Policy Brief
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Why Regulate?
New Applications of the "Johnston Test"

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How governments regulate businesses in their jurisdictions has a major effect on economic growth. Along with taxes and government spending, regulation is one of the three principal levers policymakers can move to shape the business climate of their nation, state, or city.

Most policymakers are relatively uninformed about why governments regulate in the first place, and consequently have difficulty framing the issue of regulatory reform. It is hardly their fault: the academic literature shows little consensus, and what agreement exists has not been presented in a fashion that elected officials can apply to the choices they face.

This essay attempts to fill this gap in the literature. It offers a brief survey of theories of regulation and the effects of regulation on economic growth, then comments on some of the key issues concerning regulation in the areas of consumer protection, the environment, and telecommunications. It then describes of what I call "the Johnston Test," after economist Jim Johnston, who will be introduced in due course, and applies his theory to six areas of regulation. Finally, I explain why I believe "the Johnston Test" could be a very useful tool for policymakers at all levels of government.

Why Regulate?

Much of the debate over regulation is the result of differences of opinion over the goals of regulation. What do policymakers hope to achieve when they regulate businesses?

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[1] Joseph Bast is president of The Heartland Institute. He thanks Jim Johnston, an energy economist and long-time member of The Heartland Institute's Board of Directors, for his patience in explaining his general theory of regulation and deregulation.

One view that has wilted under scrutiny is the "public interest" theory, which holds that regulation is intended primarily to benefit and protect the public at large, or at least a large and deserving portion of the public. This seemingly common-sense approach to regulation came under strong attack from economists beginning in the 1970s. George J. Stigler at the University of Chicago, for example, wrote in 1971:

> The "protection of the public" theory of regulation must say that the choice of import quotas [on petroleum] is dictated by the concern of the federal government for an adequate domestic supply of petroleum in the event of war—a remark calculated to elicit uproarious laughter at the Petroleum Club. Such laughter aside, if national defense were the goal of the quotas, a tariff would be a more economic instrument of policy: It would retain the profits of exclusion for the treasury.[2]

The public interest theory of regulation overlooks the fact that regulation in the real world often advances private interests, sometimes and even often at the expense of the public interest.

The real-world history and consequences of regulation are too much at odds with the "public interest" for this bromide to explain regulation's origins or effects. Regulation of taxicabs in many cities, for example, serves primarily to benefit taxi license or medallion holders, not consumers.[3] Regulation of the medical profession in the U.S. was begun with the deliberate intent to restrict the supply of doctors and raise their incomes.[4] Regulation of electric and other utilities came at the request of the industries themselves, not their customers, and mainly serves to guarantee high rates of return to the industries.[5] The public interest theory of regulation overlooks the fact that regulation in the real world often advances private interests, sometimes and even often at the expense of the public interest.

How about "natural monopoly" theory? According to this view, regulation protects consumers from price-gouging in industries where economies of scale encourage the formation of monopolies. But this theory, too, has taken a beating in recent years. Natural monopolies are actually extremely rare, while many competitive industries are regulated. Distinguished

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[2] George J. Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics*, Spring 1971, reproduced in George J. Stigler, ed., *Chicago Studies in Political Economy* (Chicago, IL: University of Chicago Press, 1988).

[3] Mark W. Frankena and Paul A. Pautler, *An Economic Analysis of Taxicab Regulation* (Washington, DC: Federal Trade Commission, May 1984).

[4] Reuben A. Kessel, "The A.M.A. and the Supply of Physicians," *Journal of Law and Contemporary Problems*, 1970, pp. 267-279.

