Policy Headwinds

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Every country is inside the policy frontier in key respects that affect productivity

- Schooling quality
- Labor market adaptability
- Transport infrastructure
- Trade/FDI Openness
- Rule of Law
- Efficiency of legal system
- Tax distortions and compliance burdens
- Regulatory complexity
- Ease of doing business
- Product market competition
- Management practices
- Science & engineering capabilities
Today: Two Topics

1. Regulatory Overreach
2. Policy Uncertainty
   - Global Context
   - U.S. Trade Policy
**Code of Federal Regulations** Page Count, 1949 to 2015

Page counts do not include executive memoranda, regulatory guidance, and other regulatory “dark matter.”

180,000 pages = 133 King James Bibles!

Updated from Davis (2015), who draws on Dawson and Seater (2013) and Crews (2016)
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Simply describing the US Tax Code takes
Another 70,000 pages = 52 more bibles!

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Economic Costs of Federal Regulation: How Large?

Based on a compilation of studies, Crews (2016) estimates an annual federal regulatory burden of nearly $2 trillion in 2015.

• That’s about 11% of GDP and nearly $15,000 per household, or 22% of average household income.
• Direct federal spending in 2015 was about $3.7 trillion → federal regulatory burden was more than half as large as all federal spending.
• Federal individual and corporate income tax receipts in 2015 were about $1.8 trillion

Dawson and Seater (2013) estimate much larger regulatory burdens due to cumulative growth effects.
Only 5% in mid 1950s; 10% by 1965,


25% by 2008

Figure 1: Difference in Migration Rates of Workers in Most vs. Least Licensed Occupations

Source: Census Bureau, American Community Survey 2010-2013; CEA Calculations. Number is calculated from an OLS regression controlling for race, citizenship, sex, citizenship, number of children, marital status, education, income, year, and state. Ages 25 to 65 were included.

Disproportionate Regulatory Effects On Smaller and Newer Businesses?

Yes, despite some small-firm exemptions. Why? Three basic reasons:

1. Scale economies in compliance $\rightarrow$ higher compliance costs per unit of output (or per worker) at smaller firms
2. One-time costs of developing compliance systems and knowledge $\rightarrow$ favoring incumbents over entrants
3. Larger & incumbent firms have more capacity & incentive to overcome collective action problems in lobbying
Employment in firms less than five years old fell from 17.6% of private sector employment in 1981 and 15.9% in 1988 to 8.2% in 2013.

“Young” means < 60 months since the firm first had a paid employee, as of March in the indicated calendar year.

Source: Annual Rates, Business Dynamic Statistics (BDS)
What to Do about Regulatory Overreach and Complexity?

1. Design for Simplicity
   - Carbon taxes instead of command-and-control regulations
   - High capital requirements on banks instead of detailed rules

2. Require Congressional approval of significant new regulations and interpretations
   - NLRB assertion that franchisors are “joint employers”

3. Suspend regs that lack or fail cost-benefit test, as judged by an independent commission

4. Shot clocks on reviews & project permitting

5. Restrict use of “guidance” in lieu of regulations
Policy Uncertainty Around the Globe

Recent and Ongoing Episodes


– **Europe**: Sovereign debt & banking crises in Eurozone, immigration crisis, Brexit

– **China**: Leadership transition circa 2012, stock market missteps, aggressive sovereignty claims in South China Sea

– **Russia**: Annexation of Crimea, ongoing Ukraine conflict, weak rule of law

– **Turkey**: Failed coup attempt, crackdown

– Brazil, Middle East, ...
Global EPU Index, January 1997 to October 2016

Using data for 16 countries that account for 2/3 of global GDP

Notes: Global EPU calculated as the GDP-weighted average of monthly EPU index values for the US, Canada, Brazil, UK, Germany, Italy, Spain, France, Netherlands, Russia, India, China, South Korea, Japan, Ireland, and Australia, using GDP data from the IMF’s World Economic Outlook Database. National EPU index values are from www.PolicyUncertainty.com and Baker, Bloom and Davis (2016). Each national EPU Index is renormalized to a mean of 100 from 1997 to 2015 before calculating the Global EPU Index.
2016 U.S. Presidential Election

