell Publishing, Oxford (Feb. 2012).

[3] Paul R. Noe, "Smarter Regulation for the American Manufacturing Economy," supra note 1.

The second is through *regulation*. Federal agencies issue and enforce standards ranging from environmental quality, to consumer protection, business and banking practices, nondiscrimination in employment, Internet privacy, labels and "disclosure," safe food, drugs, products, and workplaces.

The *goals* of spending programs and regulations are widely accepted. For example, a clean and healthy environment, safe food and drugs, and fair business and employment practices are among the most important things citizens expect of their government. The goals are largely nonpartisan—most conservatives, moderates, and liberals agree on them. However, the *implementation* of spending and regulatory programs often is controversial. Disagreement over government policy is inevitable in a society where people's values, opinions, incomes, and interests vary widely, and when the breadth of government has grown substantially.

A. Regulation presents special issues, problems, and controversies.

While the goals of most regulatory programs enjoy broad public support, in practice regulation usually comes down to detailed rules and lots of paperwork that can be highly costly and burdensome to those who must comply with them. This includes not only large corporations but small businesses, nonprofit organizations, schools, state and local governments, farms, and consumers and citizens. Some sectors of the economy bear the heaviest burdens, such as manufacturing, automobiles and transportation, energy and power, banking and finance, and health care and pharmaceuticals. But all of us pay for federal regulations through higher prices, fewer available products, services, and opportunities, and stifled wages or job opportunities. The costs of regulation are never "absorbed" by businesses; they always fall on real people.

In our democracy, citizens express their views at election time by voting for candidates and parties that stand for broad menus of policy positions. Between elections, choices on controversial subjects are made through presidential leadership, voting in Congress, court rulings on specific disputes, and "checks and balances" among the three constitutional branches. For citizens to intelligently hold elected officials accountable, however, policies' benefits and costs must be visible.

While policies effected through both spending and regulatory programs provide benefits to Americans, the costs associated with regulatory programs are much less transparent than their on-budget counterparts. To implement spending policies, presidents send proposed budgets each year to Congress, and Congress must both authorize activities and appropriate necessary funds to implement them. Spending agencies are generally enthusiastic about their programs and want more resources to pursue them, but the available funds are necessarily limited and must be allocated to the highest priorities by Congress and the President in a much-debated, highly-publicized, annual budget process. These checks and balances make elected officials accountable to citizens. Regulatory policies cannot be measured in the same way, however; and there is nothing equivalent to the fiscal budget to track regulatory costs. These costs are like stealth taxation, and because they are assumed to fall on businesses (even though individual consumers and workers ultimately bear them), regulatory tools may seem preferable to direct spending programs for accomplishing an agency's policy objectives.

Further, regulations have the force of law, but Congress usually just sets broad regulatory goals by statute, and delegates the power to write and enforce detailed rules to specialized regulatory agencies. This means that Congress gets credit for popular regulatory goals while the often-unpopular rules are blamed on "unelected bureaucrats." This criticism often comes not only from citizens and businesses but also from the legislators who voted for the regulatory statutes in the first place.

B. Regulatory costs are large, but invisible.

As the size and reach of the government has grown dramatically over the last century, so too have concerns about the costs and unintended consequences of regulatory programs. At the end of the nineteenth century, government accounted for less than ten percent of the U.S. economy. Today, government consumes or directs nearly half of the economy, with direct government spending alone reaching on the order of one-third of U.S. gross domestic product.[4] Regulatory costs, while off-budget and less visible, are no less real.[5]

At the federal level alone, there are over 70 federal regulatory agencies, employing hundreds of thousands of people to write and implement regulations.[6] Every year, they issue about 3,500 new rules, and the regulatory code now is over 168,000 pages long.[7] Because regulatory impacts are diffuse and hard to measure, no estimates of the actual costs of regulation are completely reliable, but some researchers peg the total annual cost at more than $2 trillion.[8] Other research suggests the drag on economic growth could be twice that much, about $4 trillion per year, or $13,000 for every man, woman, and child in the United States.[9] And we will never know the other costs, such as the value of jobs never created, factories never built, medicines never discovered, or entrepreneurial ideas never realized.

