

## THEORIES OF REGULATORY IMPACT: THE ROLES OF THE REGULATOR, THE REGULATED, AND THE PUBLIC

*William D. Berry*

Many of the theories of regulation in economics and political science are attempts to predict and explain the impacts of regulatory policy. The explanation of regulatory outcomes differs from theory to theory, partly because the theories focus on different participants in the regulatory process. And although the literature points toward *three* key actors or participants in the regulatory process—(1) the regulatory agency, (2) the regulated group, and (3) the public—rarely has the behavior of all three actors been considered in a single coherent theory. This paper reviews some of the major theories in order to demonstrate their failure to examine the role of these three actors in the regulatory process. The central thesis of this paper is that an explanation of the outcomes of the regulatory process requires an analysis of variation in the *incentives* and *goals* of the three key actors, and of the *resources* they command.

### TRADITIONAL THEORIES OF REGULATION

Three traditional theories of regulation—each pointing toward “regulatory capture” or “regulatory failure” as the dominant outcome of the regulatory process—offer important insights into the nature of regulation. The first includes theories of “commission inadequacy” which focus on the weaknesses of regulatory personnel and the inadequacy of other commission resources. The other two sets consist of “group theories” of regulation which view regulation as distributing benefits to powerful groups in society. One of these latter two sets is composed of theories in political science; the other contains scholarship by a number of economists.

#### **The Theories of Commission Inadequacy**

A number of scholars have argued that regulatory commissions are unable to implement their mandate to protect the public interest due to the weakness of agency personnel and the inadequate operating resources available to them. Frankfurter (1930:115) and Mosher and Crawford (1933:81), for example, maintain that both regulatory commissioners and their staffs lack the technical competence to deal with the intricate economic problems facing most regulatory bodies. Others point not only to the incompetence of regulatory personnel, but to the inadequacy of staff size for meeting the demands of regulation (Fesler, 1942:21; Trachsel, 1950:153). In addition, regulatory failure has been attributed both to insufficient commission funding, and to the related problem of inadequate salaries for commissioners and staff (Frankfurter, 1930:115; Trachsel, 1950:153).

#### **Group Theories of Regulation: Political Scientists**

Several political scientists have advanced theories of regulatory impact grounded in a view of the regulatory process as a struggle among private

group interests. Bernstein's (1955) "life-cycle" theory of regulatory commissions suggests that as commissions age, they go through a natural cycle of decay, and shift from being strong advocates of consumer interests to passive effectors of the interests of the regulated group. He suggests that a commission's creation is characterized by a struggle between the diffuse majority favoring regulation (the consuming public) and a powerful minority interest resisting regulation (the regulated group). Once an agency is created, the public loses interest. In contrast, the regulated group—united by a more concrete and salient interest in favorable regulation—maintains interest. Faced with such a pattern of group interest, the regulatory agency gradually adopts a posture of protecting the interests of the regulated group.

Bernstein's focus on *time* or *age* as a crucial variable is unreasonable. While certain agencies empirically exhibit Bernstein's pattern of "decay" over time; time or age is not the explanation. Rather the decay can be attributed to a change over time in the pattern of interests, incentives and resources among the commission, the public, and the regulated group. In the case of some regulatory agencies, the shifting pattern of resources and incentives among participants does not follow the cycle expected by Bernstein. Some regulatory commissions (e.g., the Interstate Commerce Commission (ICC)) may start out dominated by the regulated industry and become more "pro-consumer" in orientation over time (Posner, 1974:342).

In a theory consistent with Bernstein's, Edelman (1964) argues that when the public—which is not organized to protect its economic interests—faces a threat to these interests, it often is satisfied with a "symbolic reassurance." In many regulatory contexts, this symbol takes the form of the enactment of legislation creating a regulatory commission and including strong *written* assurances that the threat to the "public interest" will be averted. Edelman argues, however, that the ultimate impact of commission policy does not conform to the symbolic reassurance; public satisfaction with symbolic benefits allows the better organized regulated group to obtain tangible (as opposed to symbolic) benefits.

