REFLECTIONS

Stagnation by Regulation in America's Kudzu Economy

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Secular stagnation is the latest term of art used by economists to describe the U.S. economy's anemic gross domestic product (GDP) growth path, sluggish productivity, pale record of capital investment, and recent decline in labor-force participation.[1] The characterization is at home with Keynesian thinking. Indeed, the term was coined in 1938 by Alvin Hansen, America's leading exponent of Keynesian economics (Bernanke 2015). The expression is now in vogue because the economy seems to be unaffected by policy makers who, like the Wizard of Oz, believe they can wisely and magnanimously push buttons on a veritable fiscal and monetary video game that prompts the economy to respond beneficially.

Alas, the video game, the much vaunted device with monetary and fiscal policy control buttons, no longer seems to be working, if it ever did. I argue that regulation is a principle reason for this, and there is a large amount of evidence to back me up.[2]

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1. For example, see Krugman 2014 regarding secular stagnation as a Keynesian demand concept; the discussion of the concept in Bernanke 2015, which includes reference to Larry Summers's arguments regarding it; and "Grand Central" 2015. For recent commentary on why the economy may be unresponsive, see work by Charles Murray (2015a), who thinks regulation is a culprit, and by Allen Blinder (2015), who claims we (economists?) have no idea what's going on. The U.S. Bureau of Labor Statistics (2015) captured the effects of stagnation in May 2015, when the agency reported that productivity growth had fallen to a 1.4 percent annual rate in the past decade, down from the 2.2 percent growth rate in the 1990s.

2. The negative effects of regulation on GDP growth have been documented for decades. For empirical evidence for the 1970s and 1980s, see Christainsen and Haveman 1984. S. L. Parente and E. C. Prescott

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Figure 1
An Example of a Kudzu-Entangled Landscape

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On any given day, countless purposeful people attempting to make an almost infinite number of incentive-affected decisions are discouraged, constrained, or unduly advantaged by the number and extent of government rules and regulations that must be satisfied before decisions are implemented.

We have an entangled economy where all meaningful decisions are constrained by federal regulation (Smith, Wagner, and Yandle 2011). Put another way, we have a kudzu-like economic landscape with government-introduced vines growing in all directions.

Kudzu, native to Asia, was introduced in the 1930s to American agriculture by the Soil Erosion Service of the U.S. Department of Agriculture (USDA), which paid

(1999) offer a study across countries that examines determinants of differences in per capita GDP. They find barriers to the adoption of efficient technologies—regulation—to be the major factor that explains income differences. John Dawson and John Seater's (2013) study of regulation effects on the U.S. economy from 1949 to 2005 estimates the annual average loss in GDP growth to be 2.0 percentage points. Note that Djankov, McLiesh, and Ramalho (2006), who use the World Bank Doing Business Index of regulation stringency in their study of 135 countries for 1993 through 2002, find that the difference in annual GDP growth between the lowest Doing Business quartile of countries and the highest quartile is 2.3 percentage points. Casey Mulligan (2012) provides evidence of regulation effects involving the tax-on-work effects of welfare benefits and the minimum wage on overall employment. Also note that Antony Davies (2014), using the Mercatus Center's RegData index of regulatory burden for the years 1997 through 2010, found significantly lower productivity growth for the most-burdened versus the least-burdened U.S. industries.

farmers for planting kudzu tubers. Some 1.2 million acres were planted. What had been eroded fields that could not support cultivation became kudzu-covered fields that still could not support cultivation (Britton, Orr, and Sun n.d.). Alas, the kudzu-like spread of regulation has had a similar effect: stagnation by regulation. Within the kudzu family, command-and-control is the most constraining, prosperity-limiting form of regulation. Its rules specify techniques and technology and provide details on how work is to be done; it is an approach that chills competitive discovery of lower-cost and more effective ways to maintain order while sustaining economic growth. If, for example, the command-and-control approach were replaced by performance standards—easily understood outcome-based goals—then, as Philip Howard puts it, the simplified approach would open "cognitive doors, now blocked by countless rules, to the deep store of unconscious instinct and creativity that resides in each person" (2014, 54). This essay reaches the conclusion that stagnation can be remedied only by cutting back the kudzu-like constraints and ending regulatory programs that promote their growth.