Regulatory mandates often are very costly—for example, for expensive pollution control equipment, extensive testing of new drugs, and collection of detailed information from consumers. As noted, these costs are not controlled as they are for spending programs. Federal spending is limited by the available revenues, and by budgeting among many competing programs. But regulatory costs are born outside the government, by those who must comply with the rules, their customers, and their employees. Additionally, lacking the budget constraint of spending agencies, regulatory agencies are prone to excess. They often pursue their specific mission with zeal, but this results in too little

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[4] https://tradingeconomics.com/united-states/government-spending-to-gdp.
[5] Fred L. Smith, "Countering the Assault on Capitalism," supra note 2.
[6] Susan Dudley & Melinda Warren, https://regulatorystudies.columbian.gwu.edu/regulators%E2%80%99-budget-eisenhower-obama.
[7] https://regulatorystudies.columbian.gwu.edu/reg-stats#Total%20Pages%20in%20the%20Code%20of%20Federal%20Regulations%20(1936%20-%202013).
[8] Mark Crain & Nicole Crain, http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Full-Study.pdf.
[9] http://mercatus.org/sites/default/files/Coffey-Cumulative-Cost-Regs-v3.pdf.

regard for other legitimate goals, such as a strong and growing economy. This "tunnel vision" can result in rules that impose costs greater than the benefits they provide.[10]

C. Regulation faces fewer checks and balances.

Spending programs, like regulatory programs, often are authorized with broad aspirational language that everyone can support, like the 'War on Cancer' or 'No Child Left Behind.' But funds for those programs must be appropriated as well as authorized, and it is there in the budget process that we confront the necessary tradeoffs among competing priorities. In contrast, regulatory programs never realistically adjust to the reality that our country's resources are limited. Both types of programs may claim dramatic benefits from eliminating disease, or crime, or pollution, but such claims often lack credibility and accountability. We would never allow the spending agencies to collect their own taxes from the public, in whatever amounts they feel they need. Yet regulatory agencies effectively do just that.

While many regulatory costs initially fall on regulated businesses, those costs are necessarily passed on—to consumers in the form of higher prices, to employees in the form of lower wages, and to investors in the form of lower returns on investment. For this reason, regulation can produce not only large social benefits but also large negative effects on prices, wages, business investment, and job opportunities. As mentioned earlier, regulation functions essentially as stealth taxation. The balance is often ignored in political debate—when it is assumed, incorrectly, that regulation is a "free lunch."

D. The regulatory challenge.

The regulatory dilemma is this: On the one hand, regulation can be critically important to our welfare. Federal and state regulatory agencies have contributed to great improvements in air and water quality, highway safety, public health, honest commerce, racial and gender equality, and many other central aspects of American life. On the other hand, regulatory actions often have come at a cost that exceeds their benefits and sometimes actually have been counterproductive. These failures are abetted by the structure of the regulatory process: regulation operates outside our usual system of checks and balances, where policies are enacted directly by our elected representatives and disciplined by taxing and budgeting. Regulatory agencies have too often fallen short of public expectations and disappointed public trust.

Precisely because of its importance, regulation deserves constructive criticism and earnest efforts at improvement. In the following pages, we attempt to show how regulation can be reformed to achieve its valuable goals more thoroughly, more effectively, and at lower cost.

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[10] Breyer, Stephen, Breaking the Vicious Circle: Toward Effective Risk Regulation. Harvard University Press (March 15, 1995).

II. Serious problems with how regulations are made and enforced in practice.

In thinking about the real effects of regulation, it is important to understand that the special resource of the government—which private entities do not possess—is the power to coerce. Interest groups that can convince the government to use its coercive power to their benefit can profit at the expense of others. As a result, regulation tends to get "captured" by well-organized interest groups acting to maximize their own well-being, often at the expense of broader society.

Note that efforts of businesses, activist groups, unions and other organized groups to gain wealth or power through favorable government treatment (called "rent-seeking" in economic jargon),[11] is very different from "profit-seeking,"[12] when people attempt to *create* wealth by discovering and acting on new opportunities. The motivation for each of these activities is to maximize economic returns, but the *unintended consequences* of profit-seeking and rent-seeking differ dramatically.[13]

A. Why is "regulatory capture" a problem?

As Adam Smith famously wrote, "it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[14] "Profit-seeking entrepreneurs continuously move resources to more valuable uses, and in the process create economic growth and development," which *unintentionally* leads to "socially beneficial consequences."[15] More importantly, in a competitive market environment, those returns that initially accrue to a successful entrepreneur are quickly competed away by other profit-seeking entities. Ultimately, consumers receive the gains in the form of lower prices and better products.[16]