Wilson (1974) has developed a typology of regulatory environments and predicted that regulatory behavior is likely to differ in various interest group contexts. He argues that the extent to which the costs and benefits associated with a regulatory issue are concentrated determines the nature of the organizational activity of the groups with interests in the outcome. When the benefits to be obtained or the costs to be avoided fall on a small group, political organization and political action will be easier to motivate than when the benefits or costs fall on a larger group. This is the result of two factors: (1) the greater incentives for action for those in the small group [as suggested by Olson's (1965) "logic of collective action"], and (2) the greater ease of organizational activity in the small group due to the probable greater homogeneity in interests and beliefs of members.

Each of these theories predicts a similar outcome for a regulatory process which places the interests of the unorganized public against those of a small regulated group: the ultimate dominance of the interests of the regulated group in regulatory decisions. The explanations that Bernstein, Edelman and Wilson provide for such an outcome are also similar. While each stresses somewhat different factors, each focuses on the difference

between the regulated group and the consuming public in terms of (1) economic stakes and degree of interest in regulatory outcomes, (2) incentives for political action to influence regulatory policy, and (3) ease of organization.

### **Group Theories of Regulation: Economists**

In the 1970s, economists developed several "group theories" of regulatory impact which are similar to the political science theories in predicting that the ultimate beneficiaries of regulation will be politically effective groups (Stigler, 1971; Noll, 1971; Peltzman, 1976; Jarrell, 1978). They are different, however, in that they set out specific assumptions about the nature of the *incentives* and *goals* of regulators and argue that these goals are rationally pursued by providing benefits to selected private groups. Thus regulators are given an *active* role in these theories. Political science group theories of regulation tend to be less explicit about regulator incentives, essentially viewing regulators as arbitrators of group interests, and offering little explanation for why the decisions of regulators tend to serve the interests of politically effective groups. The economists realize that a theory of regulation should explicitly conceptualize the regulator as an actor in the process, and recognize that the regulator has identifiable interests which, together with the positions of interest groups, help determine the outcomes of the regulatory process.

Stigler's (1971) is the most influential of these theories of regulation. He views regulation as a commodity *supplied* by the state and *demand*ed by private groups, and argues that its provision can be predicted by analyzing the interaction between supply and demand. He assumes that the state has as a "basic resource . . . the power to coerce," but that private groups (industries and consumers) have varying demands for this power. The structural characteristics of a group determine the nature of its demand schedules for regulation, i.e., the amount that the group is willing to pay to benefit from each of the state's coercive powers. The structure of the state's political processes, on the other hand, determines the supply of regulation. Stigler assumes that decisions are made by elected representatives organized into political parties. In order to get elected and remain in office, parties need a coalition of political support. According to Stigler, a private group seeking to use the state's coercive power for its own benefit must pay for these services via the party with "votes and resources."

Stigler's theory is weakest on the supply side. His assumption that government has the power to coerce, and will provide regulatory benefits to groups that are willing and able to pay for them with votes and resources, is too simplistic. It fails to recognize the possibility of variation among governments (i.e., among regulators) in the degree of power to coerce. A more appropriate theory of regulation would assume that regulators have certain goals and incentives, but that regulators vary in the amount of resources they can bring to bear in implementing their goals. In short, both regulators' preferences and resources must be assumed to affect the nature of the "supply" of regulation.

Noll (1971) presents a theory of regulation which assumes that the primary goal of a regulatory commissioner is to satisfy a "negative success

indicator" by making decisions which minimize the likelihood of being over-ridden by Congress or the courts. It is expensive for any group to fight an unfavorable commission decision either in the courts or in the legislature. But Noll argues that for an unorganized group of consumers, the cost of such political action is even greater than that for a regulated industry. As a result, Noll predicts that a regulatory agency will make decisions more in line with the preferences of the regulated industry than with the interests of consumers.

Hilton (1972) suggests that the future-employment goal of regulatory commissioners is the major reason for the industry-protection orientation of most commissions. Since the political executives appointing regulatory commissioners generally serve shorter terms than their appointees, commissioners are not likely to be reappointed. This encourages commissioners to be heavily concerned with opening post-commission career opportunities. Noting that employment in the regulated industry is "one of the most obvious opportunities" for commissioners after leaving office, Hilton predicts that commissioners will adopt an industry orientation to avoid antagonizing the industry they hope to be able to join.