[5] Harold Demsetz, "Why Regulate Utilities?" *Journal of Law and Economics*, April 1968.

economists have pointed out that neither the number of firms in a particular market[6] nor their pricing behavior[7] is reliable evidence of market power, so regulators have no way to identify monopolies even if they wanted to regulate them. In fact, regulation is probably the leading *cause* of monopolies by erecting barriers to entry.[8] Even antitrust regulation, which is explicitly justified by concern over the effects of monopolies and cartels, has historically been used mostly against competitive industries and not monopolies.[9]

A third theory of regulation that has proven more durable over the years is called the "capture theory." As George Stigler explained in 1971, this view asserts that, "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."[10] Stigler and many economists who followed his lead have shown regulation nearly always exists because the affected industry requested it, not because consumers petitioned for it, and most regulations take forms that are beneficial to the industries being regulated, even though other forms of regulation might produce more public benefits.

Regulation nearly always exists because the affected industry requested it, not because consumers petitioned for it.

The capture theory is now part of a mainstream theory of government behavior called "public choice." Regulation, according to this view, is influenced by the incentives of legislators seeking campaign funding, bureaucrats seeking to expand their budgets and prestige, and business interests seeking advantages over their competitors.[11]

Even the capture theory, though, doesn't explain why entry and prices are regulated in some industries but not in others. For example, prices for many utilities (electricity, telephone, natural gas, water, and sewer services) were nearly universally regulated, while prices for food, housing,

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[6] William J. Baumol, John C. Panzar, and Robert D. Willig, *Contestable Markets and the Theory of Industry Structure* (New York, NY: Harcourt Brace Jonavovich, Inc., 1982). See also Sanford Ikeda, "Market Process," in *The Elgar Companion to Austrian Economics*, Peter J. Boettke, ed. (Cheltenham, UK: Edward Elgar Publishing, Inc., 1994), p. 25.

[7] William J. Baumol, *Regulation Misled by Misread Theory*, 2005 Distinguished Lecture, AEI-Brookings Joint Center for Regulatory Studies, 2006.

[8] Yale Brozen, *Is Government the Source of Monopoly? and Other Essays* (Washington, DC: Cato Institute, 1980).

[9] Dominick T. Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (Oakland, CA: The Independent Institute, 1990); Richard A. Posner, *Natural Monopoly and Its Regulation* (Washington, DC: Cato Institute, 1969, reprinted 1999).

[10] George Stigler, supra note 2.

[11] See James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor, MI: University of Michigan Press, 1962); William A. Niskanen, Jr., *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971); James D. Gwartney and Richard E. Wagner, eds., *Public Choice and Constitutional Economics* (Greenwich, CT: JAI Press, Inc., 1998).

and personal computers were never regulated. Some traditional utilities have been or are being deregulated, along with railroads, airlines, and trucking. Either the demand to be regulated varies from industry to industry and over time, or the supply—the willingness of policymakers to approve regulation—is determined by something more than campaign contributions and perks.

Before introducing a new theory of regulation, let's review the literature on why regulatory reform is needed.

Regulation and Economic Growth

Regulations impose costs, and those costs affect economic growth in much the same way as taxes and the cost and quality of public services. Regulations can raise the cost of doing business in a state and as a result hurt the competitiveness of a state's businesses, eventually leading to a loss of markets, capital, and skilled management and labor.

> The cost of regulations at all levels in the U.S. is estimated to be more than $1.5 trillion per year.

Evidence of the negative effects of regulation on economic growth was found at the international level in a recent econometric analysis showing "a strong causal link between regulatory quality and economic performance."[12] Annual rankings of countries by their "economic freedom" also find close correlations between economic growth and indices of freedom, with regulations being an important part of the indices.[13]

The cost of regulations at all levels in the U.S. is estimated to be more than $1.5 trillion per year.[14] Studies of regulations at the national level in the U.S. have found many regulations impose costs much greater than the benefits they create.[15] Money spent complying with regulations reduces people's incomes, giving rise to health and accident risks that must be taken into account when measuring the net benefit of the regulations. Economists estimate that every $15 million in additional regulatory compliance costs induces one fatality due to lost income.[16]

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[12] Hossein Jaliliana, Colin Kirkpatrick, and David Parker, "The Impact of Regulation on Economic Growth in Developing Countries: A Cross-Country Analysis," *World Development*, Vol. 35, #1, January 2007, pp. 87-103. See also Giuseppe Nicoletti and Stefano Scarpetta, *Regulation, Productivity, and Growth: OECD Evidence*, Policy Research Working Paper, The World Bank, January 2003.