In contrast to profit seeking, rent seeking emerges when regulation or other political intervention in markets creates opportunities for some people to gain "rights" that only the government can confer. Such rent-seeking to achieve favorable regulatory treatment is a rational response to the opportunity presented by regulation, and generates concentrated gains for the successful rent seekers at the expense of everyone else. But rather than creating new opportunities and value for consumers, such behavior leads to socially wasteful uses of resources. When regulations can provide competitive advantage, it is often in the self-interest of regulated parties to support them,[17] (often hiding behind public interest arguments)[18] even while other interests oppose them. Thus, talent and energy get channeled into lobbying for favorable government treatment (a zero sum game at best), rather than

[11] http://www.econlib.org/library/Enc/RentSeeking.html.
[12] https://fee.org/articles/rent-seeking-a-primer/.
[13] http://www.econlib.org/library/Enc/UnintendedConsequences.html.
[14] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ch. 2, 1776.
[15] James Buchanan, "Rent Seeking and Profit Seeking," in *The Collected Works of James M. Buchanan: Vol. 1.* Liberty Fund 1999.
[16] Susan Dudley, Exploring Regulatory Capture's Unanswered Questions, *The Regulatory Review*, 2016, https://www.theregreview.org/2016/07/04/dudley-exploring-regulatory-captures-unanswered-questions/.
[17] George Stigler, 1971, http://www.ipcreators.org/pdf-files/Stigler%20on%20regulation.pdf.
[18] Adam Smith and Bruce Yandle, 2015, http://www.amazon.com/Bootleggers-Baptists-Economic-Persuasion-Regulatory/dp/1939709369.

into entrepreneurial experimentation and innovation that leads to growth and prosperity. This leads to regulatory agencies advancing the commercial or political concerns of the most well-organized special interests (which may be, but are not necessarily, regulated parties).[19]

B. Insiders gain advantage.

Regulatory programs are sometimes captured by businesses and other "interest groups," who use them to promote their own end—such as restricting competition and suppressing innovation from new firms and business methods, or advancing their market power or political agendas. And even where regulations are well intended, they can produce unintended negative consequences. For example, drug regulation may delay the introduction of new, life-saving pharmaceuticals.

The well-connected—those who can hire lobbyists and know the right people in Washington—can gain at the expense of ordinary citizens. For example, large, established interest groups, such as large companies and trade associations, environmental groups, trial lawyers, unions, and state, local, and tribal governments, generally have much better access to legislators and regulatory officials, and can influence how regulations are designed and enforced. They often have Washington offices dedicated to ensuring their interests are reflected in regulations. This can disadvantage everyone else—ordinary consumers, taxpayers, workers, small businesses, the middle class, and the poor.

Businesses who ignore Washington, and just concentrate on competing for customers in the marketplace, can quickly find themselves on the losing side of trade policy, or tax policy, or some other regulatory tilt of the playing field. Large businesses also have advantages over smaller entities in that they have systems in place to handle the burdens of regulatory compliance, and can spread those costs over more employees and products. In heavily regulated industries like medical care or consumer finance, it becomes difficult, if not impossible to be successful by attending only to the needs of consumers. Catering to the whims of the regulators can dominate other considerations.

C. The vulnerable shoulder many of the costs.

The real costs of regulation are passed on to all Americans, who are generally unaware of these costs because they are hidden in lower wages, higher prices for consumer goods and services, and fewer products and opportunities made available. Often, those least able to represent themselves shoulder the greatest burdens.

For example, many regulations lead to higher energy and transportation costs, raising product prices on almost everything we buy. These regulations may lead to some benefits, but is it really fair to ask low-income families to pay a larger share of their income for these benefits than wealthier families?

Products standards that may make sense for many may also price low income consumers out of the market entirely. Higher prices for new cars to incorporate backup cameras, for example, make them less affordable to lower income consumers who end up driving older, less safe cars longer.

[19] Reeve Bull, http://www.regblog.org/2016/06/20/bull-combatting-external-internal-regulatory-capture/.

Some have suggested that wireless carriers offering certain programming for free or without counting against data limits would violate "net neutrality," but this could potentially preclude an offering likely to be especially attractive to lower income consumers.

Regulations in the workplace may keep the workplace safer, but they limit worker flexibility, and can dampen wages, or discourage employers from hiring less-experienced or lower-skilled workers.

Lengthy drug approval processes not only increase the cost of new drugs but discourage investment in potentially life-improving products. Consumers may face absurdly high drug prices, not because the drug is new or expensive to produce, but because it enjoys a monopoly protected by regulatory barriers. Only those pharmaceuticals with the potential to earn the highest profits can afford to go through the expense of decades' long scrutiny. And, patients are prevented from getting access to promising products during the bureaucratic delay, even those with terminal illnesses.[20]

Small, pioneering companies can't afford the costs and time required to get approval of innovative new products, and often sell out to larger companies with the expertise and resources to obtain government approvals. It is then up to the larger company whether to market the new product or crush it. This reduces competition and innovation, and ultimately increases prices.

