Cato Handbook *for* Policymakers

8TH EDITION

CATO INSTITUTE

7. Regressive Regulation

Congress should

- eliminate or reduce criminal penalties for copyright infringement and stop the use of civil asset forfeiture in infringement cases;
- end all liability for noncommercial copying;
- substantially reduce copyright terms;
- end patent protection for software and business methods;
- enact procedural reforms to limit abusive litigation by "patent trolls";
- increase the number of green cards awarded on the basis of worker skills, educational attainment, and economic value;
- end country-specific caps on green cards for highly skilled immigrants;
- raise the cap for H-1B visas and eliminate restrictions that lessen their value;
- mandate the recognition of valid occupational licenses in all states;
- authorize interstate compacts on mutual recognition of licenses; and
- eliminate antitrust immunity for state licensing boards dominated by private-sector members.

As Chapter 6 demonstrated, reviving economic growth is an urgent task with appeal across the political spectrum. But given the current polarization of American politics, is it really possible to unite left and right on a common approach to achieving this shared goal?

Yes, it is possible—and seizing this possibility offers a promising opportunity to reverse the growth slowdown through policy change. To pursue

a truly "transpartisan" pro-growth reform agenda, Congress should focus on changing policies whose primary effect is to inflate the incomes and wealth of the rich, the powerful, and the well-established by shielding them from market competition. To apply a convenient label, let's call these policies "regressive regulation"—regulatory barriers to entry and competition that work to redistribute income and wealth up the socioeconomic scale.

Avoiding Polarization and Gridlock

A policy agenda of reforming regressive regulation can take advantage of an ideological no-man's-land in contemporary American politics. Conservatives tend to valorize business and the well-off ("job creators") and take a dim view of government regulators ("bureaucrats"); progressives, meanwhile, identify with government regulators ("public servants") and the disadvantaged, while casting a suspicious eye toward business and the successful ("plutocrats"). Regressive regulation scrambles these ideological loyalties, and the effect is to mute both support for and opposition to such policies along ideological lines. Conservatives generally cheerlead for deregulation, but they don't tend to focus on the regulations that favor their constituencies. Progressives, on the other hand, instinctively defend regulation as necessary and beneficial, but that impulse weakens considerably when regulation's obvious effect is to entrench privilege and deepen disadvantage.

This peculiar state of affairs, in which ideological passions on both sides are substantially neutralized, creates an opening to cut through the prevailing polarized gridlock and effect significant policy change. Here the main conflict is not between the left and right's conflicting visions of the public interest. Instead, there is a fairly robust intellectual consensus on where the public interest lies: economists, whether they tend to vote Republican or Democratic, are likely to support reform—the status quo has few disinterested defenders. In the case of regressive regulation, the conflict can thus be persuasively framed as the perennial one between the public interest and private privilege. The only vociferous supporters that these policies can count on are the narrow interest groups that are profiting from them at the expense of the rest of us.

These circumstances suggest that the reform and repeal of regressive regulation now represent the most promising way to reinvigorate the U.S. economy's long-term growth prospects. The economic evidence is strong that dismantling barriers to entry and competition can have a significant

impact on both the level of total output and the permanent rate of output growth. Meanwhile, efforts to reform those barriers that redistribute wealth and income upward can take advantage of a political environment relatively free of the polarized ideological conflict that now plagues policymaking in so many other domains. In other words, the economic gains are large and the political conditions for realizing those gains are relatively favorable.

Three policy areas in particular offer inviting targets for action by Congress: (1) excessive protection of copyrights and patents; (2) restrictions on high-skill immigration; and (3) protection of incumbent service providers through occupational licensing.

Intellectual Property

Copyright and patent laws are supposed to promote innovation and growth by granting temporary monopolies that raise the return on producing new ideas. But copyrights and patents impose costs as well as confer benefits. First, they raise the price of protected goods and thereby burden consumers with a deadweight loss. Second, by helping some innovators, they end up hurting others. Innovation frequently occurs through borrowing and adapting others' ideas; by restricting access to those ideas, copyrights and patents raise the cost of innovation and thus push in the direction of slower growth. In recent years, the costs imposed by copyright and patent law have escalated dramatically: in the case of copyright, through the wildly excessive extension of copyright terms, criminalization of copyright violations, and ongoing hostility to new copying technologies that may be used to reproduce copyrighted material; in the case of patents, through the extension of patent protection to vaguely defined innovations in software and business methods, and the rise of "patent trolls" that buy up patent portfolios and monetize them through litigation. Because of these ill-advised developments, these laws now cause a significant drag on innovation and growth.

There is much that Congress could do to improve intellectual property law. Regarding copyrights, Congress should end or reduce criminal penalties for copyright infringement, stop the use of civil asset forfeiture in infringement cases, end any liability for noncommercial copying, and significantly reduce the term of copyright protection from the absurdly over-long present term of life plus 70 years. As for patents, Congress should simply end patent protection for software and business methods, where patents have been so badly abused; failing that, Congress should implement procedural reforms to limit abusive litigation by "patent trolls."