Trump’s surprise win in the presidential election contest brought greater economic uncertainty in several policy areas, including:

– U.S. trade policy
– U.S. immigration policy
– Institutional independence of Fed
– U.S. support for traditional allies and alliances that undergird the global economic and security order – NATO, South Korea, Japan, ...
U.S. Daily Economic Policy Uncertainty Index
1 June to 13 November 2016

Brexit

Fiscal Cliff – 7 Days Ending 31 Dec 2012: 332

Election

November 13
November 9
November 8

Trade Policy and the Dog that Bit: The Smoot-Hawley Tariff Act of 1930

**Economic backdrop:** 1929 stock market crash and early stages of the Great Depression.

**Professed Goal:** Protect American farmers and jobs from foreign competition.

**Policy Response:** The Smoot-Hawley Tariff Act, signed into law in June 1930, raised U.S. tariffs on 20,000+ imported goods to record levels.

**Result:** Trade war and trade collapse that worsened the Great Depression and took decades to fully unwind.
Trade Policy Uncertainty: Barking Dogs

Even the possibility of trade barriers inhibits investment, new product development and supply chain improvements in export and import activities and markets. **Barking trade dogs are harmful, not just the ones that bite.**

Trump’s campaign statements about trade policy, coupled with his surprise election victory, triggered a large depreciation in the Mexican Peso and other EM currencies. That will make things harder for exporting and import-competing firms in the United States.
Going forward after the election...

• The election outcome improved prospects for tax reform, fiscal stimulus, and a lessening of regulatory burdens.

• But it also intensified domestic and global uncertainty in key respects – trade, immigration and security policy, in particular.

• Unless managed, greater policy uncertainty and the prospect of harmful policies will exert a drag on trade, investment, hiring and growth in the U.S. and around much of the world.
Going forward after the election...

- President-elect Trump can improve the prospects for a strong economic performance by reassuring investors, businesses, trading partners and allies that the U.S. will not disrupt the WTO or abrogate existing trade and security treaties.
- There is great need for reassurance with respect to trade policy and security policy.
- There is also much need to reassure people who fear for their personal freedoms and security in the aftermath of the election outcome.
Additional Slides – Not for Prepared Remarks
References


Distance from World Bank’s Ease-of-Doing-Business Frontier

Defined by the best country-level scores for starting a business, dealing with construction permits, trading across borders, etc.

From “Ending America’s Slow-Growth Tailspin,” Cochrane, WSJ, 2 May 2016
Mean Time to Fill Open Job Positions in the U.S.
January 2001 to September 2016

<table>
<thead>
<tr>
<th>Month</th>
<th>Mean Time to Fill (Working Days)</th>
</tr>
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<tbody>
<tr>
<td>June 2006</td>
<td>21.5</td>
</tr>
<tr>
<td>July 2009</td>
<td>15.4</td>
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<tr>
<td>April 2016</td>
<td>29.5</td>
</tr>
<tr>
<td>September 2016</td>
<td>28.0</td>
</tr>
</tbody>
</table>

Source: DHI Hiring Indicators at [http://dhihiringindicators.com](http://dhihiringindicators.com).
Annual Rates of Job Reallocation, U.S. Private Sector, 1979-2011

Job Reallocation = Job Expansions + Job Contractions
Divide by the level of employment to express as a rate.

Quarterly Worker Reallocation Rates by Gender, Age and Schooling Attainment

The Baker-Bloom-Davis EPU Indices rely on computer-automated newspaper searches

How it works for the United States:

• For 10 major US papers, get monthly counts of articles that contain at least one word from each of three term sets:
  
  **E**: \{economic or economy\}
  
  **P**: \{regulation or deficit or “federal reserve” or congress or legislation or “white house”\}
  
  **U**: \{uncertain or or uncertainty\}

  Include “the Fed”, “regulatory” and other variants.