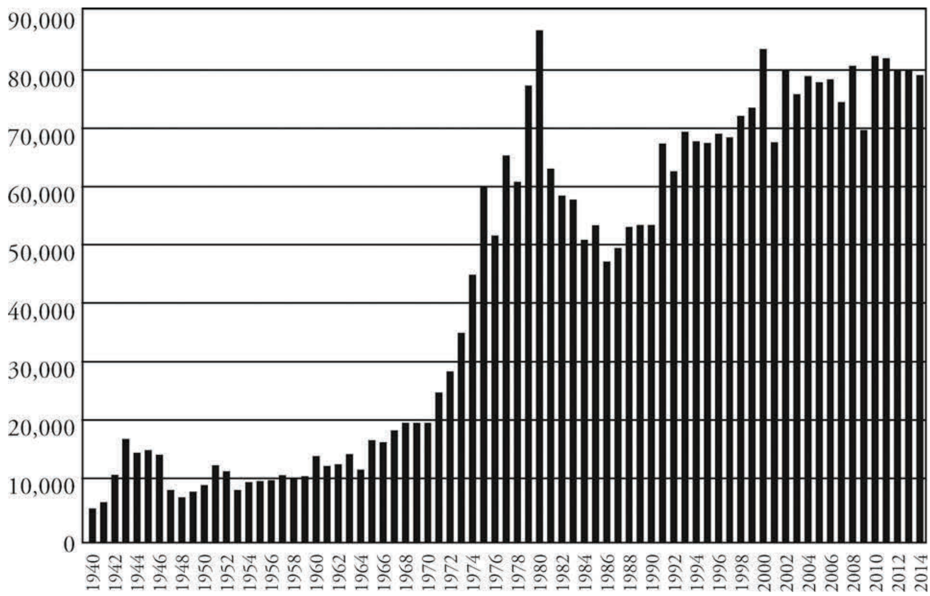
When Did the Kudzu Planting Start?

The kudzu economy did not start with the Obama administration or with the Bush II, Clinton, Bush I, Reagan, Carter, or Ford administrations, though each of them contributed to it. The origin is found in the administration of Richard Nixon. Nixon politicked for and endorsed the establishment of the U.S. Environmental Protection Agency (EPA) and the National Highway Traffic and Safety Administration in 1970; the Occupational Safety and Health Administration in 1971; and the Consumer Product Safety Commission in 1972. Moving environmental and other controls from the states to the federal level was not without controversy (Whitaker 1976), but broad interpretations of the Commerce Clause laid the foundation for the rise of the federal regulatory state.[3] The newly established agencies became the vehicles for promulgating regulations embodied in major pieces of legislation that underlay the formation of America's regulatory state.

The evidence of kudzu growth is seen graphically in figure 2 in the count of *Federal Register* pages. The massive growth seen from the 1970s forward, interrupted during the Reagan administration, when major constraints were imposed on the regulatory state but with recovery thereafter, was driven largely by progressive implementation of complex statutes specifying rules to be written but also by new initiatives inspired by growing regulatory entanglements generated along the way. For example, subsequent to the EPA regulation requiring all newly built autos sold in the United

3. Removing constitutional barriers to federalizing what had been state and local controls does not explain why demand-and-supply forces for federal regulation arose and eclipsed state control in the first place. I offer an explanation that turns on the rise of national markets for consumer goods and thus on the demand for federal as opposed to multiple state rules brought on by development of national network television (Yandle 2010b).

Figure 2
***Federal Register*, Number of Pages, 1940–2014**



Source: Author's construction using U.S. Office of Federal Register data.

