

## **A Regulatory Moratorium as Part of a Comprehensive Economic Strategy**

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Chairman Coble, Ranking Member Cohen, and other members of the committee, thank you for the opportunity to testify on H.R. 4078, The Regulatory Freeze for Jobs Act of 2012.

In an article published in the *Wall Street Journal* a year and a half ago (September 16, 2010), I joined several other economists experienced in economic policy and research—George Shultz, Michael Boskin, John Cogan, Allan Meltzer—to put forth an economic strategy to strengthen the very weak economic recovery following the 2007-09 recession. An essential element of that strategy was a proposal to “enact a moratorium on all new regulations for the next three years, with an exception for national security and public safety.” In our view enacting such a regulatory freeze and embedding it within a broader plan to balance the federal budget credibly without increasing taxes, reduce the explosive growth of future entitlements, and make monetary policy more rule-like would go a long way to restoring a strong economic recovery with robust employment growth.

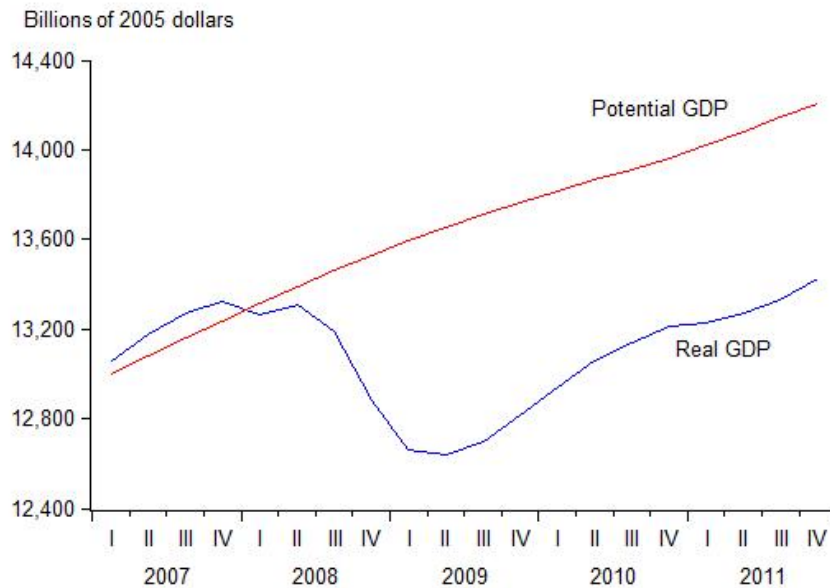
Unfortunately, neither the moratorium on new regulations nor the broader economic plan has been enacted, and, largely as a result in my view, the economic recovery has continued to be very weak. This is why it is so important to move ahead with the proposed Regulatory Freeze for Jobs Act. The act would create a moratorium on new significant regulations until the national unemployment rate stabilizes at or below 6 percent, which has an advantage over the three-year moratorium which is not tied to unemployment. Under the proposed legislation, the President could waive the moratorium for national security, but would have to explain the need for the waiver in writing, and the regulation would be subject to judicial review.

In this testimony I first provide an assessment of the state of the economic recovery, and then consider the role of regulation and regulatory uncertainty in holding back the recovery.

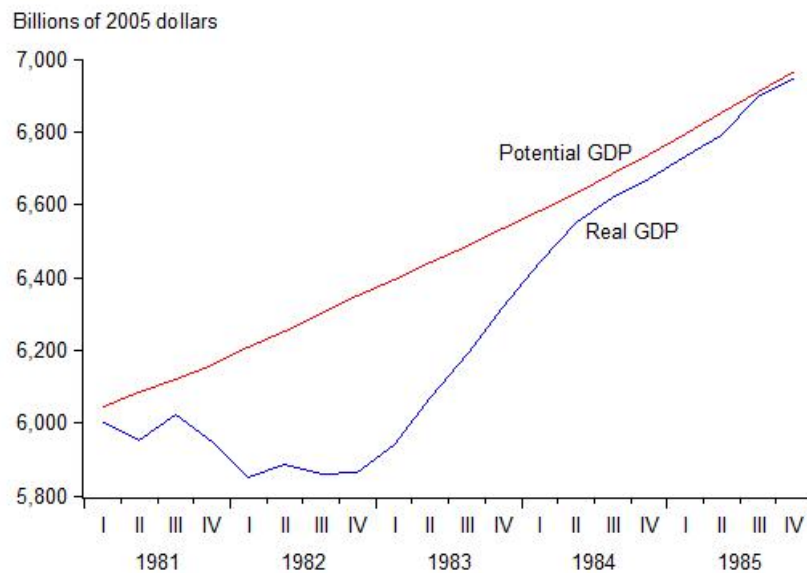
Recent data on employment and economic growth, as well as the recent downward revision of potential GDP by the Congressional Budget Office (CBO), still indicate a very weak recovery. A good standard of comparison for this recovery is the most recent recovery from a very deep recession, namely the one that ended in 1982. Several charts help make the comparison.