D. The bureaucracy is slow to change and often out of touch with the realities of an increasingly competitive global economy.

There is a growing concern that the U.S. regulatory system has become unsustainable, exceeding the basic rules needed for an efficient, competitive market capable of evolving to meet changing consumer needs.[21] Regulatory burdens accumulate, with new regulations piling on top of old. Like pebbles tossed in a stream, each individual regulation may not have a significant impact, but cumulatively, they can hinder the flow of innovation and economic growth.[22] Feedback loops are lacking in government policy.[23] Regulators have incentives to appear responsive by continually issuing new regulations, but not to evaluate how well existing rules are working. Thus, regulators typically proceed from one regulation to the next without focusing on understanding the results of their work. Insofar as regulators are concerned about results, the yardstick tends to be whether they are criticized by elected officials, interest groups, or judges. This is a weak feedback loop since, when citizens experience good or bad outcomes in their daily lives (such as safer products or higher

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20 http://righttotry.org/about-right-to-try/.

21 http://www.gallup.com/poll/176015/few-americans-gov-regulation-business.aspx.

22 As Mandel & Carew of the Progressive Policy Institute observe, "For each new regulation added to the existing pile, there is a greater possibility for interaction, for inefficient company resource allocation, and for reduced ability to invest in innovation. The negative effect on U.S. industry of regulatory accumulation actually compounds on itself for every additional regulation added to the pile." Mandel & Carew, 2013, at p. 4, http://www.progressivepolicy.org/wp-content/uploads/2013/05/05.2013-Mandel-Carew_Regulatory-Improvement-Commission_A-Politically-Viable-Approach-to-US-Regulatory-Reform.pdf.

23 Susan Dudley, "Retrospective Evaluation of Chemical Regulations. 2017. *OECD Environment Working Papers, No. 118*, http://www.oecd-ilibrary.org/docserver/download/368e41d7-en.pdf?expires=1490018292&id=id&accname=guest&checksum=CBFEE20A5B824A19F6E01DB1B59ABE63.

prices), they rarely know whether those outcomes relate to regulation or other causes.[24] Politicians' and bureaucrats' ability to learn from prior policy decisions is constrained not only by poor feedback, but also by a tendency to interpret subsequent events as vindicating the adopted policy or as justifying even *more* regulation.

III. There is a better way.

Regulation is an essential tool for achieving broad public goals, but as we have shown, poorly designed regulations can do more harm than good. Recognizing that regulations can impose costs on entrepreneurs, workers, and consumers, the U.S. government has adopted procedural and analytical requirements, such as "notice-and-comment" rulemaking and "benefit-cost analysis" for issuing new regulations. These tend to focus on one problem at a time, however, and too often are based on regulators' over-confident analysis of what consumers should value. As a result, they have done little to constrain regulations or ensure they are serving broad public goals.[25]

Thus, regulations accumulate and stifle innovation and economic growth that is beneficial for all Americans. It need not be this way, however. Americans can enjoy the benefits of regulation while reducing the costs.

A. Respect market forces and the beneficial effects of competition.

First, in deciding whether to regulate, agencies should determine whether there is a material failure of private markets.[26] This is because competitive markets are not only very efficient at allocating scarce resources to their best use, but in encouraging entrepreneurial activity and innovation. When important effects of a free market transaction (such as environmental pollution) are not captured in the decisions made by buyers and sellers, government should examine the underlying cause of that "market failure" and seek to address it by exploiting, rather than disrupting, the "marvel"[27] that is the market-based economic ecosystem.[28] For example, are property rights poorly defined, or could

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[24] John D. Graham and Paul R. Noe, "Beyond Process Excellence: Enhancing Societal Well-Being," in Achieving Regulatory Excellence, Cary Coglianese, ed., Brookings Institution Press, Washington, DC (2017), at p. 73.

[25] Susan Dudley, "Reforming Regulation," *Reviving Economic Growth: Policy Proposals from 51 Leading Experts* Brink Lindsey, ed. 2015.

[26] See Executive Order 12866, 58 FR (Oct. 4, 1993), Sec. 1(a) ("Federal agencies should promulgate only such regulations as are required by law, made necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people").

