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A New Growth Agenda

BY BRINK LINDSEY

The good news is that the coming years hold out real promise for a new wave of market-oriented regulatory reforms here in the United States. Momentum on this front crested in the late 1970s and early '80s and has been all but defunct for the past couple of decades, but that may well be about to change. The bad news is why: the reason we should be getting our political hopes up is that our economic hopes over the near to medium term are so likely to be dashed.

Let me spell out that bad news a bit. U.S. economic performance in the wake of the Great Recession of 2008–09 has been nothing short of dismal. More than three years passed before real output even returned to its pre-recession level, and a return to the pre-recession growth trend remains nowhere in sight. The story with employment is even worse: yes, the unemployment rate has gradually subsided, but only because the percentage of Americans actually in the work force has sunk to its lowest level since the late 1970s.

Debate still rages over how much of the economy's continuing sluggishness reflects short-term, cyclical factors—in particular, a shortfall in aggregate demand or deleveraging in response to the financial crisis of 2008. It is becoming increasingly clear, however, that slower growth in output and a weak labor market are now the "new normal." In other words, the ongoing economic slump is not just a matter of a temporary gap between current and "potential" output. Rather, the economy has suffered a decline in its potential or full-employment growth rate.

Consider the long-term trends for each of the four major components of economic growth: growth in labor participation, growth in labor skills, growth in investment, and growth in output-enhancing innovation. As I explained in my 2013 Cato paper "Why Growth Is Getting Harder," those trends are now uniformly unfavorable. Average hours worked per capita have fallen since 2000. Growth in so-called labor quality (as measured by years of school completed) has slowed

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BRINK LINDSEY is vice president for research at the Cato Institute. This article was adapted from his recent Cato White Paper "Low-Hanging Fruit Guarded by Dragons: Reforming Regressive Regulation to Boost U.S. Economic Growth."

India's economy is flourishing as never before—140 million people have raised themselves out of poverty in just the last three years. Cato senior fellow JOHAN NORBERG's new public television documentary (pictured above), *India Awakes*, highlights the globalization, economic liberalization, and entrepreneurship that led to this renaissance. Purchase *India Awakes* at www.freetochoosemedia.org.

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considerably. The net domestic investment rate has been trending downward for decades. And total factor productivity (TFP) growth, our best measure of innovation, has slumped again in recent years after an Internet-fueled surge between 1996 and 2004.

Consequently, there are strong reasons for believing that growth in the years ahead will fall well short of the long-term historical average. Between 1870 and 2010, growth in real (i.e., inflation-adjusted) GDP per capita averaged just under 2 percent a year. By contrast, recent long-term growth projections by top academic and government economists point to an average annual per capita growth rate in the range of 1.0 to 1.5 percent—a fairly dramatic decline from the historical trend line.

In a welcome bit of irony, such economic pessimism offers solid grounds for political optimism. Here's the basic logic: there is an inverse relationship between the external conditions for growth, on the one hand, and the incentives for good economic policy-making on the other. When conditions for robust growth are favorable, politicians can indulge in the characteristic vices of their profession—a time horizon bounded by the next election cycle and an overriding focus on dividing the pie rather than making it bigger—and still preside over a thriving economy. When, however, times get tougher, politicians must up their game or else economic performance will suffer. In the latter event, the poll numbers of incumbents start to drop, those of their challengers start to rise, and thus opportunities for policy change improve.

Now, policy change could well proceed in the wrong direction and produce worse results than the status quo. But over the past several decades at least, the general pattern around the world—as documented in the annual *Economic Freedom of the World* reports and similar sources—has been for economic policies to move toward less government control and greater reliance on market competition. And usually, progress in liberalization

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has been spurred by disappointing economic performance.

If this general pattern holds in the present case, then a protracted period of sluggish growth should open a window of opportunity for pro-market, pro-growth reforms here in the United States. In sunnier times, many bad policies widely understood to create obstacles for growth are left undisturbed because the political price to be paid for changing them doesn't seem worth it: why borrow trouble by attacking policies with powerful defenders if things are going OK anyway? But when the economic climate worsens, politicians come under increasing pressure to do something.

OPPORTUNITY FOR REFORM

Here then is the challenge for supporters of free markets: how can we best take advantage of this window of opportunity? During good times, we are forced to argue that, even if the overall economy seems to be performing well, it could be doing even better with appropriate policy reforms. Now, by contrast, we can reframe our case with a much more compelling sense of urgency: if we do not make difficult but necessary reforms, the economy will perform much worse than in the past. Since people are typically loss averse (they are more concerned about losing what they have than not getting what they want), the growth slowdown makes our case much stronger and more persuasive. But once we reframe our argument, what policy agenda best fits the new frame?

There is no shortage of possible reforms to include. For evidence I refer you to *Reviving Economic Growth*, a new Cato ebook that I edited. The book is a collection of essays by 51 prominent economists and policy experts, all of whom were asked to offer suggestions for improving the U.S. economy's long-term growth outlook. Although a number of reform ideas come up repeatedly, what is striking about the collection is just how wide-ranging and varied the proposals are. Which should not be at all surprising: fiscal and regulatory policies affect the allocation of resources and the climate for innovation along countless different margins, and thus the potential levers for improving overall economic performance are similarly numerous and diverse.