The first chart shows real GDP during the 10 quarters since the end of the 2007-2009 recession along with CBOs recently revised estimate of potential GDP. The chart clearly shows

that the economy has yet to recover back to its potential. The gradual slowing of potential GDP around 2009 and 2010 reflects CBO's decision to lower its estimate of potential GDP.

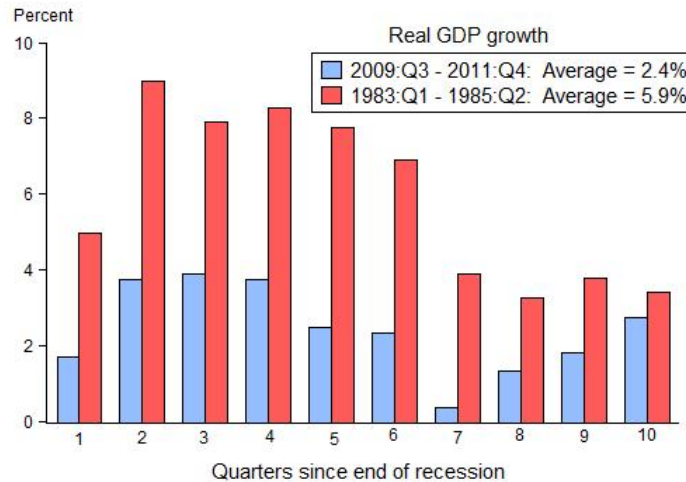


The next chart shows the recovery back to potential GDP in the 10 quarters following the 1981-82 recession. The difference between the two charts is striking, and is why one can say that the current recovery is a recovery in name only.

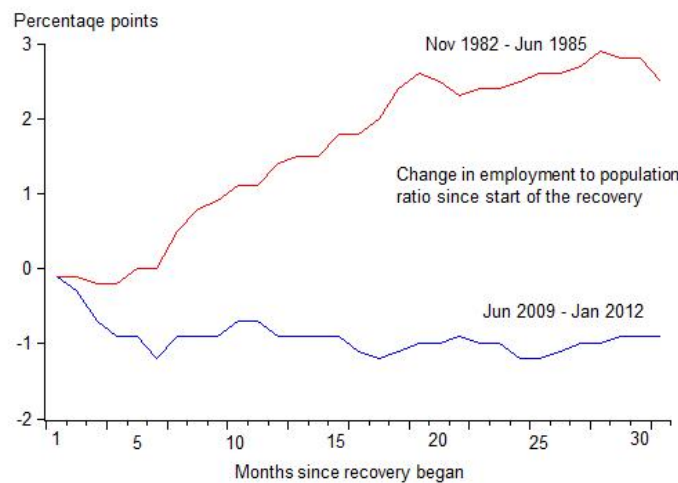


The two recoveries can also be compared by examining economic growth rates in the two periods; focusing on growth rates has the advantage of not relying on potential GDP which is

difficult to estimate and project. The growth rates in each of the ten quarters of the two recoveries are shown in the next chart. Again the comparison is striking. Economic growth averaged 2.4 percent in the recent 10 quarters compared with 5.9 percent in the 1980s recovery.



The difference between the two recoveries is also evident in number of jobs created. The next chart compares the changes in the fraction of the working age population that is actually working in the two recoveries. Note that, even with the recent news about the lower unemployment rate, there is little or no improvement in the employment-to-population ratio in this recovery. It is still lower than it was at the bottom of the recession. The poorer performance of the employment to population ratio compared with the unemployment rate is due to a substantial decline in the number of people in the labor force as many unemployed people have stopped working and are therefore no longer counted as unemployed in the official statistics.