High-Skill Immigration

Immigrants are a major catalyst of U.S. entrepreneurship and innovation. According to one study of a large sample of engineering and technology companies founded between 1995 and 2005, 25 percent of those companies had at least one foreign-born founder. Yet current immigration laws make it very difficult for such highly talented individuals to live and work in our country. Out of roughly 1 million permanent resident visas awarded each year, only about 70,000 go to individuals on the basis of their work skills or economic value. Temporary visas allow about 650,000 high-skilled workers to reside in the United States at any given time—a mere 0.4 percent of the workforce.

There are many possible steps that Congress could take to reduce barriers to high-skill immigration. Congress should expand the total number of green cards awarded annually on the basis of worker skills, educational attainment, and economic value, ideally granting green cards to any college graduate who wants to live and work here. Further, Congress should eliminate country-specific caps on high-skill immigration that currently discriminate heavily against immigrants from China and India. In addition, Congress should raise the cap on temporary H-1B visas and reduce the restrictions that limit their use, in particular, the rules that tie visas to a specific employer and prohibit spouses from working here.

Occupational Licensing

Occupational licensing has expanded dramatically in recent decades. Back in 1970, about 10 percent of all U.S. jobs were subject to licensing requirements; today the figure stands at around 30 percent. These laws are justified in the name of consumer protection, but research shows that the laws' restrictions do little or nothing to benefit consumers. They do, however, protect incumbent service providers from competition: licensing is associated with an 18 percent increase in wages for its beneficiaries. In the process, licensing slows down new business formation and job creation: for occupations licensed in some states but not others, employment growth is 20 percent lower in the restrictive states. These laws amount to a frontal assault on entrepreneurship, reducing entry by new businesses that frequently are the vessels of new ideas. Furthermore, by conditioning entry on passing exams that test knowledge of current ways of doing things, they help to cement the status quo in place and discourage the development of new business models.

Most occupational licensing occurs at the state level, but there is still significant scope for Congress to improve matters. For example, Congress could mandate that, for widely licensed occupations, anyone with a valid license in one state would be entitled to do that job in all other states. Alternatively, Congress could preemptively authorize interstate compacts for mutual recognition of licenses. In addition, Congress could follow up on the Supreme Court's decision in *North Carolina State Board of Dental Examiners v. Federal Trade Commission* and clarify that there is no antitrust immunity for actions of licensing boards dominated by private-sector members.

Barriers to Entry

The policy areas discussed above all feature regulations that erect explicit barriers to entry—whether in the economist's sense of barriers to market entry, or in the literal sense of barriers to geographic entry. Copyright and patent laws and occupational licensing limit who can engage in particular kinds of commercial activity; immigration laws limit who can enter the country.

Moreover, all of these entry barriers undermine economic growth by restricting vital inputs to innovation. Copyright and patent protections restrict the recombination of ideas that is the essence of innovation by making some ideas artificially inaccessible. Immigration laws restrict the inflow of highly skilled individuals who are disproportionately entrepreneurial and innovative. Occupational licensing restricts the formation of new businesses, which frequently are the vessels for new products or new production methods.

Finally, all these policy domains have similar distributional consequences: all of them redistribute income and wealth to the well-off and privileged. Copyright and patent laws pinch consumers for the benefit of huge pharmaceutical and media corporations. Immigration laws expose America's lowest-skilled workers to intensifying competition from foreign-born workers while shielding high-skilled workers from equivalent competitive pressures. Occupational licensing boosts the earnings of protected incumbents by restricting supply, especially in higher-income professions, while thwarting upward mobility for the less advantaged.

Beyond Left and Right

In all likelihood due to these underlying similarities, none of these policy areas have become zones of ideological or partisan conflict. To be

sure, there are vigorous debates over proper policy in all of these areas, but the contending sides are not divided along left-right or Republican-Democratic lines. In striking contrast to the polarization and gridlock that now dominate most national policy debates, opposition to regressive regulatory controls has brought together politicians and policy experts across the political spectrum.

Thus, in 2011, in the field of intellectual property, Rep. Nancy Pelosi (D-CA) joined forces with Rep. Darrell Issa (R-CA) and then-Rep. Ron Paul (R-TX) to oppose the Stop Online Piracy Act, a failed legislative effort to toughen criminal penalties for copyright violations. Among policy experts, leading critics of copyright and patent law excesses include progressives Lawrence Lessig and Dean Baker and libertarians Tom W. Bell and Jerry Brito.

With regard to high-skill immigration, a number of bipartisan reform bills have been introduced in recent years. To take a recent example, in January 2015, a group of six senators—including Orrin Hatch (R-UT), Mark Warner (D-VA), and Marco Rubio (R-FL)—introduced the Immigration Innovation Act to boost the numbers of both temporary and permanent visas for highly skilled workers. And among policy experts, scholars from the libertarian Cato Institute and the progressive Center for American Progress supported the most recent comprehensive immigration legislation passed by the Senate in 2013.