States to be equipped with catalytic converters, the agency issued regulation banning the sale of leaded gasoline because, unfortunately, the tetraethyl lead disabled the catalytic converter (Newell and Rogers 2003). This EPA ban occurred after the agency had mandated unworkable gas-tank configurations designed to limit the entry of fuel hoses from tanks that dispensed leaded gasoline, yet another regulation that did not work out as planned. Much later, when too little progress was made in reducing the ambient level of nitrogen oxide from stationary sources, the EPA brought suit against producers of medium diesel engines—the sort used in transport trucks—requiring them to meet tougher technology-based emission limitations. The regulation-by-litigation episode shifted the kudzu burden from stationary to mobile sources (Morriss, Yandle, and Dorchak 2008).

In more recent times, regulations requiring financial institutions to increase home lending to financially ill-equipped borrowers under federal "affordable-home" programs contributed to the rise of the "subprime mortgage crisis" and the sprouting of new regulations that set ever more stringent lending standards (Yandle 2010a). Included in the new financial market regulations, the Volker rule set limits on bank proprietary lending, which in turn has spawned demand for more detailed regulation defining just what is meant by proprietary lending (Howard 2014, 56). Regulations that specified auto ignition seat-belt interlocks that prevented cars from starting when seat belts were not fastened led to outraged citizens, repeal of interlocks, and new regulations requiring another technology: warning buzzers and passive restraints (*Buckling Up* 2003).

Rules by the Securities and Exchange Commission requiring debt issuers to use the rating services of Moody's, Standard & Poor's, and Fitch but denying official recognition of newly competing raters led to unsavory borrower–rating agency interaction and a host of new regulations (Yandle 2010a). Federal Trade Commission (FTC) rules that banned health claims in cigarette advertising ended the competitive search for lower-tar cigarettes and led to new FTC regulations requiring all cigarette producers to submit their products to FTC laboratories for official testing, which was followed by a sequence of new regulations regarding advertising (Calfee 1986). And most recently, the USDA is initiating a program to fund special filling stations nationwide that will have the capability to pump a richer mix of ethanol/gasoline to accommodate the fact that current leaner blends will not satisfy the annual mandate for subsidized ethanol production prized by U.S. corn producers ("Dirty Rotten Ethanol Scoundrels" 2015). In short, regulatory episodes, like the first kudzu plantings, always seem to lead to the germination of future regulatory kudzu.

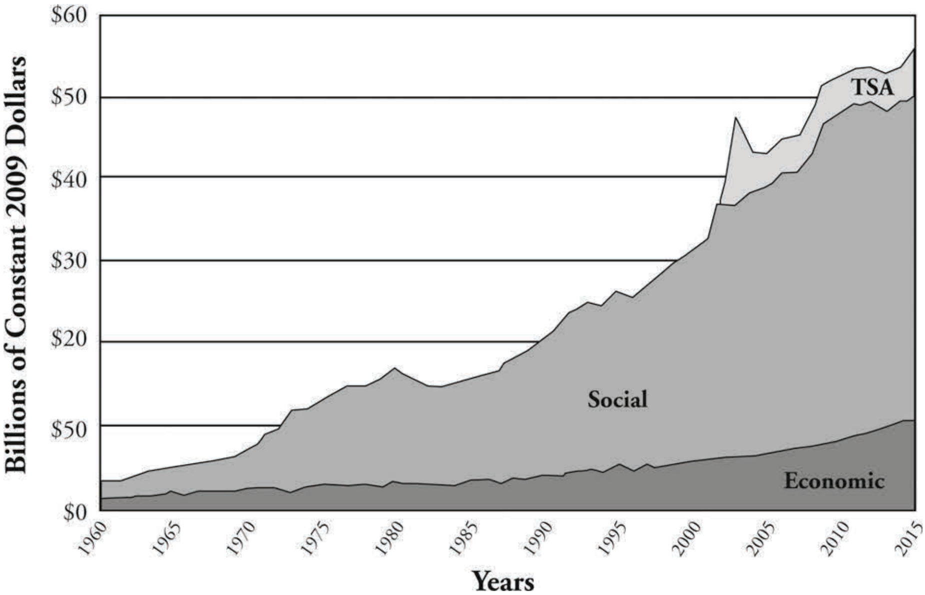
But there is more going on here than just more pages of rules. As indicated, regulatory kudzu is about what is written on the pages, the prevalence of certain kinds of rules found in the surging *Federal Register* page count. American-style prescriptive regulation is the dominant form of regulatory kudzu that spread in the 1970s. This regulatory approach mandates employment practices; how things are produced, marketed, and consumed; and what technologies must be used. Examples include the kinds of air pollution technologies to be installed on cement plants or steel mills, the types of safety equipment to be worn by workers in noisy environments and engineering approaches to be used in reducing the noise, the exact words that must be used in advertising over-the-counter drugs, the kind of health-care insurance one must purchase along with bright-line definition of when an employer must provide coverage, and the kinds of electronically controlled brakes that must be installed on railroad tank cars that carry crude oil.