Some argue that weak recovery is due to special factors such as the need for people cut back on consumption and pay back debt, commonly called deleveraging. However, the stronger

recovery in the early 1980s occurred while people were consuming a much smaller fraction of their income than in the recent recovery. The saving rate was as much as 10 percent then and only 3 to 4 percent now. And while housing has been weak in recent years, all strong economies have weak sectors, and housing is less of a drag now than other sectors, such as foreign trade, were in the strong 1980s recovery.

In my view the weak recovery is due to poor economic policy, including, and among other things, a large increase in both the number of significant regulations and the regulatory uncertainty related to new legislation. The recent issue of *The Economist* magazine entitled the “Over-Regulated America” provides many useful and specific examples of how the United States “is being suffocated by excessive and badly written regulation,” and data support these examples.

Quantitative reports from the Office of Management and Budget (OMB) show that the costs of regulation have been growing over time especially in the past few years. The Government Accountability Office reports that federal agencies issued 43 major new rules in fiscal year 2010, including 15 in the financial area, 10 in the environmental area, and 5 in the health care area. See Gattuso (2011). Many more regulatory rules are either in the process of being written and issued or forthcoming as a result of the Wall Street Reform and Consumer Protection Act of 2010, (commonly called Dodd-Frank) and the Patient Protection and Affordable Care Act of 2010.

The new regulations in the Wall Street Reform and Consumer Protection Act of 2010 and the increased uncertainty about their implementation are already severely problematic. (See Taylor (2012) which also discusses similar problems with the new health care law.) The purpose of the Dodd-Frank bill was to prevent another financial crisis, but it misdiagnosed the crisis. As a result the bill is riddled with many new regulations that are not related to the crisis, and these require very complex rulemaking to implement.

The biggest factor contributing to the misdiagnosis was the presumption that the government did not have enough power to avoid the crisis, but it most certainly did. Instead of trying to make enforcement of existing government regulations more effective and thereby help prevent future crises, the Dodd-Frank bill vastly increased the number of regulations and power of government in ways that may even encourage future crises. For example, the bill creates a new resolution or “orderly liquidation” authority, in which the Federal Deposit Insurance Corporation (FDIC) has the power to intervene between any complex financial institution and its creditors. This could increase the likelihood of bailout rather than reduce it.

People are beginning to understand that the bill does not do what its supporters claimed. For example, *The Economist*, in the recent “Over-Regulated America” issue, focusses on the “flaws in the confused, bloated law passed in the aftermath of America’s financial crisis.” The sheer complexity of the regulations coming out of the Dodd-Frank bill increases uncertainty which holds back investment and firm expansion.

Former Federal Reserve Chairman Alan Greenspan has proposed that we start over on Dodd-Frank, which he views as largely un-implementable based on his knowledge of how the

Federal Reserve and other regulatory agencies operate. (See Greenspan (2011)). The Dodd-Frank act requires more than 200 rulemakings by the Federal Reserve and other agencies, far more than they had to implement in comparable periods in the past. The general regulatory principles are put in the law but the detailed regulations must be implemented by the regulatory agencies, an almost impossible task to do, let alone do well, in the case of Dodd-Frank.

One example of the unintended consequences of the law occurred when the Ford Motor Credit Company, the financial services arm of Ford Motor Company, tried to issue asset-backed securities to raise funds to make loans to customers who wanted to buy a car. The Dodd-Frank law requires credit rating agencies to issue a credit rating on such securities, but it also requires that the credit rating agencies be liable for their opinions.

Unsurprisingly, no credit rating agency was willing to issue a rating under that circumstance. So without the asset backed security, and thus without automobile credit, it looked like many cars were not going to be sold. But rather than change the law, the SEC staff promised not to raise the issue with the Commission. As Greenspan put it, “There are innumerable hidden problems like this in the law and the sooner we decide to start from scratch, the better off this country will be.”

To sum up, a regulatory freeze is needed now for two reasons. First, the sheer number of significantly costly regulations is putting a burden on the economy and economic growth. Second in the case of the new financial law and in the case of the new health care law many of the regulations are unworkable or misplaced, and a timeout is needed before they are implemented. The proposed freeze would serve as such a timeout.

I have emphasized that it would be best for economic growth if the moratorium was part of a broad economic reform strategy. That strategy should also specify what happens after the freeze is over. In particular it should be clear that the Congress will require that new regulations should pass a rigorous cost-benefit test, perhaps conducted by an agency independent of the agencies writing the regulations. It should also require that direct as well as indirect cost estimates of regulations be published before new regulations are put into law.

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