### **The Consumer Interest Activated**

Traditional group theories of regulation rely on logic similar to Olson's (1965) to argue that consumers obey the "logic of collective action," and therefore lack sufficient interest in regulatory outcomes to motivate consumer involvement in the regulatory process (Noll, 1971; Wilson, 1974). Although Bernstein (1955) argues that consumers are involved to the extent that they are partly responsible for the creation of a regulatory commission, he maintains that their interest is only temporary, and that a decline in their involvement is inevitable. But the absence of consumer interest and involvement is not always true; in some cases the public has a strong interest in regulatory issues (Jones, 1975), and in some cases consumer groups are active as direct interveners in regulatory proceedings (Gellhorn, 1972).

Sabatier (1975) offers one of the few theories of regulation recognizing the variability of consumer interests in regulatory policy. He argues that Bernstein's "cycle of decay" is not inevitable; the most important factor in preventing the cycle of decay resulting in regulatory capture is the presence of an organized "supportive consumer constituency" which (1) monitors the activities of the regulatory agency, (2) intervenes directly to influence agency decisions (largely via testimony at hearings), and (3) must be capable of influencing the agency's sovereigns when the commission begins to show signs of decay.

Weingast (1978) also presents a theory allowing for consumer influence on regulatory policy, but rejects the assertion that only organized groups will have such influence. His theory assumes that all groups participating politically on a regulatory issue receive benefits, and allows for the influence of consumers participating electorally. Specifically, Weingast assumes that regulatory decisions are made by a representative legislature, and that consumer/voters influence these decisions through their vote choices for competing legislative candidates; electoral competition forces

legislators to take the policy positions of the "representative voter" in their districts.

## ASSESSMENT OF THE LITERATURE

This review suggests that there are *three* important actors or potential participants in the regulatory process: (1) the regulator, (2) the regulated group, and (3) the public or consumers groups. But none of these theories of regulatory impact is based upon a careful analysis of variation in the characteristics of all three actors. Accordingly, a more complete theory of regulation which considers variation in the roles of all these actors in the regulatory process is needed.

Many theories completely ignore one or more of the actors. Some rely on characteristics of consumers and the regulated industry, while ignoring the role of the regulator. For instance, Wilson's (1974) and Edelman's (1964) theories contain no analysis of the incentives or resources of the regulatory body. The "commission inadequacy" theories, on the other hand, focus on characteristics of the regulatory commission to the virtual exclusion of industry and consumer characteristics. In those theories in which characteristics of the regulator are central to the theory, the full range of important characteristics of the regulator are rarely considered. The "commission inadequacy" theories essentially focus on the limitations of commission resources to explain regulatory failure; little is said about commissioner incentives or goals. In contrast, many of the economic theorists carefully describe the goals of regulators, but pay little if any attention to the proficiency of commissions in meeting their goals (Stigler, 1971; Peltzman, 1976; Weingast, 1978); in this sense the resources of the regulator are ignored.

Often, when the characteristics of an actor *are* considered, a theory inappropriately treats these as constants rather than variables. Regulators are typically assumed to have objectives and incentive structures which are uniform across all regulators (Stigler, 1971; Hilton, 1972; Peltzman, 1976; Jarrell, 1978). However, it is reasonable to expect that the goals of regulators would vary across commissions depending on the context within which commissioners work. The public is generally viewed as having low interest and low stakes in regulatory decisions, and thus low levels of participation in the regulatory process (Bernstein, 1955; Edelman, 1964; Noll, 1971); consumer involvement and interest are thus viewed as constants. The regulated industry, on the other hand, is usually hypothesized to have high stakes and high interest in regulatory outcomes, strong incentives to participate, and large amounts of resources. No theory of regulation considers the variability of industry characteristics or behavior. While it may be true that regulated industries generally have greater incentives to participate than consumers, it is also likely that there is variation among industries and among consumer groups in incentives to participate, and that this variation is required in order to explain regulatory policy.

If we are to develop a relevant and useful theory of regulation, then all these key actors and their variable characteristics and behaviors must be taken into account. In short, we can better understand the impact of

the regulatory process through an analysis of variation in the *incentives* and *goals* of these three actors and in the *resources* at their disposal (Berry, 1980).

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