As for occupational licensing, the Obama administration issued a special report in July 2015 criticizing occupational licensing, and in 2016, it made a small amount of federal funding available to states that undertake reform. Meanwhile, in July 2014, Rep. Paul Ryan (R-WI) released a widely discussed plan for combating poverty. In the section on regulatory reform, Ryan singled out occupational licensing laws as prime examples of the "regressive regulations" that too often constrict economic opportunity for the least advantaged. Among policy experts, Alan Krueger of Princeton University, who served as chairman of the Council of Economic Advisers under President Barack Obama, is a leading critic of these regulatory restrictions; and the libertarian Institute for Justice has a long track record of challenging and overturning licensing rules in court.

It's not simply the case that one can find policy experts on both sides of the ideological spectrum who support reform of these regressive regulatory policies. More than that, it's difficult to find disinterested policy experts anywhere on the spectrum who support the status quo. Certainly,

there are strong defenders of intellectual property protection, but even in their ranks you will find recognition that current policies are seriously flawed. Thus the economist Carl Shapiro, a prominent supporter of patents generally, has written, "[While] there is no doubt that the patent system taken as a whole plays an important role in spurring innovation, the general consensus is that the U.S. patent system is out of balance and can be substantially improved." In similar fashion, the economist William Fischel, who has written sophisticated defenses of zoning, acknowledges that its exclusionary impact has increased since 1970 and that the "social and economic costs" of contemporary land use regulation are "not trivial." As far as high-skill immigration restrictions, it is difficult to find any scholar who has anything nice to say about the current state of policy.

This combination of qualities—negative impact on entrepreneurship and innovation, absence of political polarization, and an intellectual consensus in favor of reform—makes regressive regulation an especially inviting target for any campaign to enact pro-growth policy reforms. For all who are interested in better long-term U.S. economic performance, this is the low hanging fruit. Reforming these policies is something that we know will make a positive difference, and "we" here refers to the vast bulk of disinterested experts. Yes, it is true that plucking this fruit won't be easy, as the interest groups that benefit from the status quo are politically powerful, well organized, and highly motivated. But knowing what clearly needs to be done, however difficult it might be, is an advantage that should not be underestimated.

Of course, there are many other possible targets for pro-growth policy reforms that Congress could set its sights on. Many big policy battles with important implications for growth are already raging in Washington: the never-ending wrangling over tax policy, resolving the long-term fiscal imbalance, the future of health care reform after the Affordable Care Act, the future of financial regulation after Dodd-Frank. Here, often while pursuing other objectives, policymakers are confronting issues whose resolution will have a significant impact, for better or worse, on the U.S. economy's future prospects. Everyone interested in a brighter growth outlook has a stake in the outcome of these big showdowns.

That said, pursuing an agenda of curbing regressive regulation would allow us to open a new front in the policy fight. Unlike the all-too-familiar policy disputes now ongoing, a campaign against regressive regulation would feature issues new to the national policy spotlight. That is especially

true in the case of occupational licensing, since it occurs largely at the state level and thus is typically ignored by Washington. Meanwhile, the organizing rubric of regressive regulation packages together disparate issues in a novel way and can thereby impart new energy to reform efforts in each of its constituent policy domains.

This new front would look very different from the other, ongoing policy debates. Instead of the opposing forces being arrayed along the left-right axis, here the contest pits an expert consensus across the political spectrum against the interest groups who profit from existing policy. Instead of yet another left-right fight, this time the contest could be framed as a choice between the public interest and vested interests.

The idea of a left-right coalition to push deregulation may sound farfetched, but it is not without precedent. Consider the country's last major episode of pro-market regulatory reform back in the late 1970s and early 1980s. During that brief period of time, price-and-entry regulation of airlines, trucking, and railroads was systematically dismantled; price controls on oil and natural gas were lifted; interest rate caps for checking and savings accounts were removed; and the AT&T monopoly was dismantled, paving the way for competition in long-distance telephony. Those too young to remember can be forgiven for associating all of this with Ronald Reagan, but, in fact, Democrats and progressives played a major role. Jimmy Carter signed the legislation that deregulated airlines, trucking, railroads, and natural gas. On Capitol Hill, Sen. Edward Kennedy (D-MA) led the fight for airline deregulation, ably assisted by his aide Stephen Breyer. Yes, the rise of Chicago-school economics and especially the law-and-economics movement supplied momentum for these sweeping policy changes, but so did the activism of Ralph Nader.

History never repeats itself, but sometimes it rhymes. As in the 1970s, the U.S. economy today is delivering disappointing results. Back then the problem was "stagflation"; today we worry about a "great stagnation." And once again, the shifting currents of political debate are bringing together unlikely allies with a common interest in reviving prosperity and a common hostility to the entrenched interests that stand in the way. With luck, contemporary reformers can follow their predecessors' good example.

Suggested Readings

Department of the Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor. "Occupational Licensing: A Framework for Policymakers." July 2015.

Lindsey, Brink. "Low-Hanging Fruit Guarded by Dragons: Reforming Regressive Regulation to Boost U.S. Economic Growth." Cato Institute White Paper, June 22, 2015.
———. "A New Growth Agenda." *Cato Policy Report*, November/December 2015.
———. ed. *Reviving Economic Growth: Policy Proposals from 51 Leading Experts*. Washington: Cato Institute, 2015.

—Prepared by Brink Lindsey