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# MERCATUS ON POLICY

REGULATION IN THE  
21st CENTURY

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**W**HY SHOULD AMERICANS care about regulation? We should care because regulations affect almost every aspect of our lives. We should care because the outcomes of regulatory policy matter. The quality of the environment, the safety of consumer goods and industrial processes, and the adoption of quality-of-life-enhancing technology all depend to a great degree on the goals of regulatory policy.

We should also care because regulations impose a significant cost on the economy. Estimating the precise scope of this burden is difficult. Regulatory compliance (or avoidance) often comes with implicit costs that are not easily summed across the economy. However, at least one estimate puts it at over \$1 trillion.<sup>1</sup>

The next administration will have the opportunity to reformulate regulatory policy significantly. It could take steps that would greatly improve outcomes as well as minimize the costs imposed on firms and consumers. As the Mercatus Center launches a new program to investigate ways in which to improve regulatory processes and policies in the 21<sup>st</sup> century, we offer a few brief ideas for new directions a new administration could take.

## A NEW DAY BRINGS NEW PROBLEMS<sup>2</sup>

IN THE 20<sup>TH</sup> century, regulatory policy was designed to address the problems facing the country at that time. But the institutions and frameworks developed in the past are decreasingly relevant in the 21<sup>st</sup> century. The United States is shifting from a manufacturing-based economy to a knowledge-based one. Goods and services are increasingly subject to international movement. Productive capital faces international competition. Government needs to update existing regulatory policies to keep up with this changing world.

Today's regulatory system has several specific problems including:

- insufficient feedback from elected officials
- interest groups' pressure to write regulations to their advantages
- vague and often antiquated authorizing statutes
- lack of incentives for updating or eliminating older regulations
- reliance on older, intrusive types of regulations when newer, less intrusive ones may be more effective
- suspicion of new technologies
- and failure to account for regulation's effect on competition

We suggest five areas where our proposed solutions could mitigate or even eliminate some of these problems.

### 1. PERFORMANCE-BASED REGULATIONS

IN ORDER TO assess whether the government should continue or modify current regulations, policy makers and the public need to understand whether these rules are performing well. Regulatory reform statutes and executive orders should, but woefully do not, provide a consistent means to answer questions such as the following. What outcomes does the rule seek to achieve that produce concrete public benefits? How does the rule advance the mission and goals of the issuing agency? How does the agency measure the rule's success in achieving its intended outcome?<sup>3</sup>

Creating a framework that would answer these questions would require an executive order. That executive order must lay out clear requirements for performance metrics and align incentives with performance goals. Such an order would require agencies to:

- develop for each rule verifiable indicators of progress toward long-term goals, a benefit analysis demonstrating the effect of the rule on intended outcomes, and long-term performance goals that specify the outcome the rule is designed to achieve
- develop draft performance metrics along with the Office of Management and Budget (OMB) and in consultation with stakeholders
- report on performance measures each year

- adopt personnel practices (managerial contracts) that create incentives for agency management to support outcome-oriented performance measurement<sup>4</sup>

### 2. NEW RULES FOR NEW TECHNOLOGIES

In this century, the greatest gains in well-being are likely to come from emerging and heretofore unknown technologies. Biotechnology, nanotechnology, and other areas of ongoing research hold great potential to improve the environment, eliminate disease, and increase economic growth. Unfortunately, the current regulatory environment that governs adoption of these technologies discriminates against new technologies in favor of existing ones. In order to combat a regulatory agenda that is often motivated by stigma and emotion and suppresses advancement in potentially beneficial technologies, the following three policies should be pursued:

- Reject the precautionary principle. Generally regarded as an implementation of the "better safe than sorry" doctrine, this principle opens the door to regulation based on subjective and arbitrary political bias. Because there is no standard definition, despite having been adopted as official policy throughout the world, the precautionary principle is prone to application on anything but a principled basis.<sup>5</sup>
- Adopt a principle of non-discrimination that would prohibit regulatory discrimination against a product based on the process by which it was produced. Under this framework, regulation would be based solely on the evidence of risk of the individual product and not the technology used to produce it.<sup>6</sup>
- Create a voluntary health and safety certification program. New and novel technologies, even if they are treated neutrally by regulators, may still inspire public hesitation and calls for oversight due to media portrayals and activist-group pressure. In order to provide public confidence without unfairly burdening the emerging technology, the government could offer a voluntary certification for manufacturers that undertake specific health and safety testing programs.<sup>7</sup>

### 3. MEDIATING MARKETS

WHILE MARKETS ARE surprisingly efficient at providing the goods and services we want, they occasionally fail and can be improved. In some cases, stakeholders—corporations, regulators, public health officials, and the like—all agree that a problem exists, but the transaction costs are too high to reach a

solution. Where that is the case, facilitated negotiations may provide relief from this coordination problem without deadening effects on innovation. In order to facilitate coordination within an industry to solve social problems, mediation firms could bring together different perspectives on an issue and give stakeholders the opportunity to voice their concerns, encouraging cooperation.<sup>8</sup>

Industry representatives may also have an incentive to reach an agreement to avoid regulation. For instance, internet service providers worried that regulation of web traffic may soon arrive in the form of heavy-handed regulation would be well served to enter a facilitated mediation with advocates of regulation (in this case, advocates of net neutrality). If they can come to an agreement that satisfies all parties, they could eliminate the perceived need for any formal regulatory action.