[27] Hayek, 1945, says "The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; *i.e.*, they move in the right direction…. I have deliberately used the word "marvel" to shock the reader out of the complacency with which we often take the working of this mechanism for granted. I am convinced that if it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind." Available at http://www.econlib.org/library/Essays/hykKnw1.html.

[28] To illustrate, guar gum, a food ingredient used, among other applications, to make ice cream smooth and creamy was also widely used in fracking fluids. The increased demand for guar gum generated price increases leading

economic incentives, such as an emissions tax, internalize those costs without inhibiting innovation? Calibrating regulations to address market failures can ensure that government interventions achieve the intended goals while minimizing adverse consequences.

B. Do more good than harm.

Second, because the goal of regulation is to enhance, not undermine, societal well-being, regulatory agencies should consider important trade-offs and design regulations to do more good than harm. Benefit-cost analysis, despite its limitations, is the best tool for understanding regulatory consequences and ensuring that regulations provide social benefits greater than their social costs.[29] There is longstanding bipartisan consensus on this point: every President since Ronald Reagan has required regulatory agencies to use benefit-cost analysis by Executive order. As the Clinton Administration put it:

> [R]egulations (like other instruments of government policy) have enormous potential for both good and harm. Well-chosen and carefully crafted regulations can protect consumers from dangerous products and ensure they have information to make informed choices. Such regulations can limit pollution, increase worker safety, discourage unfair business practices, and contribute in many other ways to a safer, healthier, more productive, and more equitable society. Excessive or poorly designed regulations, by contrast, can cause confusion and delay, give rise to unreasonable compliance costs in the form of capital investments, labor and on-going paperwork, retard innovation, reduce productivity, and accidentally distort private incentives.
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> The only way we know how to distinguish between regulations that do good and those that do harm is through careful assessment and evaluation of their benefits and costs. Such analysis can also often be used to redesign harmful regulations so they produce more good than harm and redesign good regulations so they produce even more net benefits."[30]

Although presidential directives have required agencies to balance benefits and costs in designing their regulations for over 36 years, agencies often have interpreted their regulatory statutes to preclude doing so. Fortunately, the courts—including the Supreme Court[31]—recently have clarified

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fracking producers to seek substitutes and gum producers to expand output. Consumers probably never even noticed.

[29] See, e.g., John D. Graham and Paul R. Noe, "A Reply to Professor Sinden's Critique of the 'Cost-Benefit State,'" RegBlog, University of Pennsylvania Law School (Sept. 27, 2016); Jonathan S. Masur & Eric A. Posner, "Against Feasibility Analysis," 77 U. Chicago L. Rev. 657 (2010); John D. Graham, "Saving Lives Through Administrative Law," 157 U. Pa. L. Rev. 395 (2008); Economic Analyses at EPA, Richard D. Morganstern, ed., Resources For the Future Press (1997) (providing case studies on EPA's use of benefit-cost analysis and finding that it resulted in reduced regulatory costs and often increased benefits as well); U.S. Environmental Protection Agency, "EPA's Use of Cost-Benefit Analysis: 1981-1986," EPA-230-05-87-028 (Aug. 1987), at p. 5-2 ("the return to society from improved environmental regulations is more than one thousand times EPA's investment in cost-benefit analysis").

[30] Office of Management and Budget, Office of Information and Regulatory Affairs, Report to Congress on the Costs and Benefits of Federal Regulation (Sept. 30, 1997), at p. 10.

[31] See, e.g., Entergy Corp. v. Riverkeeper, Inc., 556 U.S. 208 (2009) (agencies have substantial discretion in interpreting a statute that is silent or ambiguous on benefit-cost balancing as authorizing it); Business Roundtable

that in the vast majority of cases, agencies may exercise their discretion to balance benefits and costs in implementing regulatory statutes. Accordingly, a president could direct all regulatory agencies to reexamine their statutory interpretations, and unless expressly prohibited by law, implement their regulatory statutes through benefit-cost balancing to do more good than harm.[32]

Moreover, to date, a significant number of regulatory agencies—so-called "independent" agencies that do not report to the President (such as the Securities and Exchange Commission, the Federal Communications Commission, and the Consumer Products Safety Commission)—are not required to conduct benefit-cost analysis for their major rules at all, but there is a strong consensus that they should be required to do so.[33] Therefore, presidents could include the independent regulatory agencies within the requirements for benefit-cost balancing, including the directive to modernize their statutory interpretations to do more good than harm.[34]

Unfortunately, the office that reviews important regulatory proposals under the presidential directives for benefit-cost balancing—the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget—is grossly underfunded for the task at hand. Since its creation over 36 years ago, OIRA has lost over half its staff (from 97 to about 47), while the staff of the regulatory agencies has almost doubled (from 146,000 to 278,000).[35] Increasing OIRA's resources commensurately could improve agency analysis and regulatory outcomes.