• Scale the EPU count for each paper and month by the count of all articles in the same paper and month

• Standardize each paper’s scaled count to unit St. Dev., then average over the 10 papers by month to get the U.S monthly index
Figure 2: US Historical Index of Economic Policy Uncertainty

Gold Standard Act
McKinley Assassination
Start of WW I
Imigration Act of 1924
Great Depression, New Deal and FDR
Versailles Conf.
Great Depression Relapse
Truman-Dewey election
Wage & Price Controls
OPEC I
OPEC II
Tet
Gulf War I
Gulf War II
Asian Financial Crisis
9/11
Fiscal Cliff
Lehman and TARP
Debt Ceiling

Adding “tariff” and “war” to the P term set, and expanding the E term set.

Notes: Index reflects scaled monthly counts of articles in 6 major newspapers (Washington Post, Boston Globe, LA Times, NY Times, Wall Street Journal, and Chicago Tribune) that contain the same triple as in Figure 1, except the economy term set includes “business”, “commerce” and “industry” and the policy term set includes “tariffs” and “war”. Data normalized to 100 from 1900-2011.
Figure 2. An Upward Drift in Policy-Related Economic Uncertainty

Newspaper-Based Index of Economic Policy Uncertainty (EPU)

Source: Baker et al. (2014). Data are annual averages of monthly values from 1949 to 2012.
Selected category-specific EPU Indices, Quarterly

Notes: Indices reflect scaled monthly counts of articles containing the same triple as in Figure 1 and one or more terms pertaining to national security (e.g., “war”, “terrorism”, or “department of defense”) and healthcare (e.g., “healthcare”, “hospital”, or “health insurance”), respectively, for the National Security and Healthcare indices. Each series is normalized to mean 100 from 1985-2009 and based on queries run Jan 18, 2015 on Access World News Newsbank newspaper archive, which covers about 1,500 US papers.
Financial Regulation Uncertainty Index, 1985 to 2014, Quarterly

Notes: The index reflects the frequency of newspaper articles about economic policy uncertainty and financial regulatory matters, as indicated by terms like “bank(ing) supervision,” “Glass-Steagall,” and “Dodd-Frank.” Data are from Baker, Bloom and Davis (2016) and are available and updated monthly at www.PolicyUncertainty.com. Normalized to a mean of 100 from 1985 to 2009.
Policy Uncertainty Measures Based on Textual Analysis of the Fed’s Beige Books and Section 1A (Risk Factors) of Firms’ 10K Filings

Notes: The left scale shows frequency counts per Beige Book (normalized by word count) of “uncertainty” and references to policy uncertainty. The right scale reports the percentage of sentences in Section 1A (Risk Factors) of annual 10-K filings that contain one or more of the policy terms listed in Appendix C. The correlation between the Beige Book Normalized Policy Uncertainty Count and the EPU index is 0.54.
The Beige Book is issued about once every six weeks, two weeks before each regularly scheduled FOMC meeting. The counts above and on the next three slides reflect human readings of Beige Book passages that mention “uncertainty”. Source: Baker, Bloom and Davis
Pre-WTO Trade Policy Uncertainty Facing Chinese Exporters to the U.S.

Policy uncertainty faced by China’s exporters in US pre-WTO

- Granted MFN status in US since 1980 (same tariffs as GATT/WTO members) BUT subject to annual renewal
- Congress voted to revoke MFN status yearly in 90s (House passed 3 times!)
- 2000: Congress passed permanent MFN status conditional on WTO accession

Acceleration of Chinese Exports to the U.S.

From 1990 to 2010: Chinese imports rose from 3% to 19% of U.S. imports. They rose from 2% to 11% in the rest of the world.

China’s accession to WTO in December 2001 and implementation of permanent Status in January 2002
Very little change in actual U.S. tariffs on Chinese imports upon China’s accession to WTO, because MFN tariff schedule was almost the same as the WTO schedule.

China’s accession to WTO in December 2001 and implementation of permanent Status in January 2002
Acceleration of Chinese Exports to the U.S.

No comparable acceleration of Chinese Exports to EU countries. No comparable Acceleration of Taiwanese exports to the United States.

China’s accession to WTO in December 2001 and implementation of permanent Status in January 2002.
Countercfactual effect on China’s share of US imports if pre-WTO uncertainty continued

Barking dogs → trade policy uncertainty → lower trade growth on counterfactual path. These negative expectational forces involve large roles for both mean and uncertainty effects.