An *Ever-Growing* Jungle

Rethinking the U.S. regulatory process.

By Joseph V. Kennedy

For the United States to regain the commanding heights it occupied during the 1980s, it needs regulatory reform. Many sectors of the economy, including health care, education, and energy, have exhibited decades of low productivity and little innovation partly because they have been weighed down with regulations that make it difficult to displace incumbent practices with new and better methods. Over-regulation also threatens new technologies such as drones, driverless cars, and medical apps that, if properly developed, could deliver huge economic and social benefits.

The United States desperately needs to improve the productivity of its economy for several reasons. Most important, higher productivity is directly tied to better living standards. It also reduces the strains of globalized competition and improves government finances, making it possible to honor more of our commitments to retirees. Finally, higher productivity, and the faster economic growth that comes with it, has broad strategic advantages at a time when the United States is facing a growing number of international challenges.

Higher productivity in turn depends upon innovation: the constant introduction of faster, better, and cheaper ways of doing something or of doing something entirely new. Yet many regulations impede innovation in an attempt to impose order and reduce risk. This tendency is especially damaging for internationally competitive sectors because U.S. companies can lose market share if forced to compete with foreign companies that face fewer regulatory costs. In order to escape these costs, they may be forced to move their production and other activities abroad.

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All markets need regulation in order to reduce negative externalities, establish a level playing field, and give both companies and consumers more certainty on how laws will be enforced. But the U.S. regulatory system has increasingly become an ever-growing jungle that is overly complex, costly, and outdated. New regulations are constantly being issued, often with little attempt to make them consistent with existing rules. Agencies seldom revisit past rules to see whether they still make sense. And few agencies seem to take existing cost/benefit mandates seriously.

Even in the best of times, regulators operate under several disadvantages when trying to get rules right. Many of these will worsen in the next few decades. The first is the information disadvantage that agencies face. Regulated companies usually have more resources and a much more detailed knowledge of their operations, the industry in which they compete, and the likely effect of proposed regulations. Although regulators can actively seek out information from the companies, much of it is naturally self-interested. Without a detailed, accurate knowledge of the industry, regulators cannot do more than guess at the impact that proposed rules will have. One of the issues delaying implementation of the Dodd-Frank Act is that, almost five years later, financial regulators are still unraveling the details of how various regulations would affect financial companies and their customers.

Agencies also face a severe shortage of resources, both money and staff. Private businesses can usually raise large sums of money anytime that doing so raises their profits by even more. If a rule is important enough, they can spend millions of dollars trying to influence it. Agency budgets usually have difficulty keeping up with inflation. Because the cost of Social Security and Medicare will increase dramatically over the next two decades, the pressure on agency spending is likely to get much worse. Tax law is exceedingly complex, yet budget constraints have significantly reduced the Internal Revenue Service's ability to advise taxpayers. Agencies will also have a tougher time attracting and keeping good people. The government hiring process is lengthy and inefficient, the best people often leave for higher-paying jobs in the industries they regulate, and a large and growing portion of government leadership is eligible to retire.

Finally, the rulemaking process is slow and politicized. New regulations can take years to write, especially if, as with drones, the agency does not want to commit itself to a rule. Almost five years after their passage, major rules associated with the Affordable Care Act and the Dodd-Frank Act have yet to be finalized. The Federal Communications Commission rules on net neutrality and the National Labor Review Board's reversal of an employer's right to stop dues check-off upon termination of a collective bargaining contract show that rulemaking can be more political than substantive.

What can be done? The fundamental problem is that much of the government process has been delegated to individual agencies that have their own agendas and are not accountable to the political process. Congress is unwilling to spend the time needed to understand the details of the issues being decided. The Administration cannot manage all of the career staff under it. And the White House is often tempted to accomplish through rulemaking policies it cannot achieve through the normal legislative process.

On the agency side, rulemaking would be improved if regulators pursued eight general principles when drafting rules:

■ **Anticipate innovation.** In a wide variety of industries, the pace of innovation is increasing. This promises faster productivity growth and broad social benefits, but only if innovation is not impeded by the rulemaking process. Rules can take a long time to be updated, so agencies need to write them with enough flexibility for future generations of technology, and update them frequently. For example, it is extremely likely that driverless cars, drones, and personal DNA testing will deliver large benefits at some time in the future. Rather than try to stifle the technology now, regulators ought to be allowing experimentation and designing broader systems within which these technologies can be safely used.