Finally, it is important that the fundamental and eminently rational requirement for regulators to balance benefits and costs to ensure regulations do more good than harm be required by statute, not just through a presidential order. A judicially enforceable benefit-cost test is needed because the status quo is inadequate for many reasons, including the institutional limitations of the agencies and OIRA (such as bureaucratic turf battles, failure to utilize both internal and external expertise, bias, and the mismatch between the vast volume of regulation and OIRA's shrinking resources), as well as political dysfunctions (including inconsistent support for OIRA by varying administrations, interest group rent-seeking, and presidential electoral politics).[36] Scholars have shown that the courts are quite capable of competently reviewing agency use of benefit-cost analysis.[37] Indeed, benefit-cost

v. SEC, 647 F.3d 1144, 1148-89 (D.C. Cir. 2011) (SEC's failure to apprise itself of the economic consequences of a regulation was arbitrary and capricious); Michigan v. EPA, 576 U.S. __ (2015) (EPA's failure to consider cost in determining whether a regulation was "appropriate and necessary" was arbitrary and capricious).

32 John D. Graham and Paul R. Noe, "A Paradigm Shift in the Cost-Benefit State," RegBlog, University of Pennsylvania Law School (April 26, 2016).

33 See, e.g., American Bar Association, Section of Administrative Law and Regulatory Practice, "Improving the Administrative Process: A Report to the President-Elect of the United States" (2016), at pp. 9-10 (urging the President to "bring the independent regulatory commissions within the requirements for cost-benefit analysis, OMB review and retrospective review of rules"). Susan Dudley, "Make Independent Regulatory Agencies More Accountable to the Public," *Forbes*, 2017, https://www.forbes.com/sites/susandudley/2017/05/09/make-independent-regulatory-agencies-more-accountable-to-the-public/.

34 John D. Graham and Paul R. Noe, "A Paradigm Shift in the Cost-Benefit State," supra note 32.

35 See Susan Dudley & Melinda Warren, G.W. Regulatory Studies Center and Washington University in St. Louis, "Regulators' Budget from Eisenhower to Obama: An Analysis of the U.S. Budget for Fiscal Years 1960 through 2017" (May 2016), at p. 20 (Table A-3).

36 John D. Graham and Paul R. Noe, "Beyond Process Excellence: Enhancing Societal Well-Being," supra note 24, at p. 72 - 87.

37 See, e.g., Caroline Cecot and W. Kip Viscusi, "Judicial Review of Agency Benefit-Cost Analysis," 22 George Mason Law Review 575 (2015); Jonathan S. Masur & Eric A. Posner, "Cost-Benefit Analysis and the Judicial

balancing is so fundamental to rational decision making that the courts already have shifted toward requiring agencies to do more good than harm, even in the absence of Congressional action.[38]

C. Base decisions on the best available information and transparency.

Important regulatory decisions should be based on high quality information and should be transparent to the public. Specifically, regulators should base their regulatory decisions, priorities, and influential information disseminations on the best available scientific and technical information, including an objective and unbiased evaluation of the cost, benefits and risks, and a careful analysis of the weight of the scientific evidence. Influential scientific information and assessments should be peer-reviewed by independent experts before being disseminated.

Agencies also should disclose early to the public the important data, models, and other key information used in major rulemakings and provide a meaningful opportunity for public input. Court settlements between regulators and interest groups to require rulemakings should be published and made available to the public, and reviewed by OIRA, before they are final.[39]

D. Gather better feedback.

The feedback loop between businesses and customers is an essential element of an economic ecosystem that regulations often disrupt.[40] When considering public policies to address perceived problems, regulators must appreciate the value of competition and choice at regulating undesirable behavior. We live in a diverse society made up of individuals in varied circumstances and with different preferences.[41] One-size-fits-all regulatory approaches at the national level that reduce competition, choice, and feedback disrupt learning processes, protect favored interests from challenge, and make the economic ecosystem as a whole less able to adapt and innovate.

E. Encourage experimentation and learning.

Regulation should not short-circuit trial and error. No one, in the market or in the government, makes mistakes on purpose, but they are inevitable, particularly in complex, rapidly changing conditions. Mistakes are inevitable when regulators take precautionary approaches to regulation or when they attempt to substitute some products for others. Mistakes in the marketplace generate

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Role," University of Chicago Law School, Coase-Sandar Working Paper Series in Law and Economics (Feb. 7, 2017).