[13] The Heritage Foundation and Wall Street Journal, *2008 Index of Economic Freedom*, http://www.heritage.org/Index/; James Gwartney and Robert Lawson, *Economic Freedom of the World 2007 Report,* Fraser Institute, http://www.freetheworld.com/release.html.

[14] Americans for Tax Reform Foundation, "Cost of Government Day: 2008 Report," http://www.atr.org/content/pdf/2008/july/071508ot-cogdreport.pdf

[15] Robert W. Hahn, *In Defense of the Economic Analysis of Regulation* (Washington, DC: AEI-Brookings Joint Center for Regulatory Studies, 2005), pp. 41ff.

[16] Randall Lutter et al., "The Cost-Per-Life-Saved Cutoff for Safety-Enhancing Regulations," *Economic Inquiry*, Vol. 37, No. 599 (1999), p. 608.

John Dawson, an economist at Appalachian State University, recently examined the correlation between federal regulation—measured by the number of pages in the *Federal Register*—and output per unit of capital, economic growth, and productivity.[17] He found that every 1 percentage point increase of the ratio of regulation to capital correlates with a .24 percentage point decrease in capital productivity. Regulation "reduced aggregate output substantially, both by shifting the level of output down and by reducing outputs trend growth rate," he concluded.

There also is extensive evidence that regulation at the state level has powerful effects on economic growth. A comprehensive review of literature on the subject conducted in 1994 by Robert Krol and Shirley Svorny, both professors of economics at California State University - Northbridge, found the following:[18]

There also is extensive evidence that regulation at the state level has powerful effects on economic growth.

- "... state restrictions on bank activities—such as within-state branch banking and interstate banking—increase bank costs and reduce competition."
- shipping rates in Florida fell almost 15 percent in the two years following intrastate trucking deregulation. A model using data on intrastate trucking in California and Nebraska forecast that deregulation would lead to a 30 percent reduction in shipping rates.
- "... a 10 percent increase in a state's minimum wage reduces teenage employment by 1 to 3 percent. This finding is consistent with evidence from time-series studies of the U.S. economy as a whole."
- "... a 1 percent increase in workers' compensation rates causes employment to decline by .11 percent."
- "... adoption of wrongful termination laws reduces state employment between 2 and 5 percent."
- "... dental fees are significantly higher in states unwilling to automatically license dentists licensed in other states. Those states also employ fewer dentists."

Consumer Protection

Regulation may be cumbersome and expensive, but this does not mean it is without some benefit. Consumer protection is often cited as the reason regulations are necessary, and few would argue against having some safety standards. But calls for such regulations are increasingly out-of-step with sound science and economics. Terrence Scanlon, former chairman of the

[17] John W. Dawson, "Regulation and the Macroeconomy," *Kyklos,* Vol. 60, #1 (2007), pages 15–36.

[18] Robert Krol and Shirley Svorny, "Regulation and Economic Performance: Lessons from the States," *The Cato Journal*, Vol. 14, No. 1 (Spring/Summer 1994), pp. 55-64.

Consumer Product Safety Commission, wrote recently:

> ... there is often a great deal of political sleight-of-hand involved in regulation. The public sees media stories showing some heretofore undiscovered horror from which only government can rescue us. New rules are issued, and regulators proclaim how they have saved motherhood and apple pie. But often unseen in the background are advocacy groups that package sensational—and, too often, wildly distorted—data for a media on the lookout for bad news. Press coverage in turn helps these groups push through new regulations or laws. These organizations also play important roles in related litigation, bringing cases against regulatory agencies and providing behind-the-scenes support for trial lawyers.[19]

People often are attracted to these calls for action out of a feeling that such government activism is the continuation of the good intentions and sometimes good results of the Progressive Era. But today's professional consumer activists have little in common with that historic movement, as Tom Holt, a national award-winning writer and journalist, points out:

Today's consumer movement does not consider free markets, individual liberty, and technology as guarantors of consumer well-being.