Nixon-era kudzu planting set in motion a burgeoning set of social regulators. Their growth rapidly eclipsed the growth of the older economic regulators who set prices, rates, and fees and provided limited certificates for those who wished to enter certain industries. The importance of social regulators is seen in figure 3; social regulation accounts for the vast majority of the growth in regulators' budgets in recent decades.

The Conditions that Support Kudzu Growth

Regulation is ideally suited for politicians, who must find ways to target benefits to supporting interest groups. For example, we know that unwanted nitrate and phosphate emissions discharged into streams can be limited by (1) applying common-law rules that protect defined property rights of owners and occupiers of land, (2) placing

Figure 3
Budgetary Costs of U.S. Regulatory Agencies, 1960–2015



Source: Dudley and Warren 2015.

a tax or fee on the amount discharged, (3) setting a performance standard that may be achieved in any way the polluter may choose, or (4) encouraging the organization of watershed communities that can embrace any combination of the control approaches just mentioned. We know that some form of property-rights protection will emerge, but use of these outcome-based instruments, in spite of their relative efficacy, cannot identify precise winners and losers ex ante.

With these regimes, there is no way to guarantee who will pay the most or who may be relieved from paying at all, which is another way of saying who will put money in the bank. Neither the associated cost nor the benefit can be targeted. In contrast, prescriptive or command-and-control regulations can easily target or relieve identifiable firms and organizations. Doing so can generate politically valuable differential effects across members of an industry. Command-and-control regulations can be used to raise rivals' cost, to block competitive entry, and to cartelize markets (Yandle 2013).

And so there are bootleggers and Baptists tripping through the kudzu vines (Smith and Yandle 2014). As I have emphasized, properly designed regulation can provide appropriable rents—money that can be banked—to targeted special interests within an industry or region, those that are more thoughtfully called the "bootleggers." And this can be done artfully while simultaneously providing politically valuable benefits to "Baptists," those moral-high-ground lobbyists who support the same regulations that are desired by bootleggers but for decidedly different reasons, thus providing helpful cover to the bootleggers and accommodating politicians (Shamoun 2013). But this is not the end of the story.

In a fiscally constrained economy, targeted benefits delivered by regulation can substitute for redistribution by way of taxing and spending, an outcome that is perhaps much appreciated by beleaguered politicians seeking to satisfy their valuable interest groups. Although real per capita federal expenditures (in 2014 dollars) have soared from $4,304 in 1962 to $10,970 in 2014, almost all of this increase is due to growth in mandatory spending for programs such as Social Security and Medicare (de Rugy 2014). Across these fifty-two years, total per capita spending rose by a bit more than two and a half times, but the mandatory category rose almost six times, from $1,124 in 1962 to $6,634 in 2014. Although looming large, mandated welfare benefits are not the kind of stuff that tends to satisfy clamoring bootleggers and Baptists. Given discretionary spending constraints and deficits as far as the eye can see, the canny and caring politician can still provide targeted benefits to valued interest groups and individuals. Regulatory kudzu is the ticket.

Can We Cut Out the Kudzu?

