Introduction

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Regulation is suddenly back in fashion. After more than thirty years of deregulation being all the rage, the financial crisis of 2007 to 2009 has dramatically changed attitudes about the proper role of government. The market fundamentalism that drove far-reaching deregulation now looks more like a passing fad than the classic staple of political economy it was advertised to be.

At the same time, current thinking about regulation may not be as fresh as its promoters imagine, based to a large extent on ideas that were in vogue back in the 1960s. Market failure theory was then in its heyday. Every college student taking Econ 101 learned that although rational individuals typically maximized the welfare of the whole society simply by pursuing their own self-interest, Adam Smith's invisible hand occasionally (and sometimes spectacularly) broke down. A factory, for example, might spew too much smoke into the air if its owners did not have to bear the costs of the resulting pollution. Concern about "negative externalities" of this sort became a powerful justification and driver of environmental regulation. And this was just one piece of a larger whole, since market failure theory was used to justify a wide range of government interventions, from antitrust law to social insurance.

Market failure theory encompasses a powerful set of ideas, and it will inevitably remain a pillar of any modern approach to regulation. But it should not be the only—nor perhaps even the principal—intellectual foundation for a new era of regulatory engagement. Since the 1960s, influential new research on government failure has helped to drive the movement for deregulation and privatization. Yet even as the study of government failure was flourishing, some very different ideas were sprouting in the social sciences with profound implications for our understanding of human behavior and the role of government. Some of these ideas, particularly from the field of behavioral economics, have begun to nudge their way into discussions of regulatory purpose, design, and implementation. Yet even here, the process is far from complete; and many other exciting new lines of research—on everything from social cooperation to co-regulation—have hardly been incorporated at all.

Now that many lawmakers and their constituents have apparently concluded that the earlier focus on government failure went too far, it is imperative that they be able to draw on the very latest academic work in thinking anew about the role of government. This, at root, is the purpose of this book: to make the newest and most important research accessible to a broad audience, expanding our conception of both the possibilities and the potential pitfalls of economic regulation at a time of great turmoil in the global economy.

The seven chapters that follow offer seven different perspectives on the subject:

- **Market failure perspective.** Joseph Stiglitz gets things started in chapter 1 with a new look at market failure, which he suggests may be far more extensive—and more damaging—than generally believed.
- **Behavioral perspective.** In chapter 2, Eldar Shafir, Sendhil Mullainathan, and Michael Barr move beyond market failure, showing how a better understanding of the limits of individual rationality can inform better regulation—to protect consumers (against "teaser rates" in subprime mortgages, for example) and to ensure that markets reward producers who make us better off rather than exploit our limitations.
- **Cooperative perspective.** In chapter 3, Yochai Benkler suggests that self-interest is only a relatively small part of what drives human behavior, and he explores how successful experiments in social cooperation (in the collective production of Wikipedia, for example) can serve as a guide for the structuring and regulation of economic activity.
- **Risk management perspective.** Tom Baker and David Moss highlight the government's critical role as a risk manager in chapter 4; they reveal this as one of government's most important and successful functions (in policies ranging from Social Security to the FDIC) and, importantly, lay out the basic dos and don'ts of public risk management.
- **Experimental perspective.** Michael Greenstone argues in chapter 5 that we can dramatically strengthen regulation of all kinds by building experimentation into the process of policymaking, developing a culture of testing (modeled after medical drug and device testing) that privileges empirical evidence over theory in the making of regulatory policy.
- **Co-regulation perspective.** In chapter 6, Ed Balleisen and Marc Eisner take up the fascinating (and highly controversial) subject of co-regulation, drawing on a growing international literature to show how best to harness private industry in regulating itself and, at the same time, providing a clear set of criteria for when government-monitored self-regulation is most likely to succeed or fail.

- **International Perspective.** Finally, in chapter 7, Rawi Abdelal and John Ruggie adopt an international perspective, demonstrating the importance of seeing regulation as part of a larger societal bargain, in which citizens accept the risks and impositions of globalization in return for a degree of social security and a sense of shared values at home.

Although regulation is now back in fashion (at least for the time being), the success or failure of regulatory reform will ultimately be decided by substance rather than style. Policymakers must have access to the very best ideas; and they could soon find themselves on the defensive if they have to rely exclusively on the same ones that their predecessors depended on thirty or more years ago. Fortunately, in the intervening years, scholars have developed new ways of thinking about regulation—new perspectives that we hope will make a positive difference, helping to strengthen policymaking at this critical moment in the life of the nation.