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Government
regulation of
business

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COMMENTS ON THE POLITICAL ECONOMIES
OF INSTITUTING FEDERAL REGULATIONS
OF ECONOMIC ACTIVITY

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The following is a list of comments which I believe are relevant in thinking about the U.S. regulatory system. The comments are terse and intended to initiate discussion. There is no attempt to be comprehensive.

1. Effective demand for goods and services always derives from both a political and market expression of preferences. Regulations represent revealed preferences concerning desired performance or outcome of the political economy. For example, a regulation prohibiting carcinogenic food additives is a political articulation of preference.

2. Establishment of the rules of the game through the political process is a precondition for expressing preferences through the market process. Exchange requires the establishment of rights. Regulations are part of the package of rights determining what can be exchanged.

3. There are many problems in articulation of preferences both through the market and the political process. Some types of preferences can be more effectively expressed through market processes and others through political processes. But note that all market demand is preconditioned by politically determined rights.

There is no basis for considering preferences revealed through the market to be more representative of preferences in general than those revealed politically.

A class of preferences, notably those concerning the physical and social environment which is shared by the community, can only be effectively expressed through the political process. Regulations reflect this set of preferences.

4. Regulations and other rights circumscribe and prescribe what has to be taken into account in making economic decisions and specify whose preferences count. All economic activity and analysis presuppose a system of rights. For example regulation of pollution influences the costs of using water and air and influences whose preferences in respect to air and water quality will be counted.

5. Economic regulations are often objected to on the basis that they restrict freedom. Regulations do restrict some persons' choices while expanding those of others. Market processes do the same. Both processes influence the opportunity sets faced by individuals and thereby shape behavior. The distribution of benefits and costs is contingent upon the pattern of behavior of each economic actor.

6. Individuals and firms seeking their self-interest will have an incentive to influence the regulatory system. Presumably if it is more beneficial to produce a change in rules with a dollar than to spend it otherwise it will be spent on influence.

For every regulatory action there are those with a concentrated interest and those with a dispersed interest. Those with a concentrated interest perceive that the individual benefits of influencing a regulatory decision exceed their costs of producing the influence and those with dispersed interest perceive the costs to exceed the benefits. It is probable that the concentrated interests will subsidize information by lobbying and otherwise seek to influence behavior. It is unlikely that the dispersed interests will do so. There are also economies of scale in subsidizing information which results in those with many economic interests in regulation to be more efficient in producing influence.

7. Political entrepreneurs, that is, candidates for office and leaders of interest groups, seek support by defining issues, proposing

solutions and representing interests of constituents. Since dispersed interests are usually numerous compared with concentrated interests political entrepreneurs will frequently seek to represent dispersed interests. This is especially true of popular and visible issues. This creates an incentive to support legislation regulating concentrated interests. By supplying funds and information the concentrated interests will have relatively more influence on less visible aspects of regulatory legislation, perhaps on the wording of a rule. Legislators also have considerable latitude to vote for their concept of a good society. Regulatory legislation results from the interaction of interests, competition of information and bargaining. One would not expect a neat, consistent set of regulations to result.

8. Dispersed interests are more influential in the enactment of specific legislation establishing broad policy than in monitoring and influencing implementation and enforcement of regulations.

9. Political competition produces a compulsion to offer legislative solutions to all social problems. Proposed solutions are in the form of changes in regulations or other property rights or public spending, that is, programs and transfers. The high costs of acquiring information and political action by individuals result in greater rewards to politicians for supporting a goal or making a pronouncement than in designing workable legislation, evaluating programs or in developing operational strategies.

10. It is next to impossible to predict with accuracy and certainty the extent and distribution of benefits and costs of proposed regulatory legislation (and also much other legislation). Partially because of this uncertainty and ignorance, information is valued and has influence. Concentrated interests have an economic advantage in the provision of such information.

Regulation often has unintended consequences.

11. Implementation and enforcement require bureaucracies. Participants in the bureaucracy have interests and preferences of their own and operate with different information and pressures than do the legislators. On-line administrators have different information and interests than central administration.

12. Each regulatory bureaucracy becomes a concentrated interest with an incentive to survive, expand and extend the scope of its authority. The result is more regulation than would be preferred in the absence of the agency.

13. Regulation in practice is a competitive game between the regulator and the regulated. The regulated have an incentive to subvert the intent of the regulation. Individuals and groups have different capabilities to deal with regulation due to other rights and endowments. This significantly affects the outcome of regulation and the effectiveness of the articulation of preferences through the political process.

14. In general it is more difficult for one public agency to regulate the behavior of another public agency than to regulate the behavior of a private firm. Public agencies share the authority of the state and each agency has incentives to protect its autonomy. Thus expansion of public enterprises may weaken or subvert the expression of preferences through the regulatory process. For example, TVA pollutes more than private power companies.

15. Regulations like other rights create a flow of benefits which are often capitalized. Changes in regulations change capitalized values and incomes. This raises difficult questions of compensation and tends to inhibit changes in regulatory legislation and practice, making regulation less adaptable to changing conditions than would otherwise be the case.

16. There are significant barriers to effective evaluation of the regulatory system. The consequences are, in fact, uncertain. The agency has an incentive to avoid the generation and distribution of information which reflects negatively upon its functions. The political entrepreneur responsible for legislation has little incentive to provide a mechanism to prove it ineffective.

17. The outcome of any benefit-cost analysis of a set of regulations is dependent upon a set of normative judgments made by the analyst about the distribution of rights. Judgments are made about the definition of output and whose preferences count. A pre-existing distribution of rights and entitlements, including other regulations, is implicitly taken as given. A different distribution would result in a different measure of benefits and costs.

18. The economic efficiency criteria of welfare economics based upon the competitive model as a norm are inappropriate for judging changes in regulations or other property rights. It assumes an unspecified set of partial rights which are used as a norm for judging other partial rights in the form of regulations.

Final Comment.

Economic regulation results from the attempt of citizens to articulate preferences about the physical and social environment they share. There are many problems in the articulation of preferences by both market and political processes. Economics supposedly deals with the mechanism for expressing preferences as guides to production of goods and services. The regulatory system is important to economic performance. In my opinion, the profession should invest more in understanding the regulatory process and contribute more to its evaluation. This means more than

making pronouncements about the goodness and badness of regulation and more than estimating changes in the distribution of benefits and costs associated with changes in regulations. It requires understanding the institutions of the political economy and the behavior of the participants. There are no simple solutions to the problems associated with the enactment, design, implementation, enforcement and evaluation of economic regulations. But it is possible to provide understanding which can lead to improvements in the regulatory system and performance of the political economy. Considerable conceptual and empirical work is needed and the scope of the discipline will have to expand to deal with the economics of influence, information and bureaucracy.