The USDA touted the real kudzu as a solution to soil-erosion problems and paid farmers $8 per acre to plant kudzu tubers. Railroads and other economic interests supported the cause, hoping that kudzu would become an abundant replacement for hay and therefore a source of transportation revenue. In a matter of a few years, 1.2 million acres of land had been planted. As kudzu grew and entangled even more acres, along with barns, houses, electricity lines, and highway rights of way, the USDA stopped subsidizing the plant, but that did not stop kudzu. Once planted, the kudzu flourished on its own. The plant was eventually declared to be a federal noxious weed, a pest, which meant that kudzu could be poisoned by farmers who hoped to reclaim their productive land.

Perhaps there is a lesson here. Maybe some regulations should be declared federal noxious weeds. Command-and-control, technology-based rules should be the first target.

Longtime regulatory scholar Clyde Wayne Crews (2015) endorses legislation introduced recently by senators Angus King (I–Me.) and Roy Blount (R–Mo.), who call for a Regulatory Reduction Commission, which might assemble an array of rules for elimination with an up or down vote by Congress (Harnett 2015). Crews also suggests dusting off an old proposal that would require congressional approval of all new rules that impose more than $100 million in annual cost on the economy. The combined actions would cut regulatory kudzu and limit future plantings. These ideas have merit, but I would add a steering wheel to the proposals: when the trimming is done, the first focus should be on snipping back command-and-control regulation and replacing it with outcome-based rules. Safe harbor might be given to rules that define property rights and encourage markets or that set performance standards and then simply leave it to markets to determine methods for achieving the standards.

But there are other possibilities to consider. In April 2015, Canada adopted a one-for-one rule that might be worthy of emulation (Berliner 2015): before a new federal regulation can be imposed, an existing regulation must be eliminated. For each new kudzu acre planted, an acre now growing must be cleared. The Canadian approach has limitations: unfortunately, regulations affecting safety, the environment, and consumer protection are not covered by the new rule. Omitting these crucial categories from treatment misses the opportunity to discover and apply less-obtrusive, prosperity-friendly approaches where they might matter most. If the United States were to follow suit, we might consider doing so on an agency-by-agency basis, again focusing on eliminating command-and-control mandates.

After making a comprehensive examination of the regulatory state, Philip Howard offers proposals for dramatic regulatory reform that might be coupled with Crews's commission and the Canadian one-for-one idea. For example, he calls for a constitutional amendment that requires all regulations having a budgetary impact to expire at the end of fifteen years (2014, 180). Consider the combined possibilities when the various reform proposals are combined. The commission would winnow out kudzu; old regulatory fields would be removed each time a new field is planted, but the new fields would expire in fifteen years. The combination would establish a new margin for a slimmer regulatory state.

Charles Murray (2015b) offers an even more radical solution for reducing the size and scope of the kudzu entanglement, one that might be used to work within the margin of the controls just mentioned. He calls for systematic civil disobedience along with the use of the courts to push back against regulations. His civil disobedience notion may not be as dramatic as the words first suggest. Murray points out that most interstate drivers routinely exceed the posted speed limit and that patrol officers just as routinely permit this form of civil disobedience other than in unusually dangerous situations (Murray 2015b, 139). Sensing that a broad cross section of the U.S. population has had enough, Murray proposes the development of a privately funded public-interest institution, which he calls the Madison Fund, to bring suits on behalf of beleaguered citizens, much like the Pacific Legal Foundation, Landmark Legal Foundation, and Institute of Justice, though much larger and specializing in litigating federal regulators. The new institute would pester and publicize the often indefensible nature of many technical rules while being cheered by a vast majority of ordinary American citizens who now feel the constraining effects of regulatory kudzu.

What about the future? Without all this freezing, plowing under, and pestering, the entangled U.S. economy will remain stagnant. Based on estimates by John Dawson and John Seater (2013) and by Simeon Djankov, Caralee McLiesh, and Rita Ramalho (2006), unless excessive regulation is sharply reduced and modified, it will cause real GDP growth to limp along at roughly two percentage points annually below its potential. This will likely continue until technological change generates new fields for growth free of kudzu. But even then, the new acreage will likely become infested unless fenced off. However, if Americans have had enough kudzu, this could be the time for a new beginning, one that embraces prosperity-friendly, market-based institutions that will help to end stagnation by regulation.

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