> What began nearly a century ago as a movement concerned primarily with working conditions and product quality has become a professionalized cadre of activists eager to redistribute wealth and put limits on consumer choice. Today's consumer movement does not consider free markets, individual liberty, and technology as guarantors of consumer well-being. It would substitute the judgment of a governing elite armed with the power of regulation to save consumers from themselves.[20]

"Consumer groups," Holt goes on to write, "see their role not so much as ombudsmen in a marketplace of increasingly complex products—a role amply filled by numerous for-profit specialty publications—but as an adjunct of government whose purpose is to mitigate the everyday consequences of individual error and impose predictable social uniformities."[21]

Other consumer advocates have reached the same conclusion. ABC News correspondent John Stossel, who won several Emmy Awards as a consumer reporter before becoming cohost and feature story producer for "20/20," has lamented the role he played over the years as a patsy for some of these advocacy groups. In his book *Give Me a Break*,[22] he critiques false alarms he

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[19] Terrence Scanlon, preface to Tom Holt, *The Rise of the Nanny State: How Consumer Advocates Try to Run Our Lives* (Washington, DC: Capital Research Center, 1995), p. vii.

[20] Tom Holt, ibid., p. ix.

[21] Ibid.

[22] John Stossel, *Give Me a Break: How I Exposed Hucksters, Cheats, and Scam Artists and Became the Scourge of the Liberal Media* (New York, NY: HarperCollins, 2004).

reported over the years concerning (in alphabetical order): airbags, ambulance service, asbestos, Aspen lead poisoning, breast implants, cigarette lighters, crack babies, dioxin, domestic violence, Erin Brockovich, ergonomics, forest fires, global warming, Love Canal, McDonald's coffee, milk price-fixing, organic food, private toilets, rent control, second-hand smoke, Times Beach, and vaccines.

Environmental Protection

No regulatory area generates more attention and emotion than environmental protection. Since the publication in 1962 of Rachel Carson's *Silent Spring*, millions of people have been concerned about the presence of "invisible poisons" in the air and water, put there by faceless corporations out to make a buck.

Like consumer protection regulation, the quest for environmental regulation began from a core of truth—we really were polluting the air and water during the 1950s and 1960s with potentially dangerous chemicals—but it then morphed into something else. Richard B. Belzer, at the time an economist with the Office of Management and Budget, asked in 1994, "Are we really trying to reduce risks to human health and the environment, or is environmental protection merely an expedient vehicle for the achievement of other political objectives? Those of us who defend the hard version of priority setting clearly believe our purpose is to reduce risk, whereas those who advocate the various 'soft' options and the alternatives raised at this conference seem to me to have other objectives in mind."[23]

"Are we really trying to reduce risks to human health and the environment, or is environmental protection merely an expedient vehicle for the achievement of other political objectives?"

Many researchers have documented the dramatic progress being made in cleaning the air and water in the U.S.,[24] yet environmental activists seldom acknowledge this progress. Fear, rather than facts, seems to be their currency, and political power rather than environmental protection seems to be their objective.

Because so much progress has been made in reducing pollution emissions, there is now little evidence that air pollution is a serious public health risk. To remain relevant, environmental activists have tried to "move the goal posts," arguing that public policy should be based on research and anecdotes that don't meet the standards for scientific accuracy and proof. The so-called "precautionary principle" claims that regulatory measures should be taken even if there is not full scientific assurance of a threat to human health or the environment.