The government, through the Administrative Procedures Act and the Negotiated Rulemaking Act, sometimes acts in this mediator capacity. Unfortunately, these government-led negotiations are often costly to stakeholders. Because these negotiations are public, participants fear that confidential or proprietary information brought forth will become a matter of record. This discourages the candid discussions that negotiations are supposed to foster.<sup>9</sup>

Privately mediated solutions do not suffer from this drawback. Mediators can guarantee confidentiality. Additionally, private facilitators are not bound by often outdated authorizing statutes. Though mediation firms are relatively new, they have been used to handle arms proliferation talks, to lead discussions of international oil pipeline construction, and to engage on environmental issues under the Clinton administration's sustainable development initiative.<sup>10</sup>

Sadly, outdated rules designed to prevent dangerous industrial collusion hamper this type of facilitated market solution. Having helped to solve various other types of problems, facilitated market solutions offer a useful and immensely potent way to address regulatory problems going forward if the rules constraining them are reexamined.<sup>11</sup>

#### 4. CONSUMERS AND COMPETITION

THE INTENT OF regulation is almost always to protect consumers, society, or some other subgroup of the population from harm. However, a side effect of regulation is often that incumbent and well-connected firms use it to drive out competitors. For decades, firms have lobbied for regulations that raise competitors' costs and create uneven playing fields. They have even encouraged the government to bring antitrust actions to prevent unwanted takeovers.<sup>12</sup>

Regulators then face two seemingly competing interests—

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consumer safety and business competition.<sup>13</sup> But if regulatory agencies would adopt the following changes, these two interests need not remain mutually exclusive:

- Regulatory agencies should consider more market-oriented solutions (such as performance standards and economic incentives) first and command-and-control options last and perform an assessment of the effects of major regulation on competition.
- Independent regulatory agencies should be subject to a congressional oversight unit, similar to the Office of Information and Regulatory Affairs.
- Agencies that develop voluntary standards should license the use of the agency's seal to be used on consumer products to signal approval.<sup>14</sup>

#### 5. A NEW REGULATORY PROCESS

THROUGHOUT THE LIFE cycle of the regulatory process, opportunities exist to substantially increase the net benefits of the entire system for both the near and long term. Starting with the strategic goals that government hopes to achieve and moving through the implementation phase, regulations evolve over time—they are constrained and shaped by this life cycle. Thus, improving the regulatory process depends substantially on understanding the steps in the process and identifying points of improvement overall.<sup>15</sup> The following are some proposed recommendations:

- An agency must define at least two Government Performance Results Act (1993) performance measures when a major regulation is proposed and at least one must be related to economic performance such as cost-effectiveness or benefit-cost assessment.

- The Office of Information and Regulatory Affairs should develop and make public a report/score card that identifies the actionable elements of its guidance, rates major proposals on each item, and explains any failures or inconsistencies that are below its standard.
- At the time a regulatory proposal goes public, the agency shall create a public access, on-line and editable (wiki) version of the regulation on which multiple parties can make comments and suggestions.
- The Bureau of Economic Analysis (BEA), in conjunction with other professional organizations, should develop time-series data on actualized risks and their economic valuation—a standard subject of regulation.
- Regulations that impose costs of more than \$100 million per year should be approved explicitly by the relevant portion of Congress.
- The Office of Management and Budget should work with the BEA to determine whether a supplemental account to the National Income and Product Accounts can be developed for regulatory impacts, costs, benefits, and other features of regulatory impacts.<sup>16</sup>

12. Bruce Yandle, "Rethinking Protection of Competition and Competitors," (working paper 08-24, Mercatus Center at George Mason University, August 2008), 1-2.
13. *Ibid*, 2.
14. *Ibid*, 3.
15. Scott Farrow, "Improving the Regulatory Process Throughout its Lifecycle: Nine Recommendations to a New Administration," (working paper 08-33, Mercatus Center at George Mason University, August 2008), 2-4.
16. *Ibid*, 9-16.

## ENDNOTES

1. Clyde Wayne Crews, Jr., "Ten Thousand Commandments 2008: An Annual Snapshot of the Federal Regulatory State" (Competitive Enterprise Institute, July 10, 2008), [http://cei.org/cei\\_files/fm/active/0/10KC\\_2008\\_FINAL\\_WEB.pdf](http://cei.org/cei_files/fm/active/0/10KC_2008_FINAL_WEB.pdf).
2. This section based on Bruce Yandle, prepared remarks for "21st Century Regulation: Discovering Better Solutions for Enduring Problems" (September 15, 2008).
3. Henry Wray, "Performance-Based Regulations," (working paper 08-25, Mercatus Center at George Mason University, August 2008), 1.
4. *Ibid*, 12-14.
5. Gary Marchant, "Lessons for New Technologies," (working paper 08-26, Mercatus Center at George Mason University, August 2008), 9-10.
6. *Ibid*, 11-12.
7. *Ibid*, 14.
8. Richard A. Williams and Andrew Perraut, "Facilitated Market Solutions for Social Problems," (working paper 08-31, Mercatus Center at George Mason University, August 2008).
9. *Ibid*, 2-5.
10. *Ibid*, 5-6.
11. *Ibid*, 9-10.

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