[38] See, e.g., Jonathan S. Masur & Eric A. Posner, "Cost-Benefit Analysis and the Judicial Role," supra; John D. Graham and Paul R. Noe, "A Paradigm Shift in the Cost-Benefit State," RegBlog, supra; Cass R. Sunstein, The Cost-Benefit State: The Future of Regulatory Protection, American Bar Association, Section of Administrative Law and Regulatory Practice, Chicago, IL (2002).

[39] Paul R. Noe, "Smarter Regulation for the American Manufacturing Economy," supra note 1.

[40] http://democracyjournal.org/magazine/31/capitalism-redefined/.

[41] Susan Dudley, "The Utility of Humility," The George Washington University, 2014, https://regulatorystudies.columbian.gwu.edu/utility-humility.

immediate pressures to make corrections. Mistakes in regulation too often create pressures for even more regulation.

When regulation is necessary, the policies themselves should be designed in ways that encourage competition and allow for experimentation and testing of regulatory hypotheses. These need not be randomized controlled trials in the scientific sense, but rather natural experiments that allow for trial and error and real-world observation of how different policies affect behavior and outcomes.[42] To generate natural experiments, whenever possible, policies should be developed at the state and local levels. Global governance structures that reduce competition among regulators will quash healthy differences that permit experimentation and learning.[43]

F. Regulatory humility.

Regulators should be humble about what they know, and what they do not. Interventions in complex systems that are not completely understood are fraught with risk. Even with the best of intentions, sensible sounding "solutions" can make things worse, and sometimes much worse. For this reason, a foundation of medical ethics is the Hippocratic Oath: First do no harm.

Regulators should follow the same principle. When a problem is not well understood, or the effects of a regulation are uncertain, or rapid technological change means present circumstances are not likely to last, regulation that impedes market adaptation can do more harm than good.

The success of capitalist systems does not depend on markets being efficient, or on people always behaving rationally, but rather their complex, adaptive[44] features, like natural ecosystems.[45] Both market participants and markets learn from their mistakes and correct them. Static analyses by benevolent regulators willing to substitute their judgment for that of diverse individuals with different circumstances and preferences ignores this insight and unwittingly reduce opportunities, growth, and human flourishing.

Like everyone else, government actors are susceptible to giving more weight to information that supports their position, discounting data, research, values and perspectives that call regulatory action into question. Political demand for costly regulation of highly publicized risks, even when scientists believe that those risks are minimal and not worth addressing, may reinforce bad government policies.

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42 http://www.latimes.com/opinion/op-ed/la-oe-sunstein-mercury-regulation-pollution-epa-20140425-story.html.

43 Susan Dudley, "The Utility of Humility," The George Washington University, 2014, https://regulatorystudies.columbian.gwu.edu/utility-humility, supra note 41.

44 http://democracyjournal.org/magazine/31/capitalism-redefined/, supra note 40.

45 Susan Dudley, "Evolution and Innovation," 2016, https://regulatorystudies.columbian.gwu.edu/evolution-and-innovation.

G. Address regulatory accumulation.

Finally, incentives are needed to address the accumulation of regulations already on the books. As noted above, unlike ecosystems and interactions in non-government spheres, where individuals and organizations are constantly learning from past experience and updating their behavior accordingly, the regulatory sphere has no feedback loop. The regulatory framework tends to focus on solving the next big problem (on the assumption that markets fail but regulators are infallible), without ever looking back to see if the rules in place are actually working as anticipated.[46] The incentives of the regulatory agency can be perverse, causing it to actively avoid the efficient solution—to prefer a system of rules and enforcement actions, for example, to a self-enforcing system of emissions taxes.

All the incentives in the federal bureaucracy are to create more and more regulations under the vast authority of the administrative state. Thus, both administrative and statutory structures should be created to counterbalance these incentives.

There should be retrospective review to streamline and simplify existing rules and to remove outdated and duplicative rules. The retrospective review process should be the start of a bottom-up analysis of how agencies can best accomplish their statutory missions. This should include a careful analysis of regulatory requirements and their necessity, as well as an estimation of their value to achieve needed outcomes. No significant new rule should be issued without a plan for review.[47]

A team within agencies (perhaps like the regulatory reform task forces established recently by Executive Order 13777) dedicated to identifying deregulatory opportunities could provide a counter-weight to the natural focus of regulatory agencies on issuing new regulations. But even such structures may at times be defeated by a culture of regulatory zeal within an agency. Thus, as Professor Michael Rappaport of San Diego Law School has suggested, Congress could create an agency that would have express statutory authority to deregulate. The agency should have the authority that all existing agencies have, but *only to pass regulations that deregulate*. The deregulatory agency would employ the additional time, insulation, and expertise that administrative agencies possess in the service of deregulation.