■ **Embrace transparency.** The Administration's handling of net neutrality rules is the opposite of what is needed. Rules should be developed in the open, by the agency, not the White House, and with adequate time for public comment and debate. The agency's rationale, including its analysis of costs and benefits, should be clearly stated. On highly politicized issues, agencies should increasingly defer to the legislative process.

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■ **Concentrate on metagoals.** People often agree on broader goals such as a safe, reliable electric grid and the need for cheaper drugs. They tend to disagree on the best ways to accomplish these goals. Since there is usually more than one way to accomplish the broader goals, rules should concentrate on setting them out and giving companies maximum flexibility in achieving them.

■ **Trust the customer.** Overly prescriptive regulation does not always protect consumers. Customers increasingly have access to information about the cost and quality of goods and services. Social media and the courts offer powerful tools for punishing companies that offer shoddy products. In many markets such as transportation and housing, new entrants are offering cheaper, more convenient alternatives. Agencies do consumers a disservice if they impose heavy regulatory costs on suppliers and outlaw competitors.

■ **Place more emphasis on reducing the cost of over-regulation.** Agencies usually focus on the risks posed by a lack of regulation. But bad regulations have their own costs, both in terms of delay and preventing positive innovations from entering the market. An expensive and lengthy drug approval process probably does minimize the chance of approving a bad drug. But it also makes it harder for every good drug to reach the market. Some never do. For instance, since 2001 stiripentol has been widely used in Europe to treat Dravet Syndrome, a genetic form of epilepsy. Yet the U.S. Food and Drug Administration still has not approved its manufacture in the United States.

■ **Adhere to cost-benefit analysis.** It is true that the benefits of regulation are often hard to measure. But that is not a license for bad regulation. Agencies need to be diligent in making sure that the benefits of new rules exceed the costs and disclosing the major assumptions behind their analysis. The cost/benefit study for the Environmental Protection Agency's new climate change regulations, for example, was done after the agency had already committed to action and relies largely on the reduction of particulate matter rather than slower warming to generate benefits.

■ **Recognize the value of time.** Time costs money. Delays in either drafting or enforcing rules hurt innovation and growth. It has taken the Federal Aviation Administration too long to issue a final rule on drones, for example, despite a congressional deadline to do so. The Food and Drug Administration's delays in approving new drugs and medical products mean that many are introduced in Europe and Asia years before Americans benefit from them.

■ **Take into account the competitiveness impact of regulation.** Regulators must exert more flexibility when companies face international competition. The goal should be to make the United States the preferred place to do business because the rules are well drafted and sensible, and enforcement is predictable and quick. Amazon has moved its research activities on drones to other countries because it cannot obtain regulatory approval here. Similarly, Boeing's ability to compete with Airbus depends partly upon how quickly the Federal Aviation Administration approves new parts and technologies.

Even in the best of times, regulators operate under disadvantages.

But the three major branches of government also have to act. The courts should stop deferring to agency judgements that are not well reasoned or backed by solid evidence. Judges should realize that agencies are not subject to the same electoral controls as Congress or the President and therefore need more scrutiny, not less. It is true that agencies usually have deeper knowledge than the courts, but that does not mean that courts should not insist that the agency use that knowledge to build a strong case for its actions.

The White House should create interagency councils that work closely with industry and consumer groups to reexamine the regulatory environment facing specific industries, especially those facing international competition. This review should take a comprehensive look at both old and prospective rules to see whether they create efficient incentives for companies to produce highly competitive products with a minimum of negative externalities.

Finally, Congress needs to stop delegating such sweeping regulatory power to the executive branch. Legislation should be updated more frequently and confine regulators' discretion to narrow, fact-based issues. The committees of jurisdiction should hold frequent oversight hearings at which those officials that actually draft regulations are forced to publicly justify their decisions. Finally, Congress needs to give agencies the resources necessary to do their jobs, while at the same time holding them accountable for results. Companies suffer when agencies are not able to issue licenses and conduct inspections in a timely manner.

The sheer volume of regulations threatens to slow productivity at exactly the wrong time. A recent report by the McKinsey Global Institute finds that demographic changes will cause U.S. per capital GDP growth to slow by 28 percent over the next fifty years unless the pace of productivity increases. This will occur at a time when federal, state, and local governments will struggle to pay promised pension and health care benefits. Regulatory reform needs to reduce the cost of business and encourage innovation, making America the best place to do business. ◆