In particular, the major economic policy debates that have dominated Washington and the nation's attention in recent years—the trajectory and composition of federal spending, the level and structure of taxation, health care policy, regulation of the financial sector, what to do about illegal immigration, and climate change and environmental regulation more generally—have important implications for growth. Yet precisely because these debates have already found the spotlight, they are unlikely to supply policy ideas that can take advantage of the political opportunity that the current growth slowdown affords. On all of these hard-fought fronts, battle lines are already clearly drawn and often reflect differences over goals and priorities other than growth. Moreover, opinions are highly polarized along partisan and ideological lines, which in the current political environment is often a recipe for stalemate and gridlock.

What we should be looking for, then, are policy ideas that are not already the subject of high-profile, politically polarized debate. America's growth slowdown is a new problem, and policy responses that address that problem are more likely to gain traction if they are not recycled ideas originally put forward to address other problems. And if a policy idea is already clearly associated with either the left or the right, in today's highly contentious environment it is all but guaranteed that the other side will fight tooth and nail against it—which makes progress of any kind difficult in the absence of large congressional majorities and unified partisan control of the White House

and Congress.

Meanwhile, of course, the items on this new policy agenda need to be effective remedies for slow growth. Since innovation is the ultimate source of long-term growth in advanced countries at the technological frontier, we should focus especially on policy reforms that can facilitate the introduction and spread of new ideas. In other words, we should target policy barriers that inhibit entrepreneurship and the reallocation of resources through competition and "creative destruction."

REFORMING REGRESSIVE REGULATION

In a new Cato White Paper with the curious title of "Low-Hanging Fruit Guarded by Dragons," I take all these factors into account and propose a pro-growth reform agenda that focuses on regulatory 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.

In the paper I identify four main areas of regressive regulation: excessive monopoly privileges granted under copyright and patent law, restrictions on high-skilled immigration, protection of incumbent service providers under occupational licensing, and artificial scarcity created by land-use regulation. Space constraints prohibit an in-depth discussion of those policies here; for details I refer you to the paper. Here I will simply offer some general observations about why targeting these policies seems to me to be the most promising strategy for reversing the growth slowdown—and for taking advantage of the growth slowdown to revive political momentum for economic freedom.

At first blush, these four policy areas seem completely unrelated. They cover highly disparate subject matters, they are administered at different levels of government, and they feature widely varying forms of regulatory apparatus. Notwithstanding all these obvious differences, there are also deep and important similarities. All the policy areas 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 and zoning regulations limit who can enter or do business within a designated geographic area.

> "I propose a pro-growth reform agenda that focuses on 'regressive regulation.'"

All of these entry barriers undermine economic growth by restricting vital inputs to innovation. Excessive 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 are frequently the vessels for new products or new production methods. And zoning restricts urban density, a vital catalyst for the innovative recombination of ideas.

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 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. And zoning gives windfall gains to wealthy landowners.

LEFT-LIBERTARIAN SYNTHESIS

In all likelihood because of these underlying similarities, none of these policy areas have become zones of ideological or partisan conflict. To be sure, proper policy is vigorously debated in all 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 from across the political spectrum.

Thus, in the field of intellectual property, Nancy Pelosi (D-CA) joined forces with Darrell Issa (R-CA) and 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 Bell and Jerry Brito.

With regard to high-skilled 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 to occupational licensing, the Obama administration's latest budget contains a provision to nudge states toward reform; furthermore, this past summer the administration released an excellent report that makes the case for deregulation in this area. Meanwhile, in July 2014, Rep. Paul Ryan (R-WI) released a widely discussed plan for combating poverty. And 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 Obama, is a leading critic of these regulatory restrictions, while the libertarian Institute for Justice has a long track record of challenging and overturning licensing rules in court.

Zoning is a local issue that has long been thought to have only local consequences, so to date it has not attracted much attention from Washington policymakers. Among policy experts, though, the pattern of support for reform across ideological dividing lines holds here as well. Edward Glaeser, who in addition to teaching at Harvard is affiliated with the libertarian-leaning Manhattan Institute, is among the nation's leading critics of current land-use regulation. Another prominent critic is Matthew Yglesias of *Vox*, who wrote his book *The Rent Is Too Damn High* while he was working for the Center for American Progress.

PUBLIC INTEREST VERSUS VESTED INTERESTS

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 very difficult to find disinterested policy experts anywhere on the spectrum who support the status quo. Certainly, there are strong defenders of both intellectual property protection and zoning, 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-skilled immigration restrictions and occupational licensing are concerned, it is difficult to find any scholar who has anything nice to say about the current state of either.

> "The idea of a left-right coalition to push deregulation may sound farfetched, but it is not without precedent."

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 by "we" I mean the vast bulk of disinterested experts. Yes, it is true that plucking this fruit won't be easy, because the interest groups that benefit from the status quo are politically powerful, well organized, and highly motivated. This is the "guarded by dragons" part of the story. But knowing clearly what needs to be done, however difficult it might be, is an advantage that should not be underestimated.

Pursuing an agenda of curbing regressive regulation would allow us to open a new front in the economic policy debate. Unlike the all-too-familiar policy disputes now ongoing, a campaign against regressive regulation would feature issues new to the national policy spotlight—especially in the case of occupational licensing and zoning, because they occur at the state and local levels and thus are 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 in the late 1970s and early 1980s. During that brief period, 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 ended, 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, Edward Kennedy 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. ■