The agency would also have the right incentives to deregulate: it would likely be filled with people who understand and support deregulation, and the agency's public reputation and internal incentive structure would be driven by the efficacy of its deregulatory actions.

By raising proposals in the form of proposed rules, the agency would both publicize the case for the deregulation and constrain any hubris from the regulatory agencies.

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[46] Susan Dudley, "The Utility of Humility," The George Washington University, 2014, https://regulatorystudies.columbian.gwu.edu/utility-humility.

[47] Paul R. Noe, "Smarter Regulation for the American Manufacturing Economy," supra note 1.

IV. Conclusion

The appropriate goal of regulation is to enhance, not undermine, societal well-being. In other words, regulation should do more good than harm. Without a counterfactual, it is impossible to know what a more disciplined regulatory environment would have meant for economic growth and well-being. However, evidence suggests that a smarter regulatory approach targeted at problems that cannot be solved by other means could have enormous benefits for current and future generations.

Though difficult to measure, it is widely recognized that the quality and extent of government regulation is "a major determinant of prosperity."[48] The World Bank conducts annual *Doing Business* surveys measuring government policies and the ease of doing business in different countries. Over the last decade, the U.S. has dropped from #4 to #8 on the World Bank's list.[49]

The World Bank finds that the highest ranked countries in its survey regulate, but "they do so in less costly and burdensome ways, and they focus their efforts more on protecting property rights than governments in other countries."[50] It observes, "a thriving private sector—with new firms entering the market, creating jobs and developing innovative products—contributes to a more prosperous society,"[51] "promotes growth and expands opportunities for poor people."[52]

Empirical studies of deregulated industries in the U.S. demonstrate the impact of regulation on innovation; they consistently find that deregulation enables greater innovation and larger price reductions than economists predicted based on pre-deregulation costs and market conditions.

A few studies have attempted to quantify the effect of regulation on economic growth, productivity, and innovation. For example, in a classic analysis from the 1980s, Jorgensen & Wilcoxen simulate the long-term growth of the U.S. economy with and without environmental regulation and conclude that "the cost of environmental regulation is a long run reduction of 2.59 percent in the level of the U.S. gross national product."[53] More recently, McGrattan and Prescott find that higher regulatory costs contribute to lower total factor productivity (TFP) and GDP.[54] Dawson & Seater estimate that regulations reduced gross domestic product (GDP) growth by 2 percent per year between 1949 and 2005, leading to an accumulative reduction of $38.8 trillion in GDP.[55]

A better regulatory system is always in the national interest: With a better regulatory system, we can have more innovative products, higher wages, and upwardly mobile jobs. A smarter regulatory

48 http://elibrary.worldbank.org/doi/abs/10.1596/0-8213-5341-1.
49 http://www.tradingeconomics.com/united-states/ease-of-doing-business.
50 http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB05-FullReport.pdf.
51 http://www.doingbusiness.org/reports/global-reports/doing-business-2014.
52 http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB04-FullReport.pdf.
53 http://www.jstor.org/stable/2555426?seq=1#page_scan_tab_contents.
54 https://www.minneapolisfed.org/research/wp/wp694.pdf.
55 http://www4.ncsu.edu/~jjseater/regulationandgrowth.pdf.

process can ensure that regulations enhance societal well-being, rather than provide an advantage for powerful interest groups. Now more than ever, regulatory reform is essential for both the economic and the political well-being of the nation. The United States faces one of its highest levels of debt to GDP since World War II.[56] The retirement of the baby boomers will only exacerbate this problem. The only solution for reducing the ratio, other than painful tax increases or benefit decreases, is the faster economic growth that regulatory reform can bring.

The United States is more bitterly divided politically than it has been for decades. If regulations focus on promoting public goods and preventing public bads, rather than serving as a forum for special interests and partisanship, the regulatory system can address the needs we have in common rather than divide us. It also can address widespread social discontent at the ability of insiders to gain at the expense of outsiders. Regulatory reform can blunt the force for division by reducing rent-seeking and unlocking the healthy competition and creativity needed to revive opportunity, prosperity, and freedom in the United States and the world.

[56] https://tradingeconomics.com/united-states/government-debt-to-gdp.