[23] Richard B. Belzer, "Is Reducing Risk the Real Objective of Risk Management?" in Adam M. Finkel and Dominic Golding, eds., *Worse Things First? The Debate over Risk-Based National Environmental Priorities* (Washington, DC: Resources for the Future, 1994), pp. 168-169.

[24] See, for example, Steven F. Hayward and Amy L. Kaleita, *Index of Leading Environmental Indicators 2007*, Pacific Research Institute and American Enterprise Institute, 2007.

The precautionary principle is not just an abstract concept, though use of the phrase is relatively recent.[25] It is the premise behind the Delaney Clause in the U.S. Federal Food, Drug and Cosmetic Act of 1958, outlawing any food additive found to induce cancer in laboratory animals regardless of the magnitude of the dose, and the 1970 Clean Air Act, which requires states to meet National Ambient Air Quality Standards without consideration of costs. More recently it has appeared in various United Nations documents.

> The precautionary principle substitutes a regulator's judgment of risk for objective standards of scientific certainty.

The precautionary principle substitutes a regulator's judgment of risk for objective standards of scientific certainty, as well as the knowledge and choices of individuals. It claims that uncertainty doesn't matter because the possible consequences of inaction are simply too big to ignore, but this is an invitation to rely on junk science and to pass unnecessary regulations. Much of what passes for "science" in the environmental debate already is unreliable epidemiological data showing extremely small and inconsistent correlations. The situation is so bad that a recent article in a peer-reviewed journal was titled "Why Most Published Research Findings Are False"![26]

Telecommunications

Once passed, regulations are often difficult to change or repeal. Markets, on the other hand, can change quickly. This has been the story regarding telecommunications during the past two decades, and it is why telecommunications can teach us some important lessons about regulation.

Advances in information technology have made the creation and transmission of data, voice, and video in digital form extraordinarily fast, inexpensive, reliable, and flexible. This in turn has caused the convergence of technologies that previously delivered each type of information: printing (text), telephone and radio (sound), television and cable (video).

Convergence has blurred the borders between industries once thought to be distinct. At the facilities level, there no longer is a distinction between "voice" and "data" networks. From end to end, today's network infrastructure of digital switches, digital fiber optic lines, and high-speed computer processors and servers handles both types of traffic the same way. Regulators have struggled to keep up with these changes. Lawrence Gasman, a highly regarded economist and expert on communications issues, wrote all the way back in 1994:

> Convergence is changing fundamentally the way we think about information and communication services. Thus convergence is the ultimate nemesis of telecommunications regulation, for in the face of telecommunications convergence,

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[25] See Indur M. Goklany, *The Precautionary Principle: A Critical Appraisal of Environmental Risk Assessment* (Washington, DC: Cato Institute, 2001), pp. 4-5.

[26] John P.A. Ioannidis, "Why Most Published Research Findings Are False," *PloS Medicine*, Vol. 2, No. 8 (August 2005), pp. 0696-0701.

> regulators quite literally no longer know what they are talking about! In this setting, legal and regulatory limits are rapidly becoming overly strict, largely inapplicable, and generally destructive.[27]

All regulations eventually become obsolete, perhaps starting the day a bill becomes law.

Regulations are difficult to update and repeal because interest groups hire staff with expertise in the most arcane details of the laws, and often with personal relationships with elected officials who serve on oversight committees. Having invested time and resources in shaping and complying with existing regulations, these groups often line up to oppose change. In the telecommunications field, this has led telephone and cable companies and Internet content providers to wage fierce lobbying and public relations battles over access to networks and pricing.

All regulations eventually become obsolete, perhaps starting the day a bill becomes law. Technological change, which is most visible in telecommunications but is occurring in every part of the economy, makes regulatory obsolescence a bigger problem than ever before. Obsolete regulations impose unnecessary costs on businesses and consumers by discouraging innovation and rewarding investment in compliance and lobbying activities that produce little consumer value.

The lesson from telecommunications regulation is that one of the great but often unnoticed benefits of deregulation is not having to constantly revise and reform existing regulations. Markets are able to make millions of adjustments to the expressed interests of millions of consumers in a single day, while regulatory reform is invariably slow and confrontational.

The Johnston Test

The discussion so far has, I hope, made the case for a new and better theory of regulation. Current theories don't explain why some industries are regulated and others are not, or why the lists change over time. The lack of a sound theory of regulation has led to excessive and counterproductive regulation in many fields, and perhaps too little regulation in others. Defective theories, such as the precautionary principle, and special interest pleading have been attracted by the vacuum left by the absence of good theory.

Regulatory reform is a promising area for bipartisan cooperation. At the national level, deregulation of trucking, airlines, and other major industries started as a Democratic initiative and was carried on by Republican administrations. Paul London, who served in the Clinton administration from 1993 to 1997, says bipartisan support for free trade, judicious use of antitrust laws, and the repeal of price and entry regulation in key sectors of the economy "made

[27] Lawrence Gasman, *Telecompetition: The Free Market Road to the Information Highway* (Washington, DC: Cato Institute, 1994), p. 20.

the prosperity of the 1990s possible."[28] So how about the twenty-first century?

Enter James L. Johnston, an economist who nearly 15 years ago offered a theory of regulation that could provide the intellectual foundation for a new round of deregulation initiatives. Johnston retired in 1993 from his position as Senior Economist at Amoco Corporation, whose economics department he joined in 1975. His primary responsibilities while at Amoco included the economic analysis of public policy issues and the hedging of corporate risk. Prior to his employment at Amoco, Johnston served as an economist with the RAND Corporation, the Institute for Defense Analyses, and the Secretary's Office of the U.S. Treasury. He earned Bachelor's and Master's degrees in economics from the University of Southern California and did graduate work toward a Ph.D. in economics at UCLA.

Johnston's theory of regulation provides three things missing from the other theories.

Johnston observes[29] that industries are most often regulated when three conditions are present: the product or service is subject to substantial shifts in supply and demand, supply reliability cannot be achieved through precautionary stocks or other market techniques, and substantial social costs are incurred when supplies are interrupted. The intended effect of regulation in such cases is to improve the stability of supply by encouraging extra investment in reliability.

Johnston's theory explains why electric utilities and the supply of doctors, for example, are so widely regulated—electricity is difficult to store, and the social costs of a power blackout or a natural disaster causing thousands or millions of people to need medical care would be huge. It also explains why the emergence of new financial instruments (such as mutual funds and futures and options markets) and institutions (such as Underwriters Laboratories and J.D. Powers and Associates) makes regulation less necessary.

Johnston's theory of regulation provides three things missing from the other theories: a criteria or test for determining when regulation may be necessary, a measurable objective for regulation (reducing the social costs caused by the interruption of supply of key goods or services), and a place to look for ways to avoid the need for new regulations or for signs that an industry has outgrown the need for existing regulations (when new technologies or market institutions emerge that can stabilize prices without government mandates).

Johnston showed how theory explains the prevalence of regulation in 11 industries ranging from airlines and drugs to telephones and electric utilities. In the table on the following two pages, I use Johnston's reasoning to identify deregulation opportunities in six industries (two of them concerning health care). Following the table are a few closing remarks.

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[28] Paul A. London, *The Competition Solution: The Bipartisan Secret behind American Prosperity* (Washington, DC: AEI Press, 2005), p. 197.

[29] James Johnston, "A General Theory of Regulation and Deregulation," in *Deregulation of Energy: Intersecting Business, Economics and Policy,* Conference Proceedings, 17th Annual North American Conference, U.S. Association for Energy Economists, October 1996, pp. 145-154; James L. Johnston, "Which Industries Are Regulated?" *Policy Brief,* The Heartland Institute, July 17, 1996.

The Johnston Test
Why Are Some Industries Regulated? Could They Be Deregulated?

Industry	Why It Was Regulated	Why It Could Be Deregulated	Possible Ways To Deregulate It
Energy Production, Cars and Trucks, and Agriculture	The supply of environmental amenities was threatened by pollution and "sprawl," clean air and water and open space cannot be stockpiled for later use, and the social cost of the effects of pollution and pesticides on wildlife and human health were thought to be large and widespread.	Nearly all sources of pollution are now controlled, the supply of environmental amenities is ample and rising, and the health effects of current and expected levels of exposure to pollution and pesticides are known with scientific certainty to be extremely small. The cost of "chasing the last molecule" of pollution greatly exceeds the social benefits.	* Enforce existing emissions controls but do not make them more stringent * Subject current and proposed regulations to cost-benefit and comparative risk assessment * Screen out "junk science" from regulatory and legal procedures * Avoid imposing restrictions on carbon dioxide emissions * Encourage new sources of energy such as CNG and a new pipeline from Alaska
Labor Terms and Conditions	The supply of well-trained workers was threatened by strikes, low bids from out-of-state (often minority-owned) contractors for public works projects, and workplace injuries. Workers needed income support between jobs to facilitate the occupational mobility needed in the New Economy, and the social and political consequences of widespread labor unrest were viewed as unacceptable.	Workers today are more highly trained, compensated, and mobile, making labor relations less confrontational. Workplace safety has improved dramatically. Reliance on minority-owned businesses is no longer viewed as undesirable and is even promoted. Public-sector unionism, workers compensation insurance, and unemployment insurance have produced unintended negative consequences that may exceed their benefits.	* Adopt Right to Work laws * Reduce minimum wage laws to the federal level * Repeal prevailing wage laws for public construction projects * Repeal public-sector collective bargaining laws * Adopt paycheck protection laws * Reform workers compensation and unemployment insurance to increase worker and employer freedom
Legal Profession	A large supply of trained "officers of the court" was needed to ensure speedy resolution of private contract disputes and liability claims as well as criminal justice and constitutional law cases. A shortage of lawyers would threaten commerce and the administration of public justice.	The supply of lawyers in the U.S. is very large relative to other developed countries,[30] and the amount and cost of tort litigation are both much higher in the U.S. than in other countries. Globalization means our high litigation costs make U.S. businesses less competitive. Contingent fee and punitive damages arrangements have led to abuse of the legal system.	* Expand the use of arbitration and other methods of conflict resolution that do not require the use of lawyers * Repeal joint and several liability * Cap punitive damage awards * Cap pain and suffering awards * Cap contingent fees

[30] The ratio of lawyers to total population is much higher in the U.S. (one for every 265 residents) than in England (one for every 400 residents), Germany (593), France (1,400), and Japan (5,800). See http://wiki.answers.com/Q/What_country_in_the_world_has_most_lawyers_per_capita.

The Johnston Test
Why Are Some Industries Regulated? Could They Be Deregulated?

Industry	Why It Was Regulated	Why It Could Be Deregulated	Possible Ways To Deregulate It
Medical Professions	Competition among too many small and unregulated medical schools during the 1930s was thought to be lowering the quality and earnings of medical professionals. A large of supply of medical professionals is needed in the event of natural disasters or war. Large hospitals are necessary to coordinate care in the event of emergencies and to subsidize emergency room services.	Advances in technology and pharmacology have made it possible for physicians in the U.S. to deliver a superior standard of care relative to the rest of the world even though there are fewer physicians per capita here than in other developed countries.[31] The U.S. has lower waiting times for most medical services and higher cancer survival rates than any other country. Large general hospitals are increasingly obsolete.	* Repeal the ban on the commercial practice of medicine * Repeal Certificate of Need (CON) restrictions to encourage new investment in facilities and equipment * Lift restrictions on physician-owned hospitals * Lift restrictions on nurse practitioner autonomy to allow the creation of more outpatient clinics and "Minute Clinics"
Health Insurance	Society's ability to weather a major public health crisis caused by an epidemic or natural disaster is strengthened if everyone has health insurance and health insurance companies have sufficient reserves to cover all claims. This requires laws forcing insurance companies to cover everyone and socializing the cost of the difficult-to-insure.	Various kinds of mandates on who and what treatments must be covered have the effect of reducing rather than increasing the percentage of the population that is privately insured. Increased worker mobility is leading more people to buy insurance in the individual market, where traditional insurance regulation results in adverse selection problems.	* Repeal coverage mandates for optional medical services * Repeal guaranteed issue and community rating requirements, particularly from the individual insurance market * Remove bans on exclusionary waivers and relax or repeal entirely rate regulations * Create high-risk pools for the hard-to-insure * Allow interstate marketing and sales of insurance policies
Property and Casualty Insurance	The social costs of war or natural disasters are mitigated if private insurance is widely available, and if publicly subsidized insurance is available when private insurance is not. Requiring auto insurers to pay all claims ("no-fault" insurance) would reduce volatility in insurance claims by reducing lawsuits.	Heavy-handed regulation of forms and rates and a large residual market for homeowners insurance have reduced the number of people with private P&C insurance. The cost of increases in unnecessary hospital visits and insurance fraud have more than offset any litigation savings achieved by the "no-fault" insurance law.	* Reduce the size of subsidized residual market insurance programs * Repeal the no-fault auto insurance law * Reduce form and rate regulations to encourage innovation and competition * End restrictions on the use of credit scoring and territorial rating to set insurance prices

[31] The U.S. in 2003 had 2.3 physicians per 1,000 population versus an average of 2.9 per 1,000 population for the OECD. See http://www.oecd.org/dataoecd/15/23/34970246.pdf.

Conclusion

The table views current regulations through the lens of the Johnston Test. It posits that the reason these industries were regulated in the first place was to improve the stability of supply by encouraging extra investment in reliability. It asks whether the original conditions that may have called for regulation still exist and whether there are other ways to accomplish the same objective without relying on regulation.

This table is only a first attempt at an application of the Johnston Test, and perhaps as its author I am unduly dazzled by what I see as its promise. Regulations that economists often attribute to the organizing advantages of special interest groups become more understandable and even defensible when framed in this way. But in return for what may seem to be a concession to the pro-regulation side, some new light is shed on why we should *not regulate* or should *no longer regulate* some industries because times have changed.

I believe the table opens up a very large and exciting research agenda for college students and professors interested in making genuine contributions to the literature on regulation. Even better, the test seems simple and intuitive enough that it can be put to work immediately, by elected officials and non-specialists. This is the sort of tool that policymakers are looking for, to help them face the constant demands from interest groups to tweak existing regulations or add new ones.

Society could benefit to the tune of hundreds of billions of dollars a year by simply asking if current and proposed regulations are justified by the Johnston Test, and repealing those that flunk the test.

Finally, research on the cost of regulation suggests that society could benefit to the tune of hundreds of billions of dollars a year simply by asking whether current and proposed regulations are justified by the Johnston Test, and repealing those that flunk the test. Is this an impossible dream? Not really.

Regulatory reform ought to be an area where liberals and conservatives agree. Both sides, though, will need to give something up. Pro-business conservatives need to stop turning to government for rules and regulations that restrict entry into their industries, raise prices, or retard innovation. They need to stop defending current regulations that are no longer necessary or are actually harmful, but which provide some small benefit to incumbent businesses.

Liberals need to give up their romantic vision of what regulation could or should achieve. Regulation is not a magic wand that can protect people from invisible threats or turn anti-social behavior into good citizenship. They, too, need to stop defending regulations that are no longer necessary and stop calling for new regulations that aren't based on sound science and real public health risks.

I suppose that time will tell if this is asking too much of either group.